

**United Nations  
Commission on  
International  
Trade Law**

**YEARBOOK**

**Volume XXIII: 1992**



**UNITED NATIONS**  
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# **NOTE**

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

The footnote numbering follows that used in the original documents on which this *Yearbook* is based. Any footnotes added subsequently are indicated by lower-case letters.

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## INTRODUCTION

This is the twenty-third volume in the series of *Yearbooks* of the United Nations Commission on International Trade Law (UNCITRAL).<sup>1</sup>

The present volume consists of three parts. Part one contains the Commission's report on the work of its twenty-fifth session, which was held in New York from 4 to 22 May 1992, and the action thereon by the United Nations Conference on Trade and Development (UNCTAD) and by the General Assembly.

In part two most of the documents considered at the twenty-fifth session of the Commission are reproduced. These documents include reports of the Commission's Working Groups as well as studies, reports and notes by the Secretary-General and the Secretariat. Also included in this part are selected working papers that were before the Working Groups.

Part three contains the UNCITRAL Model Law on International Credit Transfers, the Convention on the Limitation Period in the International Sale of Goods as amended by the Protocol amending the Convention on the Limitation Period in the International Sale of Goods, a bibliography of recent writings related to the Commission's work, a list of documents before the twenty-fifth session and a list of documents relating to the work of the Commission reproduced in the previous volumes of the *Yearbook*.

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

| <i>Volume</i> | <i>Years covered</i> | <i>United Nations publication,<br/>Sales No.</i> |
|---------------|----------------------|--|
| I             | 1968-1970            | E.71.V.1   |
| II            | 1971                 | E.72.V.4   |
| III           | 1972                 | E.73.V.6   |
| III Suppl.    | 1972                 | E.73.V.9   |
| IV            | 1973                 | E.74.V.3   |
| V             | 1974                 | E.75.V.2   |
| VI            | 1975                 | E.76.V.5   |
| VII           | 1976                 | E.77.V.1   |
| VIII          | 1977                 | E.78.V.7   |
| IX            | 1978                 | E.80.V.8   |
| X             | 1979                 | E.81.V.2   |
| XI            | 1980                 | E.81.V.8   |
| XII           | 1981                 | E.82.V.6   |
| XIII          | 1982                 | E.84.V.5   |
| XIV           | 1983                 | E.85.V.3   |
| XV            | 1984                 | E.86.V.2   |
| XVI           | 1985                 | E.87.V.4   |
| XVII          | 1986                 | E.88.V.4   |
| XVIII         | 1987                 | E.89.V.4   |
| XIX           | 1988                 | E.89.V.8   |
| XX            | 1989                 | E.90.V.9   |
| XXI           | 1990                 | E.91.V.6   |
| XXII          | 1991                 | E.93.V.2   |

## THE TWENTY-FIFTH SESSION (1992)

### A. Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session (New York, 4-22 May 1992) [Original: English]<sup>a</sup>

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<sup>a</sup>Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17) (August 1992) (hereinafter referred to as "Report").

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## INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law covers the Commission's twenty-fifth session, held in New York from 4 to 22 May 1992.

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

### 1. ORGANIZATION OF THE SESSION

#### A. Opening of the session

3. The United Nations Commission on International Trade Law (UNCITRAL) commenced its twenty-fifth session on 4 May 1992.

#### B. Membership and attendance

4. General Assembly resolution 2205 (XXI) established the Commission with a membership of 29 States, elected by the Assembly. By resolution 3108 (XXVIII), the General Assembly increased the membership of the Commission from 29 to 36 States. The present members of the Commission, elected on 19 October 1988 and on 4 November 1991, are the following States, whose term of office expires on the last day prior to the beginning of the annual session of the Commission in the year indicated:<sup>1</sup>

<sup>1</sup>Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 17 were elected by the Assembly at its forty-third session on 19 October 1988 (decision 43/307) and 19 were elected at its forty-sixth session on 4 November 1991 (decision 46/309). Pursuant to resolution 31/99 of 15 December 1976, the term of those members elected by the Assembly at its forty-third session will expire on the last day prior to the opening of the twenty-eighth regular annual session of the Commission, in 1995, while the term of those members elected at its forty-sixth session will expire on the last day prior to the opening of the thirty-first session of the Commission, in 1998.

Argentina (1998), Austria (1998), Bulgaria (1995), Cameroon (1995), Canada (1995), Chile (1998), China (1995), Costa Rica (1995), Czechoslovakia (1998), Denmark (1995), Ecuador (1998), Egypt (1995), France (1995), Germany (1995), Hungary (1998), India (1998), Iran (Islamic Republic of) (1998), Italy (1998), Japan (1995), Kenya (1998), Mexico (1995), Morocco (1995), Nigeria (1995), Poland (1998), Russian Federation (1995), Saudi Arabia (1998), Singapore (1995), Spain (1998), Sudan (1998), Thailand (1998), Togo (1995), Uganda (1998), United Kingdom of Great Britain and Northern Ireland (1995), United Republic of Tanzania (1998), United States of America (1998) and Uruguay (1998).

5. With the exception of Togo, all members of the Commission were represented at the session.

6. The session was attended by observers from the following States: Algeria, Australia, Belarus, Brazil, Colombia, Côte d'Ivoire, Cuba, Cyprus, Finland, Gabon, Ghana, Haiti, Holy See, Indonesia, Latvia, Libyan Arab Jamahiriya, Malta, Marshall Islands, Netherlands, Namibia, Pakistan, Paraguay, Peru, Philippines, Republic of Korea, Romania, Senegal, Swaziland, Sweden, Switzerland, Tunisia, Turkey, Venezuela and Viet Nam.

7. The session was also attended by observers from the following international organizations:

(a) *United Nations organs*: International Monetary Fund (IMF); United Nations Centre on Transnational Corporations;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Committee (AALCC); European Community (EC); Hague Conference on Private International Law; International Institute for the Unification of Private International Law (UNIDROIT);

(c) *Other international organizations*: Cairo Regional Centre for International Commercial Arbitration; European

Banking Federation; Inter-American Bar Association (IABA); International Chamber of Commerce (ICC); International Maritime Committee (CMI).

### C. Election of officers<sup>2</sup>

8. The Commission elected the following officers:

*Chairman:* Mr. José María Abascal Zamora (Mexico)

*Vice-Chairmen:* Mr. Samir El-Sharkawi (Egypt)  
Mr. Abbas Safarian Neamat-Abad (Islamic Republic of Iran)  
Mr. Andrzej Olszowska (Poland)

*Rapporteur:* Mr. Alfred Duchek (Austria)

### D. Agenda

9. The agenda of the session, as adopted by the Commission at its 467th meeting, on 4 May 1992, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. International payments: draft Model Law on International Credit Transfers.
5. Draft Legal Guide on International Countertrade Transactions.
6. Electronic data interchange.
7. New international economic order: draft Model Law on Procurement.
8. International contract practices: draft Uniform Law on International Guaranty Letters.
9. INCOTERMS 1990.
10. Case law on UNCITRAL texts.
11. Coordination of work.
12. Status of conventions.
13. Training and assistance.
14. General Assembly resolutions on the work of the Commission.
15. Other business.
16. Dates and places of future meetings.
17. Adoption of the report of the Commission.
18. Congress on International Trade Law.

<sup>2</sup>The election of the Chairman took place at the 467th meeting, on 4 May 1992, and the election of the Vice-Chairmen and the Rapporteur took place at the 478th meeting, on 11 May 1992. In accordance with a decision taken by the Commission at its first session, the Commission has three Vice-Chairmen, so that, together with the Chairman and the Rapporteur, each of the five groups of States listed in General Assembly resolution 2205 (XXI), sect II, para. 1, will be represented on the bureau of the Commission (see the report of the United Nations Commission on International Trade Law on the work of its first session, *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16* (A/7216), para. 14 (*Yearbook of the United Nations Commission on International Trade Law, vol. 1: 1968-1970* (United Nations publication, Sales No. E.71.V.1), part two, I, A, para. 14)).

### E. Adoption of the report

10. At its 483rd and 484th meetings, on 15 May 1992, the Commission adopted the present report by consensus.

## II. DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

### A. Introduction

11. 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<sup>3</sup> 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 Negotiable Instruments, which it renamed the Working Group on International Payments.<sup>4</sup> The Working Group carried out its work at its sixteenth, seventeenth, eighteenth, nineteenth, twentieth, twenty-first and twenty-second sessions (A/CN.9/297, A/CN.9/317, A/CN.9/318, A/CN.9/328, A/CN.9/329, A/CN.9/341 and A/CN.9/344). The Working Group completed its work by adopting the draft text of a Model Law on International Credit Transfers at the close of its twenty-second session after a drafting group had established corresponding language versions in the six languages of the Commission.

12. The text of the draft Model Law as adopted by the Working Group at its twenty-second session was sent to all Governments and to interested international organizations for comment (A/CN.9/347 and Add.1). The secretariat of the Commission prepared a commentary on the draft text (A/CN.9/346).

13. At its twenty-fourth session (1991), the Commission considered articles 1 to 15 of the draft Model Law presented by the Working Group. For lack of time, the Commission suspended its discussion of article 17 and did not discuss articles 16 and 18 of the draft Model Law. It was decided to place the draft Model Law on the agenda of the twenty-fifth session. The text of articles 1 to 15 as resulted from the work of the Commission at its twenty-fourth session and the text of articles 16 to 18 as resulted from the work of the Working Group on International Payments at its twenty-second session are contained in annex I to the report of the Commission on the work of its twenty-fourth session.<sup>5</sup>

14. At its current session, the Commission had before it a note by the Secretariat containing suggestions for the final review of the text (A/CN.9/367).

15. The Commission expressed its appreciation to the Working Group on International Payments and its Chairman, Mr. José María Abascal Zamora (Mexico), for having prepared a draft Model Law on International Credit Transfers that was generally favourably received and regarded as an excellent basis for the discussion in the Commission.

<sup>3</sup>United Nations publication, Sales No. E.87.V.9 (A/CN.9/Ser.B/1).

<sup>4</sup>*Official Records of the General Assembly, Forty-first Session, Supplement No. 17* (A/41/17), para. 230.

<sup>5</sup>*Ibid.*, *Forty-sixth Session, Supplement No. 17* (A/46/17).

## B. Discussion of articles

### Article 16

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

#### "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."

17. It was noted at the outset that the liability regime set forth in the article was based on the objective failure by a receiving bank to execute a payment order and that it did not rely on any concept such as fault or unjust enrichment on the part of the receiving bank.

#### Paragraph (1)

18. The Commission recalled that, at its previous session, a proposal was made, but not discussed, for replacing the paragraph by the following provision:

"(1) A receiving bank other than the beneficiary's bank that fails to comply with its obligations under article 7(2) is liable to the beneficiary if the credit transfer is completed under article 17(1). The liability of the receiving bank is to pay interest on the amount of the payment order for the period of delay caused by the receiving bank's failure. However, if the delay concerns only part of the amount of the payment order, the liability shall be to pay interest on the amount that has been delayed."

19. The discussion was based on the proposed text. It was noted that the differences between the proposed text and the text of paragraph (1) presented to the Commission by the Working Group were mainly of a drafting nature. The new third sentence was in substitution for paragraph (5) (see paragraph 27 below).

20. It was suggested that the receiving bank that had been in delay in the execution of a payment order should be liable to the originator of the payment order in addition to being liable to the beneficiary. It was noted that the interests of the originator were already protected by article 13(1) when the credit transfer had not been completed. Although that suggestion was not accepted, it was agreed that the Model Law should allow an originator to recover the amount of the interest that it had paid to the beneficiary on the underlying obligation in case of late completion of a credit transfer. It was recalled that a proposal to that effect had been made, but not discussed at the previous session of the Commission. The proposal read as follows:

"(2 *ter*) If the originator has paid interest to the beneficiary on account of a delay in the completion of the credit transfer, the originator may recover such amount, to the extent that the beneficiary would have been entitled to but did not receive interest in accordance with paragraphs (1) and (2), from the originator's bank or the bank liable under paragraph (1). The originator's bank and each subsequent receiving bank that is not the bank liable under paragraph (1) may recover interest paid to its sender from its receiving bank or the bank liable under paragraph (1)."

21. After discussion, the Commission adopted the substance of the proposed paragraph (1) and referred it to the drafting group. The Commission also requested the drafting group to review the text of the proposed para-

graph (2 *ter*) for consideration by the Commission at a later stage of its deliberations (see paragraph 79 below).

#### Paragraph (2)

22. The Commission approved the substance of paragraph (2) and referred it to the drafting group.

23. The Commission recalled that at its previous session a proposal was made, but not discussed, for adding the following provision after paragraph (2):

"(2 *bis*) For the purpose of this law and notwithstanding article 4(6) a bank is considered to have failed to comply with its obligation under article 7(2) if a delay is caused by its failure to pay for a payment order. Where payment is to be made by debiting the bank's account with its receiving bank, failure to pay means failure to put funds in the account sufficient to pay for the order".<sup>6</sup>

24. It was noted that the proposed provision established the responsibility of a receiving bank for any delay in the completion of the credit transfer that resulted from the failure of that bank to pay for the payment order sent by that bank in execution of the payment order it had received. Since such a delay could occur only if the receiving bank had not paid for its payment order prior to acceptance of that order by the next receiving bank, the obligation was stated to be notwithstanding article 4(6), which provided that payment was due from a sender only when the payment order had been accepted. In opposition to the proposal it was stated that it had been decided at the twenty-fourth session of the Commission that it was sufficient for the Model Law to establish (in article 4(6)) an obligation of the sender to pay the receiving bank upon the acceptance by the receiving bank of the payment order. Furthermore, it had been noted that "it was implicit in [article 7(2)], which provided that a receiving bank had to issue a payment order that 'contains the instructions necessary to implement the credit transfer in an appropriate manner', that the receiving bank had to issue a payment order that had a reasonable chance of being accepted by the next bank in the credit transfer chain".<sup>7</sup> After deliberation, the proposed provision was not accepted.

#### Paragraph (3)

25. A suggestion to merge paragraphs (3) and (4) was not adopted. The Commission approved the substance of paragraph (3) and referred it to the drafting group. It was noted that the reference in the paragraph to paragraph (3) of article 7 should be deleted as a consequence of the decision taken at the twenty-fourth session of the Commission.<sup>8</sup>

#### Paragraph (4)

26. The Commission approved the substance of the paragraph and referred it to the drafting group. It was noted that, in line with the decision taken at the previous session of the Commission on article 9,<sup>9</sup> the paragraph should also refer to paragraph (4) of article 9.

#### Paragraph (5)

27. It was noted that a receiving bank was liable under paragraph (5) only to the extent that the late payment was caused by the bank's improper action, whereas the bank's liability for delay under paragraph (1) was objective. The Commission decided that the standard of liability under paragraph (5) should be the same as the standard of liability under paragraph (1). In view of its adoption of the substance of the proposed revision of paragraph (1) (see paragraph 19 above), the Commission referred the matter to the drafting group.

#### Paragraph (6)

28. The Commission approved the substance of the paragraph and referred it to the drafting group.

#### Paragraph (7)

29. The view was expressed that the paragraph should be deleted. In favour of deletion, it was stated that, consistent with the general principle set forth in article 3, no limitation should affect the freedom of the parties to deviate by agreement from the liability regime contained in article 16. It was also recalled that the definition of "interest" adopted by the Commission at its previous session in article 2(*n*) provided that it should be calculated "at the rate and on the basis customarily accepted by the banking community for the funds or money involved". It was stated that the method of calculation was likely to result in uncertainty as to the applicable rate. The view was further expressed that limitations to contractual freedom could only reflect considerations of consumer protection, a matter which should remain outside the scope of the Model Law.

30. The prevailing view, however, was that the substance of the paragraph should be maintained. It was noted that the definition of "interest" in article 2(*n*) also provided that the parties could agree on a different method of calculation. The Commission recalled that, in the context of the discussion on the definition of "interest" at its previous session, a concern had been expressed that the reference to the parties' right to vary the provision by agreement could lead to instances in which, in the name of varying interest provisions, a bank would reduce its liability to a non-bank originator or beneficiary in violation of article 16(7). After discussion, the Commission decided that it should be made clear that a receiving bank could not reduce its liability to a non-bank originator or beneficiary by contracting to pay a low rate of interest. The matter was referred to the drafting group.

#### Paragraph (8)

31. The Commission approved the first sentence of the paragraph.

32. As to the second sentence, divergent opinions were expressed. Under one view, the sentence should be deleted, thereby leaving to rules outside the Model Law the question of availability of other remedies. Some proponents of that view stated that the Model Law should not preclude a national court from granting a remedy other than a remedy provided by the Model Law. A view was expressed that exclusivity of the remedies would be contrary to judicial

<sup>6</sup>*Ibid.*, paras. 278 and 279.

<sup>7</sup>*Ibid.*, para. 158.

<sup>8</sup>*Ibid.*, para. 160.

<sup>9</sup>*Ibid.*, paras. 187 and 188.

review found in certain systems of law and would therefore be illegal. Under another view, it was necessary to retain the principle of exclusivity of the remedies as well as the exception to that principle contained in the second sentence. It was pointed out that the principle, which made it easier for the banks to foresee the extent of their risk, provided an appropriate balance to a number of provisions in the Model Law that favoured customers of banks (e.g., article 13 on duty to refund, provisions restricting the freedom of banks to limit by contract their liability, or provisions establishing a relatively short time period within which a bank had to act upon a payment order). The prevailing view was to retain the principle of exclusivity as contained in the second sentence.

33. The Commission considered the provision in the second sentence that provided an exception to the exclusivity of remedies when the bank acted intentionally or recklessly. There were different views as to how the exception should be expressed. In support of the current text it was noted that the concepts of "recklessness" and "knowledge" as expressed in paragraph (8) were used with satisfactory results in international transport liability conventions such as the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). However, a view was expressed that analogies to those conventions were inappropriate, since credit transfers involved very high volumes of transactions at high speed and in other ways were quite different from transport of goods. In opposition to the current text it was further stated that the concepts of "recklessness" and "knowledge" were unclear and would lead to difficulties and divergences in interpretation. In addition, it was feared that minor mistakes or failures could be interpreted as reckless acts, which would defeat the purpose of the exclusivity of remedies. Furthermore, the concept of "knowledge" might open a possibility that general information concerning the underlying transaction given to an employee of the bank might lead to a presumption that the bank had "knowledge that loss might result", a result that was considered unacceptable.

34. Some of those who had objections against the wording of the exception suggested deleting the second sentence, thereby leaving the question of the availability of other remedies to rules other than the Model Law. It was also suggested that clause (b) of the second sentence should be deleted. Others proposed including a wording to the effect that the bank would be deemed to have "knowledge that loss might result" only when specific information concerning the underlying transaction would be given to the bank. The proposal that met with general agreement in the Commission was to replace, subject to review by the drafting group, the word "intent" by the expression "specific intent", to replace the word "knowledge" by the expression "actual knowledge", and to replace the expression "knowledge that loss might result" by the expression "knowledge that loss would be likely to result".

35. The question was raised whether the exclusivity of remedies established by article 16(8) applied only to a failure to perform an obligation dealt with in article 16 or also to a failure to perform an obligation dealt with elsewhere in the Model Law (e.g., payment obligations under articles 4(6) and 11(5) and (6)). The Commission decided

that the Model Law should provide a rule on exclusivity of remedies only with respect to obligations in article 16. The drafting group was requested to reformulate article 16(8) so as to implement the decision.

36. A suggestion was made that a receiving bank that failed to execute its sender's payment order in the time required by article 10(1) should, in addition to its liability to pay interest on the amount of the payment order, be liable to pay for the expenses incurred for issuance of a new payment order and for reasonable costs of legal representation. It was recalled that those issues had been addressed in earlier drafts of the Model Law. The view was expressed that while the costs incurred for issuance of a new payment order were of minor importance, costs of legal representation might be more significant. After discussion, it was generally felt that there was no need to revise the current text, particularly in view of the fact that it did not preclude national authorities from implementing any law of procedure under which the receiving bank that caused a delay in the execution of the credit transfer might be held liable for costs of legal representation.

37. A proposal was made to exclude in article 16(8) the liability of the bank when the failure to perform an obligation was due to *force majeure*. The Commission did not adopt the proposal since it considered that a bank that failed to execute a payment order should pay interest irrespective of the reason for the failure.

#### Article 17

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

##### "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."

#### Paragraph (1)

39. The view was expressed that the paragraph should be deleted since, in order to be consistent with the definition

of a "credit transfer" in article 2(a), completion of the transfer should result from the placing of the funds at the disposal of the beneficiary and not from the acceptance of the payment order by the beneficiary's bank. It was stated that, in a number of jurisdictions, a credit transfer was considered to be completed only when the funds were placed at the disposal of the beneficiary or credited to its account. Support was also expressed in favour of the deletion of the paragraph on the basis of a concern expressed at the previous session of the Commission that the notion of "completion" of a credit transfer left room for confusion with the question of discharge of the underlying payment obligation due by the originator to the beneficiary.<sup>10</sup>

40. In response, it was stated that the rule provided in the paragraph was necessary to provide certainty as to the time of completion of the credit transfer. It was also stated that, while the time of acceptance of the payment order by the beneficiary's bank was easily determinable, it would often be more difficult to determine the time when the funds were placed at the disposal of the beneficiary or credited to its account since that time would depend on bank practice and might vary with the individual agreements concluded between the beneficiary and its bank. It was further stated that the time when the funds were placed at the disposal of the beneficiary or credited to its account was significant only in the context of the underlying transaction for the purpose of which the credit transfer had been made. It was noted, however, that in other provisions of the Model Law, for example, in articles 5, 6(2) and 8(1), one of the methods provided for determining the time of payment or acceptance of a payment order relied on the time when the funds were placed at the disposal of the beneficiary. As regards the concern that the paragraph might have an impact on the discharge of the underlying obligation, it was stated that the purpose of paragraph (1) was merely to establish the moment of completion of a credit transfer and that the question of the discharge of the underlying payment obligation, to the extent it was addressed in the Model Law, was referred to in paragraph (2) (see paragraphs 43 to 47 below).

41. The prevailing view was that the paragraph should remain unchanged. It was agreed that the distinction between completion of the credit transfer and discharge of the underlying obligation was sufficiently clear in the current text. It was also agreed that any change in the current rule regarding the time of completion of the credit transfer would have undesirable repercussions on other provisions of the Model Law, for example, the provision contained in article 13 regarding the duty for the originator's bank to refund to the originator any payment received from it in the case where the credit transfer was not completed.

42. With a view to ensuring consistency between paragraph (1) of article 17 and the definition of "credit transfer" contained in article 2(a), a proposal was made to add to the paragraph the following words:

"Completion does not otherwise affect the relationship between the beneficiary and the beneficiary's bank."

It was stated that the proposed sentence would make it clear that the credit transfer was distinct from the underly-

ing transaction. After discussion, the Commission adopted the proposal and referred the text of the paragraph to the drafting group.

#### *Paragraph (2)*

43. A debate took place as to whether the Model Law should address the issues arising from the underlying transaction. The view was expressed that, as a general matter of policy, the underlying transaction should be kept outside the scope of the Model Law. It was stated that the Model Law should treat a credit transfer as an abstract operation, without regard to the purpose for which the transfer had been made or the legal effect of the transfer on the underlying transaction. Under that view, the paragraph should be deleted since it was the only provision of the Model Law that dealt with the underlying transaction. It was stated that such a provision could be detrimental to the wide acceptability of the Model Law. It was pointed out that international conventions concerning negotiable instruments, including the United Nations Convention on International Bills of Exchange and International Promissory Notes, did not contain any such provision. It was, however, pointed out that a comparison with those conventions was inappropriate because of the significant difference in the subject-matter and the content of the provisions. It was further stated that, in view of the fact that the Model Law had been drafted so as to protect banks against receiving funds at a bank they might not approve of because of its credit risk, a similar protection should be given to the beneficiary. In opposition to that statement, it was noted that the Model Law did not deal with credit risk matters. A further view was that the current text might be interpreted as assuming that the function of a credit transfer was to discharge a monetary obligation. In that connection, it was recalled that, while many legal systems already recognized the credit transfer as an acceptable method of making payment, it was a matter of policy of each State to decide whether a monetary obligation could be discharged by a credit transfer. It was recalled that the Working Group at its twenty-first session had decided that the Model Law should not attempt to deal with the issue of legal tender (A/CN.9/341, para. 12).

44. In favour of the retention of the current paragraph, it was stated that there existed a practical need to coordinate the time of completion of the credit transfer and the time of discharge of the underlying obligation. Under that view, the text was aimed at providing a solution for the difficulties that would arise if the time of completion of the credit transfer and the time of discharge of the underlying obligation were different. It was stated that the possible existence of a time gap between the two would result in an unjust situation where the originator who had accepted to pay by credit transfer would bear the risk of any obstacle to payment that might arise between the time when the credit transfer had been completed and the time when the underlying obligation was discharged. A related view was that, although the Model Law should not contain a provision providing that a credit transfer would constitute discharge of an obligation, it was appropriate for the Model Law to include a provision that governed certain aspects of the discharge when the parties had agreed that the obligation could be discharged by a credit transfer. In particular, the

<sup>10</sup>Ibid., para. 281.

Model Law might provide certainty as to the time when such a discharge took place. In that connection, it was observed that the text of the paragraph did not create a new mode of extinction of payment obligations but only provided an operational rule for those cases where the applicable law permitted, and the parties agreed, that an obligation could be discharged by means of a credit transfer.

45. A concern was expressed that the current text of the paragraph might not indicate sufficiently clearly that the beneficiary's bank should be designated by the beneficiary. It was stated that, in the absence of such a designation by the beneficiary, the provision could be interpreted as authorizing the originator to designate the beneficiary's bank. It was also stated that, in view of the fact that the Model Law had been drafted so as to protect banks against receiving funds from sources they might not approve of, a similar protection should be given to the beneficiary. Proposals were made to redraft the text to that effect, for example, by inserting a definition of the beneficiary's bank as "a bank designated by the beneficiary to receive funds as a result of a credit transfer". Another proposed solution was to provide for the right of the beneficiary to reject the funds. In response to the above-stated concern, it was suggested that, in the current text, the words "can be discharged by credit transfer to the account indicated by the originator" should be interpreted as limiting the possibility of discharge to the situation where the account had been indicated by the originator with the agreement of the beneficiary. The Commission agreed with that interpretation and decided to maintain the current text.

46. A proposal was made to add the following words to the text of paragraph (2):

"Payment under this paragraph is acceptance under paragraph (1) of this article, unless the law applicable to the underlying transaction provides for an earlier time of payment."

The proposal was not adopted by the Commission.

47. Since no consensus was reached on the deletion or on the retention of the paragraph, a suggestion was made that the paragraph should be included in an annex to the Model Law. It was indicated that such location of the paragraph would emphasize its optional nature for national legislators. After discussion, it was decided that the text of the paragraph would be included in a footnote to article 17, with an indication that national legislators might wish to consider incorporating in the national enactment that provision, which related to the discharge of the underlying obligation. The matter was referred to the drafting group.

#### *Paragraph (3)*

48. A concern was expressed that the paragraph provided for charges which it did not define. It was pointed out that paragraph (3) did not give or deny the banks any right to deduct charges, nor did it specify the kind of charges that might be deducted.

49. A proposal was made that, after the words "applicable law" in the second sentence of the paragraph, the words "governing the underlying relationship" should be inserted

so as to make it clear that the law applicable was the law governing the underlying relationship and not the law governing the credit transfer. It was stated that the fact that it was expressly provided in the second sentence of paragraph (3) that the right of the beneficiary to recover the amount of the charges was not prejudiced by the completion of the credit transfer might imply that other rights arising from the underlying relationship for which no such express provision was included in the Model Law might be prejudiced.

50. The Commission approved the substance of paragraph (3) with the proposed addition in the second sentence, and referred it to the drafting group.

#### *Pending issues in relation to article 14*

51. The Commission recalled that, at its previous session, it had postponed its final decision as to the text of article 14 until it had discussed the issues arising under article 17.<sup>11</sup> At the current session, it was noted that if a bank failed to issue a new payment order under article 14, the originator would have the option of seeking enforcement of article 14 under the applicable rules of national law or, if the credit transfer was not completed, the originator could claim a refund under article 13. The Commission decided to maintain the text of article 14.

#### *Pending issues in relation to article 5*

52. The Commission recalled that, at its previous session, it had postponed its final decision as to the text of subparagraph (b)(ii) of article 5 until it had discussed the issues arising under article 17.<sup>12</sup> At that session, a view had been expressed that the provisions of article 5 might be inconsistent with the principles contained in article 17. For example, where the sender paid the receiving bank through a third bank, there might be an inconsistency between the time when payment was made to the receiving bank under article 5(b)(ii) and the time when the obligation was discharged under article 17(2).

53. At the current session, a view was expressed that no conflict existed between those two provisions since they dealt with different issues: article 5(b)(ii) dealt with the time when the sender paid the receiving bank while article 17(2) dealt with the time when the originator discharged its obligation to the beneficiary. It was also noted that in the two articles two different credit transfers were involved and the parties played different roles in each transfer. Therefore, it was argued that no conflict existed between the two articles and no change was necessary.

54. In order to avoid any possibility that the rules contained in subparagraph (b)(ii) of article 5 might be applicable concurrently with the rules contained in paragraph (2) of article 17, a proposal was made to modify the opening words of article 5 to the effect that article 5 would be applicable only "for the purposes of articles 6 and 8". After discussion, the Commission agreed that article 5 should be modified and referred the matter to the drafting group (the

<sup>11</sup>Ibid., para. 272.

<sup>12</sup>Ibid., paras. 125 and 126.

drafting group did not deal with the matter in view of the fact that article 17(2) was placed in a footnote; see paragraph 47 above).

#### *Misdirected payment order*

55. The view was expressed that the provisions on completion of a credit transfer contained in article 17 should make it clear that a credit transfer was not complete where a payment order had been misdirected so that the funds had not reached the beneficiary's bank indicated in the payment order issued by the originator. After discussion, the Commission approved the substance of the proposal and referred the matter to the drafting group.

#### *Article 18*

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

##### *"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."

57. In discussing article 18, different views were expressed as to whether or not a provision about the conflict of laws was needed and desirable.

#### *Paragraph (1)*

58. The first sentence of the paragraph enjoyed wide support. It was pointed out, however, that if, as a result of a choice by parties, various payment orders comprising a credit transfer were subject to different national laws, it might become difficult to implement those provisions of the Model Law that required a degree of congruence among rules applicable to individual payment orders. One such provision, for instance, was article 13, which, when the credit transfer was not completed, obligated each bank in the credit-transfer chain to refund funds to its sender bank or to a prior sender.

59. As to the second sentence, divergent views were expressed. Those who opposed retaining the sentence drew attention to possible difficulties that might arise with respect to some provisions of the Model Law when receiving banks participating in a credit transfer were in different States and, as a result of the rule in the second sentence, payment orders would be subject to different national laws (e.g., article 13; see paragraph 58 above). It was said to be

preferable to find conflict-of-laws rules that would determine a single national law applicable to the whole credit transfer. The elaboration of such conflict-of-laws rules continued to be in the work programme of the Hague Conference on Private International Law as a non-priority item, and it was stated that it would be more appropriate to await the outcome of that work than to retain a rule that might in some situations lead to undesirable results. A delay in establishing a conflict-of-laws solution was said to be acceptable since few court disputes were reported regarding conflict of laws in international credit transfers. In addition, further consideration was necessary to determine whether paper-based credit transfers and electronic transfers, both of which were covered by the Model Law, required different conflict-of-laws rules.

60. It was noted that the Working Group had considered and rejected a "single-law" approach. Those who supported the second sentence considered that, while the ideal solution would be to have a rule determining a single national law for the whole credit transfer, either such a "single-law" rule was not feasible or it would take a long time before international agreement could be reached on such a rule. Even if it were possible to elaborate a single-law conflict-of-laws rule, the applicability of the single law would not be achieved unless all banks participating in a credit transfer were in States that had adopted the conflict-of-laws rule. Until a good number of States had the same or similar substantive law on credit transfers, it was unlikely that many States would agree to a single-law conflict-of-laws rule. With the growing acceptance by States of the Model Law, however, any possible difficulty that might arise from incongruous laws on individual payment orders would be reduced. It was therefore considered useful to retain the second sentence, which provided a workable conflict-of-laws rule. Without the rule in the second sentence, it would be uncertain in many national laws whether a given payment order should be subject to the law of the sender or to the law of the receiving bank. Another merit of the second sentence was that it reduced the possibility of application of a national law that had little or no connection with the case at issue.

61. Since no consensus was reached on the deletion or on the retention of paragraph (1), as well as paragraphs (2) and (3), the Commission decided to place article 18 in a footnote in a form similar to the footnote to article 17 (see paragraph 47 above). It was indicated that such location of the article would emphasize its optional nature for national legislators.

#### *Paragraph (2)*

62. The Commission approved the substance of the paragraph, subject to the deletion of the words "for the purposes of article 4(1)".

#### *Paragraph (3)*

63. The Commission approved the substance of the paragraph.

#### *Other issues*

64. When discussing the text of articles 1 to 15 of the draft Model Law at its previous session, the Commission had decided that a number of issues should be reconsidered

after the entire text of the draft Model Law had been considered. In addition, the Secretariat had reviewed the articles already adopted by the Commission to identify potential problems of a technical variety. The problems identified by the Secretariat were discussed in a note containing suggestions for the final review of the draft Model Law (A/CN.9/367). The Commission at its current session proceeded with the review of those issues.

#### *Definition of "beneficiary's bank"*

65. The Commission recalled that, at its previous session, it had agreed to consider the need for a definition of the term "beneficiary's bank".<sup>13</sup> While at the current session some support was expressed for including in the Model Law a definition of the term, the Commission decided that there was no need for such a definition.

#### *Rule of interpretation*

66. The Commission recalled that, at its previous session, it had deferred the decision on the possible insertion in the Model Law of a general provision along the lines of article 7(2) of the United Nations Convention on Contracts for the International Sale of Goods.<sup>14</sup> After discussion at its current session, the Commission decided not to insert such a provision.

#### *Drafting suggestions made by the Secretariat*

67. The Commission referred drafting suggestions made by the Secretariat (see A/CN.9/367, paras. 5, 8, 12, 15, 22, 33 and 35) to the drafting group.

#### *Application of article 10(1) to the beneficiary's bank*

68. The Commission proceeded with the discussion of the question whether article 10(1) would apply to the beneficiary's bank and, if it would not, whether there was a need to define execution with regard to the beneficiary's bank (see A/CN.9/367, paras. 16-20). Views were expressed in favour of both the application and the non-application of the article to the beneficiary's bank. After discussion, the Commission decided that article 10(1) should apply to the beneficiary's bank. Since the text of the paragraph currently led to that result, it was decided to leave it unchanged, notwithstanding a view that the current text could be interpreted as not being applicable to a beneficiary's bank. In the context of that discussion, it was decided that the definition of "execution" in article 2(1) should be retained and the brackets should be removed. It was pointed out, however, that the beneficiary's bank under article 8 simply accepted or rejected a payment order and then incurred the obligation set forth in article 9. The view was expressed that the word "execution" was apt to cover that situation.

69. It was noted that the value-date rule in article 10 (1 *bis*) applied to the beneficiary's bank, while the value-date rule in article 10(1 *ter*) did not apply to such a bank, although differing views were expressed on the extent to which those paragraphs were capable of being applied to the beneficiary's bank.

#### *Other substantive proposals*

70. It was proposed that a provision should be inserted in the Model Law requiring the receiving bank to execute the transfer in the currency or in the unit of account stipulated by the sender. The purpose of the proposal was to clarify that receiving banks were not allowed, without the consent of the interested party, to convert the funds received into a currency other than that in which the order was denominated. The Commission recalled that the matter had been discussed at its previous session.<sup>15</sup> After discussion at its current session, the Commission decided that the text of paragraph (2) of article 7 should remain unchanged.

71. In view of the fact that paragraph (8 *bis*) of article 11 provided that the principles applicable to the revocation of a payment order also applied to amendments of the payment order, a proposal was made that, wherever a provision of the Model Law addressed "payment order or revocation", it should also address the amendment. The Commission adopted the substance of the proposal and referred the matter to the drafting group.

72. A view was expressed in connection with article 4(2) that there was an uncertainty in the meaning of the expression "comparison of signature" as to whether it included also cases where both signatures and seals were compared. That method was frequently used in the banking practice in some States for the authentication of paper-based credit transfers. In view of the fact that that method was widely used in some States, it was said to be desirable to exclude expressly that case from "comparison of signature". The Commission, recalling the discussion of the issue at the previous session,<sup>16</sup> decided that the provision should remain unchanged.

#### **C. Report of the drafting group**

73. After consideration of articles 16 to 18 of the draft Model Law, the entire text of the draft Model Law was submitted to a drafting group for implementation of the decisions taken by the Commission and revision to ensure consistency within the text and between language versions. The Commission, at its 481st and 482nd meetings, on 13 May 1992, considered the revised text of the draft Model Law prepared by the drafting group.

74. It was noted that, pursuant to a decision by the Commission (see paragraph 61 above), the text of article 18 had been placed by the drafting group in a footnote to the title to chapter I and had been labelled article Y. With respect to the opening words to that footnote, the Commission noted that the reason for incorporating the text of article Y into a footnote was the lack of a consensus on its inclusion in the Model Law itself. The text had been placed in a footnote as a drafting suggestion for those States that might wish to consider adding a provision on conflict of laws when enacting the Model Law. The Commission was agreed therefore that the opening phrase of the footnote should read: "The Commission suggests the following text for States that might wish to adopt it".

<sup>13</sup>Ibid., para. 84.

<sup>14</sup>Ibid., para. 222.

<sup>15</sup>Ibid., paras. 154-156.

<sup>16</sup>Ibid., para. 108.

75. In the context of the discussion of article Y, it was noted that paragraph (3)(b) established the rule that branches and separate offices of a bank in different States were different banks. It was suggested that the implications of such a rule, for example in the case of insolvency of a bank having branches or offices in different States, might be studied by the Commission at a later session. This issue was stated to be an important banking supervisory concern due to recent events concerning international banking problems.

76. With respect to article 10(1 *bis*), a continuing concern was expressed that the issue of value date should not have been dealt with by the Model Law, but that it should rather have been left for consideration by the parties in the context of their contractual relationships.

77. With respect to article 11(1), the view was expressed that the text should state more clearly that a revocation order should follow the same route as the payment order that was intended to be revoked. After discussion, the Commission was agreed that the text of the draft Model Law was sufficiently clear in that respect.

78. With respect to article 12, the Commission recalled the decision it had made at its previous session to indicate that there would not be any sanction for breach of the duty to assist.<sup>17</sup> After discussion, the Commission was agreed that, in order to express more clearly the decision, the text of the article should state that a receiving bank was "requested" to assist the originator and each subsequent sending bank in completing the banking procedures of the credit transfer.

79. With respect to the proposed paragraph (2 *ter*) of article 16, it was noted that the drafting group had placed the paragraph between square brackets in view of the earlier decision of the Commission to reconsider the issue after review of the text by the drafting group (see paragraph 21 above). The proposal was objected to on the ground that it might interfere with the underlying relationship between the originator and the beneficiary. It was also stated that such a provision might produce the unintended result of encouraging a bank liable under paragraph (1) to delay payment of interest until such time as the originator had paid interest to the beneficiary in accordance with the underlying transaction. In favour of the proposal, it was stated that the proposed paragraph (2 *ter*) did not interfere with the underlying transaction since it did not establish an obligation for the originator to pay interest but only established a mechanism by which the originator was subrogated to the beneficiary in its rights against the liable bank. After discussion, the Commission adopted the proposal.

80. With respect to paragraph (8) of article 16, it was noted that the paragraph had been separated from the remaining provisions of article 16 by the drafting group and placed in a separate article entitled "Exclusivity of remedies". A drafting proposal was made that the exclusivity of remedies should be defined by reference to "non-compliance with the obligations dealt with in article 16" instead

of being defined by reference to "non-compliance with articles 7 or 9", as suggested by the drafting group. After discussion, the Commission agreed that the proposed wording would alter the scope of the provision. The Commission adopted the text of the article as suggested by the drafting group.

81. With respect to article 17, it was noted that, pursuant to a decision by the Commission (see paragraph 47 above), the text of article 17(2) had been placed in a footnote. As regards the opening words to that footnote, the Commission was agreed that the reason for placing paragraph (2) in a footnote was the lack of consensus on the inclusion of the text of the paragraph in the Model Law itself. The text had been placed in a footnote as a drafting suggestion for those States that might wish to consider adding a provision related to the discharge of the underlying obligation when enacting the Model Law. The Commission was agreed therefore that the opening phrase of the footnote should read: "The Commission suggests the following text for States that might wish to adopt it".

#### D. Adoption of the Model Law and recommendation

82. The Commission, after consideration of the text of the draft Model Law as revised by the drafting group,<sup>18</sup>

<sup>18</sup>The articles of the draft Model Law as submitted to the Commission by the Working Group were renumbered upon adoption of the Model Law by the Commission. For the development of the draft articles in the Working Group, see A/CN.9/346.

| No. of article in Model Law | No. of draft article before the Commission | No. of article in Model Law | No. of draft article before the Commission |
|-----------------------------|--|-----------------------------|--|
| 1                           | 1  | 12(1)                       | 11(1)                                      |
| 2(a)                        | 2(a)                                       | 12(2)                       | 11(2)                                      |
| 2(b)                        | 2(b)                                       | 12(3)                       | 11(3)                                      |
| 2(c)                        | 2(c)                                       | 12(4)                       | 11(4)                                      |
| 2(d)                        | 2(d)                                       | 12(5)                       | 11(5)                                      |
| 2(e)                        | 2(e)                                       | 12(6)                       | 11(6)                                      |
| 2(f)                        | 2(f)                                       | 12(7)                       | 11(6 <i>bis</i> )                          |
| 2(g)                        | 2(g)                                       | 12(8)                       | 11(6 <i>ter</i> )                          |
| 2(h)                        | 2(h)                                       | 12(9)                       | 11(6 <i>bis</i> )                          |
| 2(i)                        | 2(i)                                       | 12(10)                      | 11(7)                                      |
| 2(j)                        | 2(j)                                       | 12(11)                      | 11(8)                                      |
| 2(k)                        | new  | 12(12)                      | 11(8 <i>bis</i> )                          |
| 2(l)                        | 2(k)                                       | 12(13)                      | 11(9)                                      |
| 2(m)                        | 2(l)                                       |                             |  |
| 3                           | 2(n)                                       | 13                          | 12   |
| 4                           | 2 <i>bis</i>                               | 14                          | 13   |
| 5                           | 3  | 15                          | 14   |
| 6                           | 4  | 16                          | 15   |
| 7                           | 5  | 17(1)                       | 16(1)                                      |
| 8                           | 6  | 17(2)                       | 16(2)                                      |
| 9                           | 7  | 17(3)                       | new  |
| 10                          | 8  | 17(4)                       | 16(3)                                      |
| 11(1)                       | 9  | 17(5)                       | 16(4)                                      |
| 11(2)                       | 10(1)                                      | 17(6)                       | 16(6)                                      |
| 11(3)                       | 10(1 <i>bis</i> )                          | 17(7)                       | 16(7)                                      |
| 11(4)                       | 10(1 <i>ter</i> )                          | 18                          | 16(8)                                      |
| 11(5)                       | 10(2)                                      | 19(1)                       | 17(1)                                      |
| 11(6)                       | 10(4)                                      | 19(2)                       | 17(3)                                      |
| 11(7)                       | 10(5)                                      | Y (note to chapter I)       | 18   |
|                             | 10(6)                                      | note to article 19          | 17(2)                                      |

<sup>17</sup>Ibid., para. 249.

adopted the following decision at its 484th meeting, on 15 May 1992:

*The United Nations Commission on International Trade Law,*

Recalling its mandate under General Assembly resolution 2205 (XXI) of 17 December 1966 to further the progressive harmonization and unification of the law of international trade, and in that respect to bear in mind the interests of all peoples, and in particular those of developing countries, in the extensive development of international trade,

Noting that an increasing number of payments in international trade are carried out by means of credit transfers, particularly as a result of the development of high-speed international electronic funds transfer systems,

Recalling the publication of the Legal Guide on Electronic Funds Transfers prepared by the Secretariat,<sup>1</sup>

Being of the opinion that the establishment of a model law on international credit transfers that is acceptable to States with different legal, social and economic systems contributes to the development of harmonious international economic relations,

Being convinced that the UNCITRAL Model Law on International Credit Transfers significantly contributes to the establishment of a unified legal framework applicable to all international credit transfers, whether in electronic or in paper-based form,

1. *Adopts* the UNCITRAL Model Law on International Credit Transfers as it appears in annex I to the report of its current session;

2. *Requests* the Secretary-General to transmit the text of the UNCITRAL Model Law on International Credit Transfers, together with the *travaux préparatoires* from the twenty-fourth and twenty-fifth sessions of the Commission, to Governments and other interested bodies;

3. *Recommends* that all States give due consideration to the UNCITRAL Model Law on International Credit Transfers when they enact or revise their laws, in view of the current need for uniformity of the law applicable to international credit transfers.

### III. INTERNATIONAL COUNTERTRADE

#### A. Introduction

83. At its twenty-first session, in 1988, the Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up contracts in countertrade transactions.<sup>19</sup>

84. At its twenty-second session, in 1989, the Commission considered the report entitled "Draft outline of the possible content and structure of a legal guide on drawing

up international countertrade contracts" (A/CN.9/322) and decided to prepare such a legal guide.<sup>20</sup>

85. At its twenty-third session, in 1990, the Commission considered several draft chapters of the legal guide (A/CN.9/332 and Add.1-7). The discussion in the Commission is reflected in annex I to the report of the Commission on the twenty-third session.<sup>21</sup> There was general agreement in the Commission with the overall approach taken in preparing the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein.<sup>22</sup> The Commission decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them to the Working Group on International Payments.<sup>23</sup>

86. The Working Group on International Payments, at its twenty-third session in September 1991, considered the remaining draft chapters of the legal guide and draft illustrative provisions (A/CN.9/WG.IV/WP.51 and Add.1-7). The discussion in the Working Group is reflected in document A/CN.9/357. The Working Group requested the Secretariat to revise the draft chapters of the legal guide and present them to the Commission at the twenty-fifth session.

87. The Commission at its current session had before it the following draft materials for the legal guide: the covering report (A/CN.9/362); draft chapters "I. Introduction to legal guide" (A/CN.9/362/Add.1); "II. Scope and terminology of legal guide" (A/CN.9/362/Add.2); "III. Contracting approach" (A/CN.9/362/Add.3); "IV. Countertrade commitment" (A/CN.9/362/Add.4); "V. General remarks on drafting" (A/CN.9/362/Add.5); "VI. Type, quality and quantity of goods" (A/CN.9/362/Add.6); "VII. Pricing of goods" (A/CN.9/362/Add.7); "VIII. Participation of third parties" (A/CN.9/362/Add.8); "IX. Payment" (A/CN.9/362/Add.9); "X. Restrictions on resale of countertrade goods" (A/CN.9/362/Add.10); "XI. Liquidated damages and penalty clauses" (A/CN.9/362/Add.11); "XII. Security for performance" (A/CN.9/362/Add.12); "XIII. Failure to complete countertrade transaction" (A/CN.9/362/Add.13); "XIV. Choice of law" (A/CN.9/362/Add.14); "XV. Settlement of disputes" (A/CN.9/362/Add.15); "Draft illustrative provisions" (A/CN.9/362/Add.16); and "Chapter summaries" (A/CN.9/362/Add.17).

#### B. Discussion of text of draft Legal Guide

##### *General discussion*

88. The Commission expressed its appreciation to the Working Group on International Payments and its Chairman, Mr. Michael Joachim Bonelli of Italy, for having prepared a draft text of a Legal Guide on International Countertrade Transactions, which was generally favourably received and regarded as an excellent basis for the discussion in the Commission.

<sup>19</sup>*Ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), paras. 245-249.

<sup>21</sup>*Ibid.*, Forty-fifth Session, Supplement No. 17 (A/45/17).

<sup>22</sup>*Ibid.*, para. 16.

<sup>23</sup>*Ibid.*, paras. 17 and 18.

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), paras. 32-35.

89. The Commission reiterated its conviction that the Legal Guide, while not encouraging or discouraging the conducting of international trade through countertrade, would significantly assist parties from all regions of the world to establish fair and balanced contractual relations when they decided to engage in countertrade. The Commission stressed the particular importance of the Legal Guide for developing countries.

90. A number of observations were raised concerning the translation of technical terms into languages other than English. The Commission requested the Secretariat to review the text with a view to ensuring observance of usage in current legal texts and international commerce. Where translation of a term might be misunderstood, it was suggested to indicate in parentheses the term in the original language. Where a term had a special meaning in one language only, it was said to be most appropriate to keep the term in its original version. It was stressed that, as a general policy, it was useful to follow the translations used in previous UNCITRAL legal texts. The following examples of terms whose translation should be reviewed were given: barter (chapter II, paragraph 14); goods (chapter II, paragraph 28); standards (chapter VII, paragraph 11); joint venture (chapter VII, paragraph 37); trust (chapter IX, paragraph 10); "swing" (chapter IX, paragraph 53); "best efforts" (chapter VIII, paragraph 19); termination (chapter XI, paragraphs 18 and 28); "hold-harmless" clause (chapter X, paragraph 24); liquidated damages and penalties (chapter XI); remedies (chapter XIII, sect. B).

#### *Chapter I. Introduction to Legal Guide (A/CN.9/362/Add.1)*

91. The Commission agreed to insert in paragraph 2, after the third sentence, the following sentence: "Mr. Michael Joachim Bonell of Italy served as chairman of the sessions of the Commission and the Working Group devoted to the drafting of the Legal Guide." Subject to that modification, the chapter was approved.

#### *Chapter II. Scope and terminology of Legal Guide (A/CN.9/362/Add.2)*

##### *Section A*

92. As a consequence of the Commission's decision to insert in chapter VI three paragraphs concerning commitments to invest (see paragraph 99 below), the Commission decided to insert in the third and fourth sentences of paragraph 2 a reference to investment. Subject to that modification, the Commission approved section A.

##### *Sections B, C and D*

93. The Commission approved the texts of the sections.

##### *Section E*

94. The Commission decided to include in paragraph 16 a reference to the fact that the supply of a production facility usually required bank financing. Subject to that modification, the Commission approved section E.

#### *Chapter III. Contracting approach (A/CN.9/362/Add.3)*

95. The Commission adopted the proposal to refer in the first sentence of paragraph 4 not only to the quantity of goods but also to the quality of goods. Subject to that modification, the Commission approved the chapter.

#### *Chapter IV. Countertrade commitment (A/CN.9/362/Add.4)*

##### *Sections A, B, C, D and F*

96. It was decided to place the discussion contained in section F, "Stage when commitment fulfilled", before section C, "Time period for fulfilment of the countertrade commitment". Subject to that modification, the sections were approved.

##### *Section E*

97. It was agreed to insert in paragraph 33, at the end of the first sentence, text along the following lines: "or the extent to which the components of the purchased goods were produced locally ('local content' or 'local value added')". Subject to that modification, the section was approved.

#### *Chapter V. General remarks on drafting (A/CN.9/362/Add.5)*

98. The chapter was approved.

#### *Chapter VI. Type, quality and quantity of goods (A/CN.9/362/Add.6)*

99. The Commission decided to add after paragraph 23 the following text:

"23 *bis*. In some countertrade transactions, in particular in some indirect offset transactions, it is agreed that the exporter, i.e. the party committed to purchase goods, may earn fulfilment credit by investment of capital. Sometimes it is agreed that the exporter must fulfil a specified part of the countertrade commitment through investment.

"23 *ter*. It is advisable for the countertrade agreement to define the type of investments that will count towards fulfilment of the countertrade commitment. Eligible investments may be defined, for example, by the size of the capital and the form in which it is to be invested; the jurisdiction in which the recipient of the investment must be incorporated or have its place of business; the type of business activities that must result from the investment; the markets in which products or services of the recipient of the investment are to be offered; the type of technology to be used by the recipient of the investment; or the ownership of the technology.

"23 *quater*. The parties may consider whether the fulfilment credit granted for an eligible investment is to be equal to or different from the amount of the investment (see chapter IV, 'Countertrade commitment', para-

graphs 31 to 34). Furthermore, it may be considered whether, in counting the amount of the investment towards fulfilment of the countertrade commitment, any interest or dividend paid to a creditor or investor is to be deducted."

100. Subject to the foregoing addition, the Commission approved the chapter.

*Chapter VII. Pricing of goods (A/CN.9/362/Add.7)*

101. The Commission approved the chapter.

*Chapter VIII. Participation of third parties (A/CN.9/362/Add.8)*

102. The Commission approved the chapter.

*Chapter IX. Payment (A/CN.9/362/Add.9)*

103. The Commission approved the chapter.

*Chapter X. Restrictions on resale of countertrade goods (A/CN.9/362/Add.10)*

104. The Commission approved the chapter.

*Chapter XI. Liquidated damages and penalty clauses (A/CN.9/362/Add.11)*

*Title*

105. A question was raised as to the appropriateness of referring in the title to both liquidated damages clauses and to penalty clauses. The concern behind that question was that drawing a distinction between the two types of clauses might be confusing to readers in legal systems that did not distinguish between the two types of clauses. It was suggested that the title might be modified to read "Agreed sum due upon failure of performance", based on the terminology used by the Commission in the Uniform Rules on Contract Clauses for an Agreed Sum due upon Failure of Performance. It was pointed out, however, that the present title was intended to recognize the distinction made in some legal systems between liquidated damages, as pre-assessments of the extent of damages due for failure to perform, and penalty clauses as sanctions for failure to perform. It was also noted that the same title was used in the analogous chapter in the UNCITRAL Legal Guide on Drawing up Contracts for the Construction of Industrial Works (hereinafter referred to as the "Legal Guide on Construction") and that uncertainty might arise from a divergence in this respect between the two legal guides. Accordingly, after deliberation, the Commission decided to retain the title in its present form.

*Section A*

106. No objections were raised to a proposal to invert the order of paragraphs 1 and 2.

107. The Commission considered whether it would be appropriate to attempt to define and distinguish liquidated damages and penalty clauses beyond what was contained in paragraph 1. The generally held view was that this would not be appropriate, in particular because a more extended discussion of liquidated damages and penalty clauses would be outside the focus of the Legal Guide, which was confined to issues specific to countertrade.

108. It was suggested that mention should be made in paragraph 6 of the possibility of compensating for non-performance by the delivery of goods. Such an approach might be helpful when the obligated party was short of currency. The Commission was of the view that the generally accepted function of liquidated damages and penalty clauses was to provide monetary compensation. Nevertheless, the Commission agreed that it would be useful for the Legal Guide to point out that, in the event of a currency shortage on the part of the party obligated to pay the agreed sum, the parties were not precluded from agreeing that the obligation to pay the agreed sum could be liquidated by delivery of goods in an agreed quantity and quality.

109. The Commission agreed to a suggestion that mention should be added, in paragraph 7 or 12, of the requirement in some legal systems that the amount stipulated in the liquidated damages or penalty clause may not exceed the amount of the underlying obligation, and of the prohibition in some legal systems of claims for damages for failure to perform in cases covered by penalty clauses.

110. The Commission approved section A, subject to the agreed-upon changes.

*Sections B through F*

111. The Commission approved sections B through F, subject to the repositioning of paragraph 21 to follow paragraph 23.

*Chapter XII. Security for performance (A/CN.9/362/Add.12)*

112. The Commission approved the chapter.

*Chapter XIII. Failure to complete countertrade transaction (A/CN.9/362/Add.13)*

*Sections A, C and D*

113. The Commission approved the sections.

*Section B*

114. The Commission approved the section, subject to the deletion of the last sentence of paragraph 9.

*Chapter XIV. Choice of law (A/CN.9/362/Add.14)*

*Section A*

115. The Commission agreed to reformulate paragraph 2 as follows: "Under the rules of private international law (in

some legal systems referred to as 'conflict-of-laws' or 'choice-of-law' rules) of most jurisdictions, the parties are permitted by agreement to choose the applicable law. Under some laws there are, however, some restrictions on that choice. If the parties do not choose the applicable law, the rules of private international law of the forum will determine which law governs the legal relationship."

116. It was agreed to replace the second sentence of paragraph 5 by the following: "For example, most States do not allow freedom of choice with respect to the question of transfer of ownership of goods or disposition of funds held in a bank."

117. Subject to the above changes, the Commission approved the section.

#### *Section B*

118. The Commission agreed to delete in the sixth sentence of paragraph 10 the words "unless the parties have chosen the applicable law". The Commission also agreed to delete the penultimate sentence in paragraph 10.

119. The Commission decided to replace in the fourth sentence of paragraph 12 the words "Under other systems" by the words "Under most systems".

120. The Commission accepted the proposal to mention in paragraph 15 that some States did not recognize the type of agreement referred to in the first sentence of paragraph 15, and that under the law of those States the transaction would be governed by the national law determined pursuant to the rules of private international law.

121. It was agreed to replace in the first sentence of paragraph 16 the words "In many national laws" by the words "In most national laws".

122. Subject to the above changes, the Commission approved the section.

#### *Sections C and D*

123. The Commission approved the sections.

### *Chapter XV. Settlement of disputes (A/CN.9/362/Add.15)*

#### *Section A*

124. The Commission agreed with the proposal to delete in the fourth sentence of paragraph 2 the word "impartial".

125. The Commission agreed that the penultimate sentence of paragraph 17 should refer to paragraph 7, which contained further discussion on rules in some States limiting the freedom of parties to enter into an arbitration agreement.

#### *Sections B and C*

126. The Commission approved the sections.

#### *Section D*

127. With respect to the discussion in the underlined sentence in paragraph 16, the Commission decided that the sentence should be reformulated so as to avoid an erroneous impression that an arbitral tribunal could enforce the remedy of specific performance.

128. The Commission agreed to delete the words "In general" at the beginning of the first sentence of paragraph 18.

129. The Commission agreed to add in the second sentence of paragraph 21, after the words "is not enforceable", the words "as such", or words of the same meaning, so as to make it clear that the award, while not being enforceable in expedited proceedings similar to the proceedings for the enforcement of judicial decisions, was binding on the parties as a contract.

130. As to the discussion in paragraph 36, it was pointed out that article I(3) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) made it possible to limit the applicability of the Convention to awards made in States parties to the Convention. The Commission was agreed that, in view of the foregoing, the question whether a State was a party to the Convention was one of the factors in choosing the place of arbitration and that that factor should be reflected in paragraph 36.

131. The Commission decided that in paragraph 29 greater emphasis should be placed on the useful features of the UNCITRAL Arbitration Rules.

132. Subject to the foregoing modifications, the Commission approved the section.

#### *Sections E and F*

133. The Commission approved the sections.

### *Draft illustrative provisions (A/CN.9/362/Add.16)*

134. The Commission decided to delete, in the text of the footnote to paragraph 21 in chapter XIII, the words "physical or legal". Subject to that modification, the Commission approved the draft illustrative provisions.

### *Chapter summaries (A/CN.9/362/Add.17)*

135. The Commission requested the Secretariat to revise the chapter summaries and reflect in them, where necessary, the changes made in the chapters of the Legal Guide. Subject to those changes to be made, the Commission approved the chapter summaries.

#### *Index*

136. The Commission noted that the Secretariat would prepare an index to the Legal Guide.

### C. Decision of the Commission and recommendation to the General Assembly

137. The Commission, at its 479th meeting on 12 May 1992, adopted the following decision:

*The United Nations Commission on International Trade Law.*

Recalling its mandate under General Assembly resolution 2205 (XXI) of 17 December 1966 to further the progressive harmonization and unification of the law of international trade, and in that respect to bear in mind the interests of all peoples, and in particular those of developing countries, in the extensive development of international trade,

Noting that an appreciable share of international trade is carried out through countertrade transactions,

Being of the opinion that a legal guide on contractual issues in international countertrade transactions will be helpful to parties involved in such transactions, and in particular to parties from developing countries,

1. Adopts the UNCITRAL Legal Guide on International Countertrade Transactions;
2. Invites the General Assembly to recommend the use of the Legal Guide for international countertrade transactions;
3. Requests the Secretary-General to take effective measures for the widespread distribution and promotion of the use of the Legal Guide.

138. The Secretariat was requested to edit the text of the Legal Guide adopted by the Commission and to publish it expeditiously. The Commission expressed agreement with statements emphasizing that, in view of the usefulness of the Legal Guide in all regions of the world, the secretariat of the Commission and other relevant units of the United Nations Secretariat should take effective measures to publicize the Legal Guide worldwide.

139. The Commission decided that the publication containing the Legal Guide should set forth an invitation to readers to communicate to the Secretariat their comments on the Legal Guide.

### IV. LEGAL PROBLEMS OF ELECTRONIC DATA INTERCHANGE

140. At its twenty-fourth session, in 1991, the Commission was agreed that the legal issues of electronic data interchange (EDI) would become increasingly important as the use of EDI developed and that the Commission should undertake work in that field. The Commission was agreed that, given the number of issues involved, the matter needed detailed consideration by a Working Group.<sup>24</sup>

141. At its current session, the Commission had before it the report of the Working Group on International Payments on the work of its twenty-fourth session (A/CN.9/360). As

requested by the Commission, the report contained recommendations for future work by the Commission with respect to the legal issues of EDI. The report suggested that any future work by the Commission in the field should be aimed at facilitating the increased use of EDI. The report also noted that the deliberations of the Working Group had made it clear that there existed a need for legal norms to be developed in the field of EDI. The report further suggested that the review of legal issues arising out of the increased use of EDI had also demonstrated that among those issues some would most appropriately be dealt with in the form of statutory provisions. Examples of such issues included: formation of contracts; risk and liability of commercial partners and third-party service providers involved in EDI relationships; extended definitions of "writing" and "original" to be used in an EDI environment; and issues of negotiability and documents of title (A/CN.9/360, para. 129).

142. The report also suggested that other issues arising from the use of EDI were not ready for consideration in the context of statutory provisions and would require further study or further technical or commercial developments. While it was generally felt by the Working Group that it was desirable to seek the high degree of legal certainty and harmonization provided by the detailed provisions of a uniform law, it was also felt that care should be taken to preserve a flexible approach to some issues where legislative action might be premature or inappropriate. As an example of such an issue, it was stated that it might be fruitless to attempt providing legislative unification of rules on evidence applicable to EDI messaging. It was stated in the report that, on some such issues, the Commission might deem it appropriate to undertake the preparation of legal rules, legal principles or recommendations (A/CN.9/360, para. 130).

143. The Working Group recommended that the Commission should undertake the preparation of legal norms and rules on the use of EDI in international trade. The Working Group was agreed that such norms and rules should be sufficiently detailed to provide practical guidance to EDI users as well as to national legislators and regulatory authorities. The Group also recommended that the Commission, while it should aim at providing the greatest possible degree of certainty and harmonization, should not, at that stage, make a decision as to the final form in which those norms and rules would be expressed (A/CN.9/360, para. 131).

144. As regards the possible preparation of a standard communication agreement for worldwide use in international trade, the Working Group was agreed that, at least currently, it was not necessary for the Commission to develop a standard communication agreement. However, the Working Group noted that, in line with the flexible approach recommended to the Commission concerning the form of the final instrument, situations might arise where the preparation of model contractual clauses would be regarded as an appropriate way of addressing specific issues (A/CN.9/360, para. 132).

145. The Working Group reaffirmed the need for close cooperation between all international organizations active

<sup>24</sup>Ibid., Forty-sixth Session, Supplement No. 17 (A/46/17), paras. 314-317.

in the field. It was agreed that the Commission, in view of its universal membership and general mandate as the core legal body of the United Nations system in the field of international trade law, should play a particularly active role in that respect (A/CN.9/360, para. 133).

146. At its current session, the Commission expressed its appreciation for the work accomplished by the Working Group. In line with the suggestions of the Working Group, the Commission was agreed that there existed a need to investigate further the legal issues of EDI and to develop practical rules in that field. It was agreed, along the lines suggested by the Working Group, that no decision should be taken at this early stage as to the final form or the final content of the legal rules to be prepared by the Commission. In particular, it was agreed that, while some issues would most appropriately be dealt with in the form of statutory provisions, other issues might more appropriately be dealt with through model contractual clauses.

147. After discussion, the Commission endorsed the recommendation contained in the report of the Working Group (A/CN.9/360, paras. 129-133) and entrusted the preparation of legal rules on EDI to the Working Group on International Payments, which it renamed the Working Group on Electronic Data Interchange.

148. The Commission also reaffirmed the need for active cooperation between all international organizations active in the field. The Commission decided that the Secretariat should continue to monitor legal developments in other organizations such as the Economic Commission for Europe (ECE), the European Communities and the International Chamber of Commerce (ICC), facilitate the exchange of relevant documents between the Commission and those organizations and report to the Commission and its relevant Working Groups on the work accomplished within those organizations.

## V. PROCUREMENT

149. 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.<sup>25</sup> The Working Group commenced its work on the topic at its tenth session (1988), and continued work at the eleventh, twelfth, thirteenth and fourteenth sessions; the reports of those sessions are contained in documents A/CN.9/315, A/CN.9/331, A/CN.9/343, A/CN.9/356 and A/CN.9/359, respectively.

150. At its current session, the Commission had before it the reports of the Working Group on the work of its thirteenth session, held in New York from 15 to 26 July 1991 (A/CN.9/356), and of its fourteenth session, held at Vienna from 2 to 13 December 1991 (A/CN.9/359). The report of the fourteenth session indicated that the Working Group was nearing the completion of its work on the draft Model Law (A/CN.9/359, para. 248).

151. The Commission noted with approval that it was the intention of the Working Group to submit the draft Model Law to the twenty-sixth session of the Commission in 1993 for finalization and adoption and that, in that light, the Working Group expected to complete work on the draft Model Law at its fifteenth session (scheduled to take place in New York from 22 June to 2 July 1992). The Commission agreed to a request from the Working Group to authorize a sixteenth session of the Working Group, to be held at Vienna from 5 to 16 October 1992, in the event that the Working Group did not complete its work at the fifteenth session. It was noted that, even if a sixteenth session were to prove necessary, sufficient time would remain to circulate the draft Model Law for comments prior to the twenty-sixth session of the Commission.

152. The Commission accepted the recommendation of the Working Group that priority should be given to the preparation of a commentary aimed at giving guidance to legislatures preparing legislation based on the Model Law, but that the preparation of that commentary should not delay the completion of the Model Law. The Commission also noted that the draft commentary would be prepared by the Secretariat and that a small and informal ad hoc working party of the Working Group would be convened to review the draft commentary.

153. Noting that the preparation of a Model Law on procurement was particularly timely and urgently needed in view of the fact that an increasing number of States were considering reform of their procurement laws, the Commission expressed appreciation for the work performed by the Working Group so far and requested it to proceed with its work expeditiously, with a view to consideration of the draft Model Law by the Commission at its next session.

## VI. GUARANTEES AND STAND-BY LETTERS OF CREDIT

154. The Commission, at its twenty-second session, held in 1989, decided that work on a uniform law on guarantees and stand-by letters of credit should be undertaken, and entrusted that task to the Working Group on International Contract Practices.<sup>26</sup>

155. The Working Group had commenced its work on the topic at its thirteenth session by considering possible issues of a uniform law. At its fourteenth and fifteenth sessions, the Working Group had examined draft articles 1 to 7 of the uniform law and further issues to be dealt with in a uniform law. The reports of those sessions of the Working Group are contained in documents A/CN.9/330, A/CN.9/342 and A/CN.9/345.

156. At its current session, the Commission had before it the reports of the Working Group on the work of its sixteenth and seventeenth sessions (A/CN.9/358 and A/CN.9/361). The Commission noted that the Working Group had during its sixteenth session examined draft articles 1 to 13 and during its seventeenth session draft articles 14 to 27 of the uniform law prepared by the Secretariat.

<sup>25</sup>*Ibid.*, Forty-first Session, Supplement No. 17 (A/41/17), para. 243.

<sup>26</sup>*Ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

157. The Commission noted that the Working Group had requested the Secretariat to prepare, on the basis of the deliberations and conclusions of the Working Group, a revised draft of articles 1 to 27 of the uniform law. The Commission further noted that, when discussing the appropriateness of including provisions on conflicts of law and jurisdiction in the uniform law, the Working Group had requested the Secretariat to continue consulting with the Hague Conference on Private International Law on possible methods of cooperation in that field.

158. The Commission expressed its appreciation for the progress made by the Working Group so far and requested it to continue carrying out its task expeditiously.

## VII. INCOTERMS 1990

159. At its twenty-fourth session, in 1991, the Commission had considered a request from the Acting Secretary-General of the International Chamber of Commerce (ICC) that the Commission should consider endorsing INCOTERMS 1990 for worldwide use. In order to allow consideration of that request, the Commission had before it the text of INCOTERMS 1990 (A/CN.9/348). It was recalled that the Commission, at its second session in 1969, had endorsed INCOTERMS 1953. Reference was made to the importance of INCOTERMS as a widely used practical tool and to the need for wider awareness of INCOTERMS. Furthermore, appreciation was expressed for the efforts made by ICC to revise INCOTERMS in order to stay abreast of changes in transportation techniques and trade documentation. However, while at the twenty-fourth session several delegations had indicated their desire to endorse the text of INCOTERMS, some delegations had indicated that, owing to the fact that late publication of document A/CN.9/348 had prevented them from carrying out the consultations required prior to endorsement, they had not been prepared to endorse the text of INCOTERMS at that session. The Commission regretfully felt obliged to postpone consideration of endorsement until the current session.

160. At its current session, the Commission was agreed that INCOTERMS 1990 succeeded in providing a modern set of international rules for the interpretation of the most commonly used trade terms in international trade. The Commission noted with appreciation that the new method of presenting INCOTERMS 1990 facilitated their reading and understanding. Several delegations reported that INCOTERMS 1990 were already widely used in their countries. The Commission expressed its appreciation of the continuing cooperation which the Commission had enjoyed with ICC.

161. At its 480th meeting, on 12 May 1992, the Commission adopted the following decision endorsing INCOTERMS 1990:

*The United Nations Commission on International Trade Law,*

*Expressing its appreciation to the International Chamber of Commerce for having transmitted to it the revised text of INCOTERMS, which was approved by*

*the Commercial Practices Commission of the International Chamber of Commerce and entered into force on 1 July 1990, and for requesting the Commission to consider endorsing INCOTERMS 1990 for worldwide use,*

*Congratulating the International Chamber of Commerce on having made a further contribution to the facilitation of international trade by revising INCOTERMS to take account of changes in transportation techniques and to adapt the terms to the increasing use of electronic data interchange,*

*Noting that INCOTERMS constitute a valuable contribution to the facilitation of international trade,*

*Commends the use of INCOTERMS 1990 in international sales transactions.*

## VIII. CASE LAW ON UNCITRAL TEXTS (CLOUT)

162. At its twenty-first session (1988), the Commission decided to establish a system for collecting and disseminating information on court decisions and arbitral awards relating to normative texts emanating from the work of the Commission.<sup>27</sup> At the current session it was reported that the Secretariat had established the system. It was explained that the system relied on national correspondents designated by those States adhering to a Convention or having enacted legislation based on a Model Law. The Commission was informed that the features of the system were explained in detail in the User Guide that would be published together with the first batch of abstracts of court decisions, which related to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) and the UNCITRAL Model Law on International Commercial Arbitration (1985).

163. The Commission noted with appreciation and satisfaction that the case collection system had been established and congratulated the national correspondents and the Secretariat on the work that had been done so far in relation to the establishment of the system. The Commission further urged States to cooperate with the Secretariat in the operation of the system, and in particular to appoint national correspondents, on whose work the operation of the system was dependent.

## IX. COORDINATION OF WORK

164. The Commission had before it a note by the Secretariat on assistance by multilateral organizations and bilateral aid agencies in the modernization of commercial laws in developing countries (A/CN.9/364). The note reported that a number of multilateral organizations and bilateral aid agencies were involved in rendering assistance in activities whose objective was the modernization of commercial law in developing countries. The assistance rendered typically took the form of the provision of experts, as well as of funding to be used in the execution of projects. It was further noted that those activities concentrated on the modernization and development of legislation in the fol-

<sup>27</sup>*Ibid.*, Forty-third Session, Supplement No. 17 (A/43/17), paras. 98-109.

lowing areas: investment laws; intellectual property law; maritime legislation; and laws and regulations in areas such as taxation, insurance, customs, procurement and export and import trade.

165. The note by the Secretariat recommended that, in view of the fact that the activities of multilateral organizations and bilateral aid agencies could play a significant role in the development of international trade law and that that work had implications for the harmonization of international trade law, the Commission might wish to request the Secretariat to continue to monitor the work of those organizations in that area. Further, the Commission might wish to recommend to those multilateral organizations and bilateral aid agencies thus far not involved in that kind of work to consider taking a more active part in such activities and to consider including such activities in the terms of reference of their work. In addition, the Commission might wish to urge that there should be greater cooperation and consultation between UNCITRAL and the multilateral organizations and bilateral aid agencies when those organizations carried out projects designed to modernize commercial law in developing countries.

166. A concern was expressed that the type of note before the Commission should not mean that the Secretariat might not in the future prepare reports on the current activities of other organizations related to the harmonization and unification of international trade law such as those that had been prepared in the past. It was explained that the preparation of such "current activities" reports had taken place at intervals and that such a report would again be prepared in the near future. It was noted that, in between such reports, the Secretariat had in the past prepared reports that focused on special issues and that the note before the Commission was one such special report.

167. The Commission noted with appreciation the efforts of the Secretariat to monitor the activities of multilateral organizations and bilateral aid agencies relating to the modernization of commercial laws in developing countries.

## X. STATUS OF CONVENTIONS

168. The Commission considered the status of signatures, ratifications, accessions and approvals of conventions that were the outcome of its work, that is, the Convention on the Limitation Period in the International Sale of Goods (New York, 1974) ("the Limitation Convention"), the Protocol amending the Limitation Convention (Vienna, 1980), the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) ("the Hamburg Rules"), the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) ("the United Nations Sales Convention"), the United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988) ("the UNCITRAL Bills and Notes Convention") and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991) ("the United Nations Terminal Operators Convention"). The Commission also considered the status of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York,

1958). In addition, the Commission took note of the jurisdictions that had enacted legislation based on the UNCITRAL Model Law on International Commercial Arbitration ("the UNCITRAL Model Arbitration Law"). The Commission had before it a note by the Secretariat on the status of those Conventions and of the Model Law as at 23 April 1992 (A/CN.9/368).

169. The Commission was pleased to note that, since the report submitted to the Commission at its twenty-fourth session (1991), Romania and Uganda had ratified the Limitation Convention and its amending Protocol. As a result of those actions, 10 States were currently parties to the Limitation Convention as amended by the Protocol, while 3 States were parties to the unamended Convention.

170. The Commission took pleasure in noting that one additional State, namely Zambia, had acceded to the Hamburg Rules, bringing the total number of parties to 20. As a result, the Convention would come into force for all parties thereto on 1 November 1992.

171. With respect to the United Nations Sales Convention, the Commission noted with satisfaction that Ecuador and Uganda had become parties to the Convention, and that Canada had, to this point, extended the application of the Convention to all Provinces and Territories except Yukon.

172. The Commission noted with pleasure the accession of Bangladesh, Latvia and Uganda to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

173. The Commission noted with pleasure that the United States of America had signed the United Nations Terminal Operators Convention.

174. With respect to the UNCITRAL Arbitration Model Law, the Commission noted with pleasure that legislation based on the Model Law had been enacted in Finland.

175. Representatives and observers of a number of States reported that official action was being taken with a view to adherence to the United Nations Sales Convention, the Limitation Convention as amended by the Protocol, the Hamburg Rules, the UNCITRAL Bills and Notes Convention, and to adoption of legislation based on the UNCITRAL Model Arbitration Law.

## XI. TRAINING AND ASSISTANCE

176. The Commission had before it a note by the Secretariat that set out the activities that had been carried out in respect of training and assistance during the period between the twenty-fourth and the current session of the Commission as well as possible future activities in that field (A/CN.9/363). The note indicated that since the statement of the Commission at its twentieth session (1987), "that training and assistance was an important activity of the Commission and should be given a higher priority than it had in the past",<sup>28</sup> the Secretariat had endeavoured to

<sup>28</sup>Ibid., Forty-second Session, Supplement No. 17 (A/42/17), para. 335.

devise a more extensive programme of training and assistance than had been previously carried out. In doing so the Secretariat had kept in mind the decision of the Commission at its fourteenth session in 1981, that a major purpose of the training and assistance activities should be the promotion of the texts that had been prepared by the Commission.<sup>29</sup>

177. As announced to the twenty-fourth session of the Commission in 1991,<sup>30</sup> a regional seminar on international trade law, organized jointly by the UNCITRAL secretariat and the South Pacific Forum secretariat, was held at the Forum secretariat headquarters in Suva, Fiji, from 21 to 25 October 1991. The seminar was organized for the South Pacific States. Sixteen participants, who were mainly senior government officials and therefore well placed in their respective countries to influence decisions relating to acceptance of UNCITRAL texts, attended the seminar. They were from the following States members of the South Pacific Forum: Australia, Cook Islands, Fiji, Kiribati, Micronesia (Federated States of), Nauru, Papua New Guinea, Solomon Islands, Tonga, Tuvalu and Vanuatu.

178. The Forum secretariat provided the facilities necessary for the holding of the seminar, which was financed by a grant from the Government of Australia and by funds from the UNCITRAL Trust Fund for Symposia. Australia further supported the seminar by providing two lecturers; the other lecturers were a Canadian consultant, a lawyer from the region and two members of the secretariat of the Commission. The seminar considered the conventions and other legal texts prepared by the Commission.

179. A seminar on international commercial arbitration was held in Mexico City from 20 to 21 February 1992. The seminar was jointly organized by the Mexican Ministry of External Relations and the secretariat of the Commission. Lectures were given by four Mexican experts, a consultant and a member of the secretariat of the Commission. The lectures were on various legal texts, including the UNCITRAL Model Arbitration Law and the UNCITRAL Arbitration Rules, and on various issues of international arbitration practice. The seminar was attended by about 80 ministry officials, practitioners and law teachers.

180. The Commission was informed that the Secretariat expected to intensify even further its efforts to organize or co-sponsor seminars and symposia on international trade, especially for developing countries. It was reported that, as announced at the twenty-fourth session of the Commission<sup>31</sup> and in view of the interest shown in the Fourth UNCITRAL Symposium and the advantages of holding symposia in connection with the sessions of the Commission when they were held at the location of the Commission's secretariat at Vienna, it was intended to organize the Fifth UNCITRAL Symposium on International Trade Law on the occasion of the twenty-sixth session of the Commission, in June 1993.

181. It was reported that the Secretariat had received requests to hold seminars from various States in Africa, Asia

and Latin America and that tentative plans had been made for organizing in November 1992 a series of national seminars in Indonesia, the Philippines and possibly Malaysia and Thailand. It was also reported that another such series might next be organized in some countries of Latin America. It was suggested that the Secretariat should consider extending that series of seminars to Africa. It was explained that the Secretariat planned to extend such seminars to Africa depending on the availability of funds. It was further explained that the Secretariat had held seminars in Africa in previous years: Lesotho (1988), Guinea (1990) and Cameroon (1991).

182. The Secretariat was of the view that country seminars were relatively cost-effective from a financial point of view, since the only expense was normally the travel cost of lecturers. However, country seminars required a significantly greater expenditure of time for each country than did regional seminars. Therefore an appropriate balance between regional seminars and country seminars would depend to some degree on the balance between the financial resources available to the Secretariat and the amount of time that could be devoted to the organization and holding of such seminars.

183. The Secretariat reported that awareness of the UNCITRAL legal texts among many countries, in particular developing countries, was resulting in increasing requests for technical assistance from individual Governments and regional organizations. The Secretariat had been requested on a number of occasions to consult with individual countries during their consideration of UNCITRAL texts. In addition, requests from regional organizations on matters that ranged from review of laws of member States with a view to harmonization and possible unification to provision of a consultant had been received.

184. It was noted that the programme of training and assistance, in particular the holding of regional seminars, depended on the continued availability of sufficient financial resources. It was pointed out that no funds for the travel of participants and lecturers had been provided for in the regular budget. As a result, expenses had to be met by voluntary contributions to the UNCITRAL Trust Fund for Symposia. The contributions made to the UNCITRAL Trust Fund for Symposia on a multi-year basis had been of particular value because they had permitted the Secretariat to plan and finance the programme without the need to solicit funds from potential donors for each individual activity. Such contributions had been received from Canada and Finland. In addition, the annual contribution from Switzerland had been used for the seminar programme. Other financial contributions had been made by Australia and France. A view was expressed that the Commission should look at the possibility of raising funds from other sources such as foundations and the private sector to support its training and assistance programme. It was further suggested that Governments in developing countries should be encouraged to seek funding to supplement the efforts of UNCITRAL.

185. The Commission expressed its appreciation to all those who had participated in the organization of UNCITRAL seminars, and in particular to those that had

<sup>29</sup>Ibid., *Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 109.

<sup>30</sup>Ibid., *Forty-sixth Session, Supplement No. 17*, para. 338.

<sup>31</sup>Ibid., para. 337.

given financial assistance to the programme of seminars and the UNCITRAL Trust Fund for Symposia. The Commission also expressed its appreciation to the Secretariat for its efforts to conduct an expanded programme of seminars and symposia.

## XII. RELEVANT GENERAL ASSEMBLY RESOLUTIONS AND OTHER BUSINESS

### A. General Assembly resolution on the work of the Commission

186. The Commission took note with appreciation of General Assembly resolution 46/56 of 9 December 1991 on the report of the United Nations Commission on International Trade Law on the work of its twenty-fourth session. In particular, the Commission took note of the request by the General Assembly that the Fifth Committee, in order to ensure full participation by all Member States, consider granting travel assistance, within existing resources, to the least developed countries that are members of the Commission, as well as, on an exceptional basis, to other developing countries that are members of the Commission at their request, in consultation with the Secretary-General, to enable them to participate in the sessions of the Commission and its working groups. The Commission further took note of the recommendation of the General Assembly, expressed in paragraph 3 of resolution 46/56 B, that the Commission rationalize the organization of its work and consider, in particular, the holding of consecutive meetings of its working groups, and of the Assembly's request, in paragraph 4 of the same resolution, that the Commission submit a report on the implementation of the resolution to the Assembly at its forty-seventh session.

187. The Commission considered the recommendation of the General Assembly contained in paragraph 3 of resolution 46/56 B. It was observed that the Commission had on two previous occasions, at its twenty-first session (1988) and at its twenty-third session (1990), considered the rationalization of its working methods, including the issue of whether the holding of consecutive meetings for its working groups was practicable and whether it could result in savings on the cost of the travel expenses for delegations to UNCITRAL meetings. The Commission had concluded that the holding of consecutive meetings for its working groups was impracticable. It was noted that because of the nature of the work assigned to each working group, delegations were normally composed of different experts. The holding of consecutive working group meetings would not result in a lesser number of experts travelling to such meetings and would not therefore result in savings on travel costs for delegations. It was further observed that even where the same experts might be able to travel to more than one working group meeting, the length of time that the experts might be required to be away from their duty stations, if working group meetings were to be consecutive, might be too long. Many experts might not be able to afford long periods of absence from their work. Moreover, it was observed that such a practice might encourage States to keep the same experts already attending one working group meeting for the following one, notwithstanding that

those experts might not be the appropriate ones, to the detriment of the work of the Commission.

188. The Commission further observed that the holding of consecutive working group meetings would not result in saving on staff travel costs since different members of the UNCITRAL secretariat were normally assigned to service each working group. The members of the secretariat were customarily involved in the preparation of background research studies analysing various aspects of the subject under consideration by the working group to which they were assigned. It was noted that it would be impracticable to assign a member of staff who had not been involved in the preparation of documents relating to a particular working group to service that working group. The holding of consecutive working group meetings would not therefore result in a reduction in the number of members of the secretariat travelling to such meetings. It was suggested that the Commission should continue to consider its working methods and the rationalization of its work (see paragraph 187).

189. The Commission was in general agreement with efforts to find ways and means by which assistance could be given to developing countries, in particular to the least developed countries, as well as, on an exceptional basis, to other developing countries that were members of the Commission, at their request, in consultation with the Secretary-General, to enable them to participate in the sessions of the Commission and its working groups. The view was expressed that such assistance would have to be considered in the context of the overall budget. It was also stated that recommendations on the subject might require consideration by the Fifth Committee of the General Assembly.

### B. UNCITRAL Congress on International Trade Law (New York, 18-22 May 1992)

190. The Commission recalled its decision taken at its twenty-fourth session to entrust the Secretariat with the task of organizing, in the context of the current, twenty-fifth, session of the Commission a Congress on International Trade Law.<sup>32</sup> The Commission also recalled that the Congress was to be a contribution by the Commission to the activities of the United Nations Decade of International Law.

191. The Commission noted with appreciation the preparations by the Secretariat for the Congress, which was to take place during the third week of the Commission's session, that is, from 18 to 22 May 1992. It was noted that, after publishing the preliminary programme for the Congress in January 1992 (A/CN.9/1992/INF.1), the Secretariat had published the final programme on 8 May (A/CN.9/1992/INF.2). The Commission was pleased that participants had been invited to consider the accomplishments achieved in the progressive unification and harmonization of international trade law during the past 25 years and the needs that could be foreseen for the next 25 years. It was appreciated that over 60 speakers from different regions and legal systems would present a panoramic view of developments in major areas of international com-

<sup>32</sup>Ibid., paras. 343-349.

mercial law, and the Commission expressed gratitude to those speakers for their readiness to contribute to the Congress.

192. It was noted that the sessions of the Congress would be devoted to the following areas: process and value of unification of commercial law; sale of goods; supply of services; payments, credits and banking; electronic data interchange; transport; dispute settlement; and the future role of UNCITRAL. The Commission approved the practice-oriented approach of the Congress in that it would provide to practising lawyers, corporate counsel, ministry officials, judges, arbitrators, teachers of law and other users of uniform legal texts: (a) up-to-date information and practical guidance concerning principal legal texts of universal relevance; (b) an opportunity to express their opinion on the current state of the unification of the laws and rules governing world commerce; and (c) a forum in which to voice their practical needs as a basis for future work by the Commission and other formulating agencies.

### C. Time period for signing a convention

193. It was observed that, in the case of the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991), States had been given about one year within which to sign the Convention. It was further observed that signature of a convention was in many States an important step leading towards adherence to a convention. It was pointed out that the process of consultations that had to precede a signature often required more time than one year and that, in future conventions, it would be preferable to provide for a longer period, perhaps two years, for signing them. It was further recommended that the Secretariat, several months before the expiry of the time period for signature, should remind the States of the approaching deadline. Such a reminder might be useful in that it might accelerate the process of consideration of the convention and increase the number of States that would eventually adhere to the convention.

### D. Bibliography

194. The Commission noted with appreciation the bibliography of recent writings related to the work of the Commission (A/CN.9/369).

### E. Date and place of the twenty-sixth session of the Commission

195. It was decided that the Commission would hold its twenty-sixth session from 7 to 25 June 1993 at Vienna.

### F. Sessions of the working groups

196. It was decided that the Working Group on International Contract Practices would hold its eighteenth session from 30 November to 11 December 1992 at Vienna. As to the nineteenth session of the Working Group, the Commission expressed a preference for the session to be held from 19 to 30 April 1993 in New York, although the Commission noted that it might be necessary to hold the session from 12 to 23 April 1993 in New York.

197. The Commission noted that the Working Group on the New International Economic Order would hold its fifteenth session from 22 June to 2 July 1992 in New York. The Working Group expected to complete its preparation of the draft Model Law on Procurement at that session. It was decided that the Working Group might hold its sixteenth session from 5 to 16 October 1992 at Vienna if, in the judgement of the Working Group, its progress in respect of the preparation of the draft Model Law on Procurement so warranted.

198. The Commission, recalling its decision to rename the Working Group on International Payments the Working Group on Electronic Data Interchange to reflect the topic currently being dealt with by the Working Group (see paragraph 147 above), noted that the Working Group would not hold its session from 31 August to 11 September 1992 in New York as originally planned; instead, the session would be held from 4 to 15 January 1993 in New York.

### ANNEX I

[Annex I, which contains the UNCITRAL Model Law on International Credit Transfers, is reproduced in part three, II, of this Yearbook.]

### ANNEX II

[Annex II, which contains the list of documents before the Commission at its twenty-fifth session, is reproduced in part three, VI, of this Yearbook.]

### B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board on the first part of its thirty-ninth session (TD/B/39(1)/15)

*"B. Progressive development of the law of international trade; twenty-fifth annual report of the United Nations Commission on International Trade Law (agenda item 10(b))*

#### *"Action by the Board*

"449. At its 809th meeting, on 29 September 1992, the Board took note of the report of the United Nations Commission on International Trade Law on its twenty-fifth session (A/47/17), which had been circulated to the Board under cover of a note by the UNCTAD secretariat (TD/B/39(1)/6)."

## C. General Assembly: report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session: report of the Sixth Committee (A/47/586)

### I. INTRODUCTION

1. The item entitled "Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session" was included in the provisional agenda of the forty-seventh session of the General Assembly pursuant to Assembly resolutions 46/56 A and B of 9 December 1991.

2. At its 3rd plenary meeting, on 18 September 1992, the General Assembly, on the recommendation of the General Committee, decided to include the item in its agenda and to allocate it to the Sixth Committee.

3. In connection with the item, the Sixth Committee had before it the following documents:

(a) Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session;<sup>1</sup>

(b) Report of the Secretary-General on the granting of travel assistance to least developed and other developing countries that are members of the United Nations Commission on International Trade Law (A/47/454);

(c) Letter dated 6 October 1992 from the Chairman of the Sixth Committee to the Chairman of the Fifth Committee (A/C.6/47/4);

(d) Letter dated 12 October 1992 from the Chairman of the Fifth Committee to the Chairman of the Sixth Committee (A/C.6/47/7).

4. The Sixth Committee considered the item at its 3rd to 5th, 9th and 37th meetings, on 23 and 24 September, 6 October and 19 November 1992. The summary records of those meetings (A/C.6/47/SR.3-5, 9 and 37) contain the views of the representatives who spoke on the item.

<sup>1</sup>Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17).

5. At the 3rd meeting, on 23 September, Mr. José María Abascal Zamora (Mexico), Chairman of the United Nations Commission on International Trade Law at its twenty-fifth session, introduced the Commission's report on the work of that session. At the 5th meeting, on 24 September, the Chairman of the Commission made a closing statement.

### II. CONSIDERATION OF DRAFT RESOLUTION A/C.6/47/L.4/REV.1

6. At the 37th meeting, on 19 November, the representative of Austria introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session" (A/C.6/47/L.4/Rev.1), sponsored by Argentina, Austria, Brazil, Chile, Czechoslovakia, Denmark, Egypt, Finland, Greece, Guinea, Hungary, Kenya, Morocco, Myanmar, Nigeria, Norway, Poland, Spain, Sweden, Thailand, Turkey and Uruguay, later joined by Belarus, Cyprus, Colombia, France, Germany, India, Indonesia, Italy, Mexico and Russian Federation.

7. At the same meeting, the Committee adopted draft resolution A/C.6/47/L.4/Rev.1 without a vote (see paragraph 9).

8. The representative of Canada made a statement in explanation of position after the adoption of the draft resolution.

### III. RECOMMENDATION OF THE SIXTH COMMITTEE

9. The Sixth Committee recommends to the General Assembly the adoption of the following draft resolution:

[The text is not reproduced in this section. The draft resolution was adopted, with editorial changes, as General Assembly resolution A/47/34 (see Section D below)]

## D. General Assembly resolution 47/34 of 25 November 1992

47/34. *Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session*

*The General Assembly,*

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it created the United Nations Commission on International Trade Law with a mandate to further the progressive harmonization and unification of the law of international trade and in that respect bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Reaffirming its conviction that the progressive harmonization and unification of international trade law, in reducing or removing legal obstacles to the flow of international trade,

especially those affecting the developing countries, would significantly contribute to universal economic cooperation among all States on a basis of equality, equity and common interest and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples,

Stressing the value of participation by States at all levels of economic development and from different legal systems in the process of harmonizing and unifying international trade law,

Having considered the report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session,<sup>1</sup>

<sup>1</sup>Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17).

# I. INTERNATIONAL PAYMENTS

## A. Draft Model Law on International Credit Transfers: suggestions for the final review: note by the Secretariat (A/CN.9/367) [Original: English]

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### INTRODUCTION

1. At its twenty-fourth session the Commission considered 15 of the 18 articles of the draft Model Law on International Credit Transfers that had been prepared by the

Working Group on International Payments. In preparation for the completion of the consideration of the draft Model Law by the Commission, the Secretariat has reviewed the articles already adopted in the Model Law to identify potential problems of a technical variety. In many cases the

problems that have been identified are of a drafting nature. In other cases they are of a substantive nature, at times involving fundamental policy considerations.

2. The most important problems that the Secretariat has identified relate to the various time periods established by the Model Law. In order to make clear the issues involved, part one of this note sets out the scheme for the time periods in some detail and refers to problems with that scheme that the Commission may wish to consider; in some cases solutions for those problems are suggested. Other problems identified by the Secretariat are set forth in part two of this note.

## I. TIME PERIODS

3. The Model Law establishes time periods during which the receiving bank must perform a certain number of actions. Those time periods are interrelated, which in many cases makes them difficult to understand. The basic time period from which other time periods must be calculated is the "execution period".

### A. Definition and length of execution period

#### 1. Definition of "execution period", article 2(k)

4. As adopted by the Commission at its twenty-fourth session, article 2(k) provides:

"Execution period" means the period of one or two days beginning on the first day that a payment order may be executed under article 10(1) and ending on the last day on which it may be executed under that article, on the assumption that it is accepted on receipt."

5. The Commission may wish to attempt to find a clearer formulation. For example, the execution period might be said to end "at the end of" the last day on which it may be executed. Secondly, the meaning of the last phrase, "on the assumption that it is accepted on receipt", may not be clear (see below, paragraphs 11, and 24 to 28).

6. The definition, like the obligation on which it depends contained in article 10(1), encompasses three separate fact situations dealt with below: (i) the payment order contains no indication as to when it is to be executed and it is accepted in normal course, (ii) the payment order is deemed to be accepted under article 6(2)(e) or 8(1)(h), and (iii) the payment order contains an indication as to when it is to be executed.

#### 2. Execution period of payment order accepted in normal course

7. Article 10(1) provides that a payment order that contains no indication as to when it is to be executed must be executed not later than the banking day after the banking day it is received. Thus, the normal execution period is two banking days in length.

8. Although the current text was adopted by the Commission at its twenty-fourth session, the rule that the normal execution period would begin on receipt of the payment order by the receiving bank dates from the earliest drafts of the Model Law. The rule in article 10(1) does not specifically take account of the fact that under article 7 a receiving bank is obligated to execute the payment order only if it has accepted the order. The Working Group was of the view that it was understood that article 10(1) provided the period of time during which execution had to occur only if the payment order was accepted (A/CN.9/346, comment 6 to article 10), a view that was apparently shared by the Commission at the twenty-fourth session. The Commission may wish to make explicit that interpretation of the text (see suggested redraft, below, paragraph 36).

9. *Length of execution period after acceptance pursuant to article 6(2)(a) to (d).* Since the execution period under article 10(1) runs from the time of receipt and not the time of acceptance, the period of time for execution subsequent to acceptance varies depending on the way in which the payment order is accepted. There are three basic situations. First, since article 6(2)(c) provides that a receiving bank that is not the beneficiary's bank accepts a payment order by executing it, there would be no execution period after acceptance and none would be needed. Second, where the payment order is accepted upon receipt under article 6(2)(a), i.e., where there has been a prior agreement that the receiving bank would "execute payment orders from the sender upon receipt", the bank would have up to two banking days after acceptance to execute the payment order if the normal rule of article 10(1) is held to apply. For further discussion of this example and a suggestion that a different rule should be understood to apply, see below, paragraph 15. Third, if before the end of the banking day after receipt acceptance occurs by one of the voluntary acts set out in article 6(2)(b) or (d), the execution period expires at the end of the banking day after receipt. Therefore, the receiving bank will have an execution period after acceptance that will range between a maximum of two full banking days and a minimum of minutes.

#### 3. Execution period for payment order that is deemed accepted

10. The problems in determining when a payment order is deemed to be accepted under article 6(2)(e) (or article 8(1)(h) in the case of the beneficiary's bank) are discussed below, paragraphs 24 to 28. At this point it is sufficient to note that articles 6(3) and 8(2) provide that a receiving bank that has received payment for the payment order must either accept the order or give notice of rejection by the end of the second banking day after receipt. If it fails to do either one, articles 6(2)(e) and 8(1)(h) provide that the payment order is deemed to be accepted at that time.

11. Since article 10(1) provides that the payment order must be executed by the end of the first banking day after its receipt, at the moment of deemed acceptance the receiving bank is already one day late in fulfilment of its obligation to execute the order. That conclusion, which is the consequence of a literal application of article 10(1), seems to have been intended by the Commission. Any doubts are

eliminated by the last clause of the current definition of "execution period" in article 2(k), i.e., "on the assumption that it is accepted on receipt." That clause was added by the drafting group at the twenty-fourth session to overcome the problem that the deemed acceptance rule in articles 6(2)(e) and 8(1)(h) depends on the passage of the execution period but the application of the execution period in article 10(1) depends on the acceptance of the payment order by the receiving bank. The difficulties in regard to the length of the execution period in the case of deemed acceptance are compounded when the sender pays for the payment order after the end of the second banking day following the banking day the receiving bank receives the payment order (for a more complete discussion, see below, paragraphs 24 and 25).

#### 4. *Execution period for payment order that contains instructions as to time of execution*

12. Article 10(1)(a) provides that a payment order that contains an instruction that the order is to be executed on a date later than the banking day after the banking day of receipt is to be executed on the indicated date. From a literal application of the text, an instruction that the payment order is to be executed on the day of receipt would be of no effect; the execution period would end at the end of the banking day after receipt. That consequence is the unintended result of the change in the normal execution period from a same day rule, as it was in the draft prepared by the Working Group, to a next day rule, as in the current text adopted by the Commission at the twenty-fourth session. The change would appear to have been made without an appropriate adjustment in the text of article 10(1)(a). Such an adjustment is suggested in the redraft of article 10(1)(a) (see below, paragraph 36).

13. Article 10(1)(b) provides a somewhat similar rule to that provided in article 10(1)(a) but in respect of the situation where the order specifies a date when the funds are to be placed at the disposal of the beneficiary. However, application of the current text of article 10(1)(b) to a particular payment order could lead to a requirement of execution on the day of receipt and no change in the text seems necessary.

14. Even if article 10(1)(a) is modified as suggested in paragraph 36, or in the case of the current text of article 10(1)(b), the receiving bank's obligation would not appear to be clear when the application of the provision would lead to an execution period that terminated prior to the day of receipt of the payment order. Such a situation might easily arise. Of course, the receiving bank could and should reject the payment order or ask for further instructions. If it does nothing, the current text might be interpreted to say that the receiving bank has received "a payment order [that] cannot be executed because of insufficient data" and that the bank has a notification obligation under article 7(4) or 9(2), or the current text might be interpreted to say that failure to reject the payment order would lead to deemed acceptance of it. In the view of the Secretariat the former interpretation is preferable since the receiving bank does not know the reason for the execution date, and the originator may not wish the order to be accepted or executed at

all when it cannot be executed on the desired date. The Commission may wish to consider whether any amendment to the current text would be desirable in order to make clear what the appropriate interpretation should be.

15. *Sender and receiving bank have agreed that the bank will execute payment orders from the sender upon receipt.* Articles 6(2)(a) and 8(1)(a) provide that, if the sender and the receiving bank have agreed that the bank will execute payment orders from the sender upon receipt, the payment order is accepted upon receipt. Those provisions were drafted with the specific situation of the Clearing House Automated Payments Systems (CHAPS) in mind, though they are expected to be applicable to a large number of bilateral and multilateral agreements among banks and between banks and their customers. However, articles 6(2)(a) and 8(1)(a) govern only the acceptance of the payment order, not the requirement to execute it, and article 10(1) does not anticipate this situation. For a payment order to be subject to an execution period other than the normal two days ending on the banking day after receipt, the payment order itself would have to say so. While it is true that an agreement such as the one under discussion could be understood to be an agreement under article 3 that varied the rights and obligations of parties to a credit transfer, it would be preferable to anticipate this particular type of agreement in article 10(1) as well (see the proposed text in paragraph 36).

#### B. *Application of article 10 to the beneficiary's bank*

16. It would appear not to be clear whether article 10 is intended to apply in general to the beneficiary's bank. In favour of applying article 10 generally to the beneficiary's bank is the fact that the definition of "receiving bank" in article 2(g) includes a beneficiary's bank. Therefore, unless an individual paragraph in article 10 explicitly excluded its application to the beneficiary's bank, it would automatically apply.

17. It appears that two specific provisions of article 10 were expected to apply to the beneficiary's bank. First, article 8(2) requires a beneficiary's bank that has received payment for a payment order but that does not accept it "to give notice of rejection no later than on the banking day following the end of the execution period". Since the execution period is defined in article 2(k) in terms of the time-limits in article 10(1), article 8(2) could be applied only if article 10(1) was applicable to the beneficiary's bank. Second, article 10(2) contains time-limits for giving notices that are to be given only by the beneficiary's bank.

18. A textual argument against the general application of article 10 to the beneficiary's bank is that the term "execution" as defined in article 2(l) does not clearly include the actions to be taken by the beneficiary's bank, although, as pointed out in paragraph 43, the definition of "execution" is drafted in such a way as to indicate that the term also applies to the beneficiary's bank, without indicating in what way. More importantly, the general policy of the Model Law is that it does not affect the relationship between the beneficiary and the beneficiary's bank. That

policy would seem to indicate that, contrary to what was said in paragraph 17, the time-limit for execution of the payment order in article 10(1) should not apply to the beneficiary's bank. See in particular article 10(1 *ter*), discussed in paragraph 19, and article 9(1), which provides:

"The beneficiary's bank is, upon acceptance of a payment order, obligated to place the funds at the disposal of the beneficiary, or otherwise to apply the credit, in accordance with the payment order and the law governing the relationship between the bank and the beneficiary".

19. Paragraph (1 *ter*), relative to the date as of when the receiving bank must execute for value, specifically does not apply to the beneficiary's bank. It can be presumed that the drafting group at the twenty-fourth session of the Commission, where paragraph (1 *ter*) was drafted, was of the opinion that it was not necessary to set out a rule in respect of the beneficiary's bank. Since paragraph (1 *ter*) does not apply to the beneficiary's bank, it would appear that paragraph (1 *bis*) should also not apply to the beneficiary's bank.

20. Since the question of the application of article 10 to the beneficiary's bank appears not to have been resolved, the Secretariat's proposed redraft of article 10(1) in paragraph 36 makes no change to the existing text in that respect. The Commission, however, may wish to consider each of the paragraphs in article 10 to determine whether it should or should not apply to the beneficiary's bank.

### C. Interpretation of term "banking day"

21. The term "banking day" is used in articles 5(b)(i) and (ii), 6(3) and (4), 8(2) and (3) and 10(1), (1 *bis*) and (2) to indicate the day on which certain actions must be done. The term is not defined and there is no indication in the report of the twenty-fourth session, when it was decided to use the term, as to what days would be banking days (A/46/17, para. 203). It might be thought that a banking day would be a day on which the bank in question performed the type of action under consideration in the provision in question. Under such an interpretation, in a given State all banks might have the same banking days or banking days might differ from one bank to another or even in regard to different activities in the same bank. This interpretation would be in line with the terminology currently found in article 10(4) and (5), which refer to "the day the bank executes that type of payment order" or "performs that type of action" without using the term "banking day".

22. It is therefore suggested that the term "banking day" be defined as follows: "Banking day" means a day on which the bank performs the type of banking operation in question.

23. If the Commission adopts this definition of "banking day", the term might be used in article 10(4) and (5) as well. However, the suggested individualized definition of "banking day" might make the provision in paragraph (5) redundant.

### D. Time for giving notice of rejection and consequences of failing to do so

#### I. Receiving bank other than the beneficiary's bank

24. Where the receiving bank never receives payment for the payment order and the bank neither accepts nor rejects the order, article 6(4) provides that the order ceases to have effect at the close of business on the fifth banking day following the end of the execution period, i.e., at the close of business on the sixth banking day after the banking day of receipt.

25. Article 6(3) provides that a receiving bank that receives payment for a payment order (prior to the end of the sixth banking day after the banking day of receipt) but does not accept the order pursuant to article 6(2)(a) to (d) is required to give notice of rejection no later than on the banking day following the end of the execution period. The expected operation of the provision is easiest to understand if it is assumed that the receiving bank receives the payment order and payment for it at the same time. According to article 2(k) the execution period ends on the last day on which it may be executed under article 10(1), "on the assumption that it is accepted on receipt", i.e., the execution period ends at the end of the banking day after the banking day of receipt. Therefore, the receiving bank would be required to give notice of rejection no later than the second banking day after the banking day of receipt. Having failed to give the required notice of rejection, the receiving bank is deemed to have accepted the payment order pursuant to article 6(2)(e) at that time, i.e., the end of the second banking day after the banking day of receipt. As noted above in paragraph 11, under article 10(1) the bank would be required to execute the order by the end of the first banking day after the banking day of receipt, i.e., the day prior to its deemed acceptance.

26. The appropriateness of the execution period and the time-limits for giving notice of rejection would seem to be particularly questionable where the receiving bank receives payment for the payment order subsequent to its receipt of the order. For example, if the payment was received on the third banking day following the banking day of receipt of the payment order, the payment order would still be effective.

27. If the bank promptly accepted the order by sending its own payment order to an appropriate intermediary bank or to the beneficiary's bank (article 6(2)(c)), i.e., by executing the order (article 2(l)), it would have done so on the third banking day after receipt of the payment order, two days after it was required to execute the payment order under article 10(1). Similarly, the receiving bank would already be in breach of its obligations as to time of execution under article 10(1) if it immediately accepted the payment order under article 6(2)(b) or (d). The problem does not arise when acceptance takes place under article 6(2)(a); the situation under article 6(2)(e) is discussed immediately below.

28. If the bank did not accept the payment order, it would be required to give notice of rejection no later than on the banking day following the end of the execution period. As noted above in paragraph 25, the notice of rejection must

be given not later than the second banking day after receipt of the payment order, i.e., the day prior to the receipt of the payment in the example given. Article 6(2)(e) further provides that the payment order is accepted when the time for giving notice of rejection has elapsed without notice having been given, i.e., the day prior to the receipt of the payment in the example given. Therefore, in the example given, not only would the time for execution under article 10(1) have expired, but the literal application of the current text would make the deemed acceptance retroactive.

29. It should be noted, however, that a separate rule exists in article 10(1 *ter*) in regard to the day as of which the receiving bank must give value when it has accepted a payment order by virtue of article 6(2)(e). See paragraph 36 below.

30. The Commission may wish to consider whether it regards these results to be appropriate and, if it does not, the changes in the Model Law it might wish to make.

## 2. Beneficiary's bank

31. Although, as indicated above in paragraph 17, it is unclear whether article 10(1) is intended to apply to the beneficiary's bank, the time-limit for giving a notice of rejection is the same for the beneficiary's bank under article 8(2) as it is for other receiving banks under article 6(3). Therefore, the discussion in paragraphs 25 and 26 is fully applicable to the time-limit for giving the notice of rejection by the beneficiary's bank under article 8(2) and to the "deemed acceptance" of the payment order under article 8(1)(h). The questions raised about the time-limit for execution by the beneficiary's bank would also be applicable if the time-limits for execution in article 10(1) apply to the beneficiary's bank.

### E. Time as of when value must be given

32. As part of the decision to extend the normal execution period to the banking day following the day of receipt of the payment order, a new paragraph (1 *bis*) was added to article 10, which, subject to exceptions that will be considered below in paragraph 34, provides that:

"If the receiving bank executes the payment order on the banking day after it is received, ... the receiving bank must execute for value as of the day of receipt."

33. Although it is apparent that the Commission wished to adopt a general policy that, in the normal case where a receiving bank accepts a payment order by executing the order, value must be given as of the banking day of receipt, the provision does not say so. By its terms the provision applies neither to the case where the payment order is executed on the day of receipt, nor to the case where the payment order is executed on the second day after receipt (for a proposed redraft see below, paragraph 36).

34. Article 10(1 *bis*) provides that it does not apply if the payment order contains a specific date when the payment order is to be executed or a specific date when the funds are to be placed at the disposal of the beneficiary. Presumably the receiving bank must give value as of the day the

receiving bank is required to execute the payment order under article 10(1)(a) or (b), and the proposed redraft of article 10(1 *bis*) in paragraph 36 so provides.

35. Article 10(1 *ter*), rather than article 10(1 *bis*), applies to a receiving bank that is not the beneficiary's bank when that bank has accepted the payment order under article 6(2)(e) by failing to give a required notice of rejection. In such a case the receiving bank must execute for value as of the date when it received payment, i.e., the day when its obligation to accept or reject the payment order began (except in the rare case when payment was made prior to receipt of the payment order by the receiving bank; compare also the possible retroactive acceptance of the payment order as described in paragraph 26). The provision appears to work properly, except for the situation in which payment is made before the payment order is received, for which case a minor amendment is proposed in paragraph 36. As noted above in paragraph 19, article 10(1 *ter*) does not apply to the beneficiary's bank, presumably because it was thought that the question falls outside the scope of the Model Law.

### F. Proposed redrafted article 10(1), (1 *bis*) and (1 *ter*)

36. The following redraft of paragraphs (1), (1 *bis*) and (1 *ter*) of article 10 is suggested in accordance with the discussion above:

#### "Article 10

"(1) In principle, a receiving bank that is obligated to execute a payment order under article 7(2) [or article 9(1)] is obligated to do so on the banking day it is received. However, if it does not, it shall do so on the banking day after the payment order is received, unless

"(a) a different day is specified in the payment order or in a separate agreement between the sender and the receiving bank, in which case the payment order shall be executed on that date, or

"(b) the order specifies a date when the funds are to be placed at the disposal of the beneficiary and that date indicates that later execution is appropriate in order for the beneficiary's bank to accept a payment order and execute it on that date.

"(1 *bis*) A receiving bank that is obligated to execute a payment order must execute for value as of the day of receipt, except when complying with subparagraph (a) or (b) of paragraph (1), in which case it must execute for value as of the first day of the execution period as so indicated, or when paragraph (1 *ter*) is applicable.

"(1 *ter*) A receiving bank that becomes obligated to execute a payment order by virtue of accepting the payment order under article 6(2)(e) must execute for value as of the later of the day on which the payment order is received and the day on which

"(a) where payment is to be made by debiting an account of the sender with the receiving bank, there are sufficient funds available in the account to pay for the payment order, or

"(b) where payment is to be made by other means, payment has been made."

## II. OTHER MATTERS

### A. Branches and separate offices of a bank

37. The Working Group at its eighteenth session decided that the definition of "bank" should no longer contain the statement that branches of a bank were considered to be separate banks but that consideration should be given in each of the substantive provisions as to whether branches should be treated as banks. Consequently, provisions to that effect are found in articles 1(3), 7(6), 10(6), 11(9) and 18(3).

38. It is suggested in A/CN.9/346, comment 43 to article 2, that the issue might arise in other provisions, such as articles 12 to 14. There is no provision in the Model Law that appears to the Secretariat to raise special policy issues that would suggest that a branch or separate office of a bank should not be considered to be a separate bank. Therefore, the Commission may wish to consider whether it would wish to have a general rule to that effect and delete the five separate provisions.

### B. Definition of "credit transfer", article 2(a)

39. The first two sentences of the definition of "credit transfer" adopted by the Working Group and submitted to the Commission were:

"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."

40. At the twenty-fourth session of the Commission, the first part of the first sentence was changed to read:

"Credit transfer" means one or more payment orders, beginning with the originator's payment order, . . ."

41. The report of the twenty-fourth session indicates that the purpose of the change in the text was to contribute to a more precise definition and to meet the concern underlying a proposal to delete the second sentence of the definition (A/46/17, para. 28). It is submitted that the prior text was more accurate. A credit transfer consists of a number of operations, including the issue of payment orders and the payment for them. That sense is better reflected in the first sentence of the prior text than in the first sentence of the current text.

42. The Commission may also wish to consider whether the concerns expressed at the twenty-fourth session might not be better met by referring in the first sentence of the former definition as set forth in paragraph 39 to "the issue of the originator's payment order" and in the second sentence to "the issue of any payment order by the originator's bank or any intermediary bank intended to carry out the originator's payment order". Such a change might be considered to better reflect the words "series of operations" in the first sentence of the former definition.

### C. Definition of "execution", article 2(f)

43. The definition of "execution" in article 2(f), which is in square brackets, refers only to the actions to be taken by a receiving bank other than the beneficiary's bank. However, the definition indicates that the term may apply also to a beneficiary's bank, without indicating in what way (for the discussion of this question at the twenty-fourth session, see A/46/17, paras. 75-81).

44. As regards a receiving bank other than the beneficiary's bank, a payment order is executed when "a payment order intended to carry out the payment order received by the receiving bank" is issued. Therefore, the payment order received would be "executed" even though an improper payment order was issued or a payment order was issued to an improper bank. That definition seems to come from article 6(2)(c), where the issue is whether the receiving bank has accepted the payment order received. However, in most provisions of the Model Law where the word "execute" or "execution" is used it is used in relation to the receiving bank's obligation under article 7(2). In that provision the receiving bank must issue a payment order that is consistent with the payment order received. Only in articles 15 and 16(8) is it clear that the payment order may have been improperly executed, and those two provisions speak of the consequences of such improper execution. The Commission may wish to consider whether a payment order should be considered to be "executed" when it does not carry out the payment order received, even though it was intended to do so.

### D. Definition of "interest", article 2(n)

45. It has been suggested that the "banking community" to which reference is to be made to calculate the amount of interest owed may not be clear. That would not matter if interest rates for a given currency were the same in all markets. It may be doubted whether interest rates are the same in all markets for currencies that are not widely used in international trade and finance. It may also be questioned of currencies that are widely used in international trade and finance. If the Commission were to decide that the relevant banking community should be more specifically designated, it might choose between the banking community of the currency, the banking community of the defaulting bank and the banking community of the bank to which the interest will be paid.

### E. Obligations of sender, article 4

#### 1. Article 4(2)

46. Literally, "a mere comparison of signature" pursuant to article 4(2) would consist of nothing more than the comparison of the signature on the payment order with a sample in the possession of the receiving bank. Where the authentication procedure consisted of "a mere comparison of signature", the traditional rule would apply that the bank would be responsible for a false or fraudulent transfer. If the authentication required any other procedure, such as the showing of an identity or guarantee card to the bank

employee, it would not be a mere comparison of signature. The Commission may wish to consider whether this interpretation of what is meant by a mere comparison of signature is correct and to adjust the text if that seems called for.

## 2. Article 4(3)

47. Article 4(3) does not appear to be drafted sufficiently clearly. It is suggested that it would more clearly state its purpose if formulated as follows:

"The parties are not permitted to agree that a purported sender is bound under paragraph (2) if the authentication is not commercially reasonable in the circumstances."

## 3. Article 4(5)

48. In the report of the Secretariat to the twenty-fourth session of the Commission it was suggested that the word "error" should be understood to include all discrepancies between the payment order as it was intended and the payment order as it was received, whatever the source of the discrepancy (A/CN.9/346, comment 24 to article 4). The Commission took the view that "paragraph (5) covered errors in transmission of a payment order, and did not cover ... fraudulent alterations of a payment order by a third person" (A/46/17, para. 118).

49. The Commission may wish to further consider the Secretariat's suggestion. It would appear to the Secretariat that the issue in paragraph (5) is whether the sender and the receiving bank have agreed upon a procedure for detecting erroneous duplicates or errors in a payment order and whether use of that procedure by the receiving bank would have revealed the erroneous duplicate or the error. It is understood that paragraph (5) will come into play only if the authentication procedure referred to in article 4(2) verifies only the source of a payment order but not its content. There is nothing in the procedure envisioned in paragraph (5) that depends upon the reason for the error or duplicate. It may have been a mistake on the part of the sender, a transmission error, or fraud by a third person. It is submitted that the criterion for application of paragraph (5) is the same in all cases, i.e., "use of the procedure by the receiving bank revealed or would have revealed the erroneous duplicate or the error".

50. Especially in the light of the interpretation given to paragraph (5) at the twenty-fourth session, it is suggested that the word "discrepancy" should be substituted for the word "error".

## F. Payment to receiving bank, article 5

### 1. "For the purposes of this law"

51. While the opening words of article 5 were adopted by the Commission at the twenty-fourth session with a view to excluding application of article 5 to issues outside the Model Law itself, such as the insolvency of either the

sender or the receiving bank (A/46/17, para. 124), it is difficult to see that they will have the desired result (see comments of Finland to the twenty-fourth session, A/CN.9/347, pp. 18-19). It might well be seen to be incongruous to apply article 5 to determine whether the sender had fulfilled its obligations to the receiving bank under the Model Law but not to apply article 5 to determine whether the receiving bank had a claim against the sender in insolvency proceedings of the receiving bank.

### 2. Time when availability of credit leads to payment, article 5(b)(i) and (ii)

52. The concerns raised by Finland in its comments to the twenty-fourth session referred to in paragraph 49 related primarily to payment pursuant to article 5(b)(i) and (ii). The Commission may wish to consider a different approach to those problems. The reason why payment is not considered to be made to the receiving bank under article 5(b)(i) and (ii) until the receiving bank uses the credit or a period of time has passed after the receiving bank has learned of the credit is that the receiving bank should not be forced to accept credit at the sending bank or at the third bank, as the case may be, even if it has an account at that bank. If payment is final at the time the credit is entered to the account, the receiving bank would have no means to control its credit exposure to that bank. An alternative approach would be to consider the payment as having been made at the time the receiving bank's account was credited but to give the bank a period of time to reject the credit. It may be noted that the credit would, in any case, be rejected automatically if the receiving bank rejected the payment order under article 6(3) or 8(2) within the requisite period of time. If this approach were to be taken, it would have consequences for the various time-limits that arise out of the deemed acceptance rule.

53. If the Commission does not wish to follow the approach suggested above, it would appear to be necessary to re-examine the drafting of the current text. The two subparagraphs, which are identical in all pertinent respects, provide that payment is considered as having been made to a receiving bank "on the banking day following the day on which the credit is available for use and the receiving bank learns of that fact". In practical terms, that means that the relevant event is that the receiving bank has learned that the credit is available for use. Therefore, it must be assumed that the banking day in question is the banking day of the receiving bank. It must also be assumed that the payment is made to the receiving bank at the end of that banking day rather than at some time during the day. Otherwise there would be no fixed time when payment was made.

54. These questions were discussed by the Working Group at its twenty-second session without any firm conclusions having been reached (A/CN.9/344, paras. 72-80). If the Commission is in agreement with the conclusions of the Secretariat, the last clause of the two subparagraphs might be redrafted to read:

"at the end of the banking day following the banking day on which the receiving bank learns that the credit is available for use."

3. *Time when credit to an account is used, article 5(b)(i) and (ii)*

55. In the same discussion the Working Group noted that in most cases the credit would not be withdrawn, i.e., "used", 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 (A/CN.9/344, para. 71). That leaves a question as to how to determine whether the receiving bank has used a specific credit. As article 5 is currently drafted, that determination would have to be made according to otherwise applicable law. The Commission may wish to consider adding a provision to state that credits to an account are considered to have been withdrawn in the order in which they were made to the account.

G. *Revocation, article 11*

1. *Paragraphs (1) and (2)*

56. It is suggested that the two paragraphs would read more easily if the last two words "if later" were deleted

and the pertinent parts of the provisions were drafted as follows:

"... before the later of the actual time of execution and the beginning of the day on which ..."

and

"... before the later of the time the credit transfer is completed and the beginning of the day when ..."

2. *Paragraph (6)*

57. It is suggested that, for the sake of clarity, the words "to the previous sender" should be replaced by the words "to its sender".

H. *Duty to assist, article 14*

58. It should be recalled that the Commission at its twenty-fourth session "decided to postpone its final decision regarding the article until it had discussed the issues arising under articles 16(5) and 17" (A/46/17, para. 272).

## II. INTERNATIONAL COUNTERTRADE

### A. Report of the Working Group on International Payments on the work of its twenty-third session

(New York, 3-10 September 1991) (A/CN.9/357) [Original: English]

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#### INTRODUCTION

1. The Commission, at its nineteenth session (1986), in the context of its discussion of a note by the Secretariat entitled "Future work in the area of the new international economic order" (A/CN.9/277), considered the topic of countertrade. There was considerable support in the Commission for undertaking work on the topic, and the Secretariat was requested to prepare a preliminary study on the subject.<sup>1</sup>

2. At its twenty-first session (1988), the Commission had before it a report entitled "Preliminary study of legal issues in international countertrade" (A/CN.9/302). The Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up countertrade contracts. In order for the Commission to decide what further action might be taken, the Commission requested the Secretariat to prepare for the twenty-second session of the Commission a draft outline of such a legal guide (see A/43/17, paras. 32-35).

3. At its twenty-second session (1989), the Commission considered the report entitled "Draft outline of the possible

content and structure of a legal guide on drawing up international countertrade contracts" (A/CN.9/322). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare for the next session of the Commission draft chapters of the legal guide (see A/44/17, paras. 245-249).

4. At its twenty-third session (1990), the Commission considered the following materials prepared by the Secretariat: a proposed structure of the legal guide (A/CN.9/332, para. 6); an outline of the introductory chapter to the legal guide (A/CN.9/332/Add.1); draft chapter II, "Scope and terminology of legal guide" (A/CN.9/332/Add.1); draft chapter III, "Contracting approach" (A/CN.9/332/Add.2); draft chapter IV, "General remarks on drafting" (A/CN.9/332/Add.3); draft chapter V, "Type, quality and quantity of goods" (A/CN.9/332/Add.4); draft chapter VI, "Pricing of goods" (A/CN.9/332/Add.5); draft chapter IX, "Payment" (A/CN.9/332/Add.6); and draft chapter XII, "Security for performance" (A/CN.9/332/Add.7). Draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), was submitted to but not considered by the Commission. A summary of the discussion in the Commission on the draft chapters (A/CN.9/332/Add.1-7) is contained in annex I to the report of the Commission on the work of its twenty-third session (A/45/17).

<sup>1</sup>Report 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.

5. There was general agreement in the Commission with the overall approach taken in preparing the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein (A/45/17, para. 16). The Commission decided that the remaining draft chapters, which it requested the Secretariat to prepare, should be submitted, together with draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), to the Working Group on International Payments. The Commission also requested the Secretariat to redraft the chapters considered by it at its twenty-third session and the chapters to be submitted to the Working Group on International Payments in the light of the discussion at those sessions. The Commission decided that the final text of the legal guide should be submitted to its twenty-fifth session, to be held in 1992 (see A/45/17, paras. 17 and 18).

6. The Working Group on International Payments commenced its work on the draft legal guide at its twenty-third session held at United Nations Headquarters in New York from 3 to 10 September 1991. The Group was composed of all States members of the Commission. The session was attended by representatives of the following States members: Bulgaria, Canada, Chile, China, Cuba, Cyprus, Czechoslovakia, Egypt, France, Germany, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Pakistan, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America and Yugoslavia.

7. The session was attended by observers of the following States: Austria, Bahamas, Brazil, Burkina Faso, Indonesia, Lebanon, Malaysia, Oman, Poland, Sweden, Switzerland, Syrian Arab Republic, Uganda, United Republic of Tanzania and Venezuela.

8. The session was attended by observers from the following international organizations:

(a) *United Nations organization*: Centre on Transnational Corporations;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Committee, Inter-American Development Bank, Preferential Trade Area for Eastern and Southern African States;

(c) *International non-governmental organizations*: Argentine-Uruguayan Institute of Commercial Law, International Bar Association, International Chamber of Commerce.

9. The Working Group elected the following officers:

*Chairman*: Mr. Joachim Bonell (Italy)

*Rapporteur*: Mr. Abbas Safarian (Islamic Republic of Iran)

10. The following documents were submitted to the session:

(a) Provisional agenda (A/CN.9/WG.IV/WP.50);

(b) Draft legal guide on drawing up contracts in international countertrade transactions (A/CN.9/WG.IV/WP.51), report of the Secretary-General;

(c) Draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), which was originally submitted to the Commission and which the Commission referred to the Working Group;

(d) Draft chapter VIII, "Participation of third parties" (A/CN.9/WG.IV/WP.51/Add.1);

(e) Draft chapter X, "Restrictions on resale of goods" (A/CN.9/WG.IV/WP.51/Add.2);

(f) Draft chapter XI, "Liquidated damages and penalty clauses" (A/CN.9/WG.IV/WP.51/Add.3);

(g) Draft chapter XIII, "Failure to complete countertrade transaction" (A/CN.9/WG.IV/WP.51/Add.4);

(h) Draft chapter XIV, "Choice of law" (A/CN.9/WG.IV/WP.51/Add.5);

(i) Draft chapter XV, "Settlement of disputes" (A/CN.9/WG.IV/WP.51/Add.6);

(j) Draft illustrative provisions (A/CN.9/WG.IV/WP.51/Add.7).

11. The following documents considered by the Commission at its twenty-third session in 1990 were made available at the session:

(a) Draft legal guide on drawing up contracts in international countertrade transactions (A/CN.9/332), report of the Secretary-General;

(b) Outline of chapter I, "Introduction to legal guide", and draft chapter II, "Scope and terminology of legal guide" (A/CN.9/332/Add.1);

(c) Draft chapter III, "Contracting approach" (A/CN.9/332/Add.2);

(d) Draft chapter IV, "General remarks on drafting" (A/CN.9/332/Add.3);

(e) Draft chapter V, "Type, quality and quantity of goods" (A/CN.9/332/Add.4);

(f) Draft chapter VI, "Pricing of goods" (A/CN.9/332/Add.5);

(g) Draft chapter IX, "Payment" (A/CN.9/332/Add.6);

(h) Draft chapter XII, "Security for performance" (A/CN.9/332/Add.7);

(i) Report of the United Nations Commission on International Trade Law on the work of its twenty-third session, New York, 25 June-6 July 1990 (A/45/17).

## I. DELIBERATIONS AND DECISIONS

12. The Working Group considered draft chapters VII, "Fulfilment of countertrade commitment"; VIII, "Participation of third parties"; X, "Restrictions on resale of goods"; XI, "Liquidated damages and penalty clauses"; XIII, "Failure to complete countertrade transaction"; XIV, "Choice of law"; and XV, "Settlement of disputes", as well as draft illustrative provisions. The report of the deliberations and decisions of the Working Group is set forth below.

13. The Working Group requested the Secretariat to revise the draft chapters and illustrative provisions in the light of its deliberations and decisions and to present them to the Commission at its twenty-fifth session.

## II. CONSIDERATION OF DRAFT CHAPTERS OF LEGAL GUIDE ON INTERNATIONAL COUNTERTRADE

### *General discussion*

14. The Working Group considered whether it would be desirable to shorten the present title of the draft legal guide. In favour of retaining the present title it was stated that the title accurately reflected the contents of the legal guide and that it would be in line with the type of title used for the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works. Difficulties cited with the present title, aside from the impracticality of its length, included that the reference to "drawing up contracts" might not be a precise enough formulation in view of the fact that the legal guide did not focus on contracts that were involved in a countertrade transaction but on the countertrade agreement, which raised issues specific to countertrade. The prevailing view was that a shorter title, along the lines of "Legal Guide on International Countertrade Transactions", was preferable because it was more practical and adequately conveyed the subject-matter of the legal guide.

15. It was agreed that, in order to facilitate use of the legal guide, chapter summaries should be included at the beginning of each chapter and that a subject-matter index should be drawn up.

16. The observation was made that the use of the term "supplier" to refer to a party supplying goods on either side of a countertrade transaction might not be precise enough in all cases. The Secretariat was requested to review the use of that term in view of that observation.

17. The view was expressed that the legal guide should contain some reference to insurance aspects of countertrade transactions and should devote more attention to financing issues. It was agreed that references to insurance and financing aspects should be incorporated in the existing chapters of the legal guide.

## VII. Fulfilment of countertrade commitment (A/CN.9/332/Add.8)

### *A. General remarks*

18. No changes were suggested to section A of draft chapter VII.

### *B. Defining eligible supply contracts*

19. The view was expressed that the techniques of identifying eligible supply contracts by geographical origin (paragraph 6) and by identity of the supplier (paragraph 7) might conflict with rules adopted pursuant to the General Agreement on Tariffs and Trade and with mandatory rules of competition law. It was agreed that the paragraphs in question should refer to the need for provisions dealing with eligibility to be consistent with such rules of law.

### *C. Stage when commitment fulfilled*

20. The Working Group noted that two approaches were presented with respect to the point of time at which fulfilment of the countertrade commitment might be deemed fulfilled. It was generally felt that the second approach, under which fulfilment would be deemed to be achieved upon the occurrence of some event after the conclusion of a supply contract, was more complicated and fraught with risk for the parties than the first approach, under which fulfilment would be deemed to be achieved simply upon the conclusion of a supply contract. It was pointed out, as an example of this greater complexity, that the second approach might result in uncertainty when exempting impediments affected the ability of a party to take the steps necessary in the performance of a supply contract to achieve fulfilment of the countertrade agreement. It was further suggested that the use of the second approach would necessitate additional provisions specifically dealing with such possible implications. The Working Group agreed that the legal guide should warn parties about the greater complexity of the second approach and, because of that complexity, advise parties to opt for the first approach.

### *D. Amount of fulfilment credit*

21. A question was raised as to whether the intended import of paragraph 14 was that the technique of variable rates of fulfilment credit was used predominantly in indirect offset transactions. In that connection, the view was expressed that the inclusion of such a provision in the countertrade agreement would be of limited relevance in a bilateral countertrade transaction since, in such a transaction, the parties to a supply contract, being the same parties as the parties to the countertrade agreement, could alter in a supply contract any provisions on fulfilment credit set forth in the countertrade agreement. It was stated in response that, while such a variable rate technique was more likely to be used in a multi-party, offset transaction in which there were a number of potential suppliers and types of goods, such a technique might also be used in a two-party transaction. It was agreed that this should be made clear in paragraph 14.

### *E. Time period for fulfilment of countertrade commitment*

22. The Working Group recognized the need for the legal guide to refer to situations in which, due to a variety of circumstances, it may be necessary to agree to extend the fulfilment period stipulated in the countertrade agreement. However, a number of concerns were expressed as to the precise formulation used in draft chapter VII, in particular with regard to the reference in paragraph 25 to demonstration of "good faith efforts" as a prerequisite to obtaining an extension.

23. One concern was that the inclusion of the reference to "good faith efforts" raised questions as to the nature of the countertrade commitment envisaged in the legal guide. It was suggested that the use of such an expression might suggest that the legal guide was addressing countertrade

commitments involving only a commitment to expend "best efforts" to conclude a supply contract, rather than a commitment to actually conclude a supply contract. In response to that concern, it was pointed out that at issue in paragraph 25 was an extension of the fulfilment period and not a release from the countertrade commitment on the ground that "best efforts" expended to fulfil the commitment had been unavailing.

24. Another concern was that the term "best efforts" was ambiguous and likely to lead to disputes. A suggestion for dealing with that concern was that the reference to a requirement of demonstrating good faith efforts should be deleted in its entirety since the extension of the fulfilment period could be regarded as essentially a matter to be left to be negotiated by the parties. In response to that view, it was stated that a certain degree of ambiguity was inherent in transactions of the type in question and that therefore the term did not have to be modified. It was also pointed out that removal of the mention of good faith efforts might suggest that a party that had not made any effort to fulfil the countertrade commitment should nevertheless be entitled to claim an extension. Another suggestion for dealing with the ambiguity involved in the current formulation was to replace the term "good faith efforts" by the term "reasonable efforts". However, it was not generally felt that the use of that term would substantially diminish the problem of ambiguity.

25. Misgivings were also expressed as to the example of demonstrating good faith efforts contained in the third sentence of paragraph 25, namely, the showing of a "certain number of contacts" with potential suppliers in search of suitable countertrade goods. It was suggested that the term "contacts" was not sufficiently precise, particularly since the example was intended to refer to situations in which suppliers rejected or were unable to satisfy offers to purchase countertrade goods. It was further stated that under the general contract law of a number of legal systems, the mere showing of "contacts" would not be sufficient to excuse delay in fulfilment of a contractual obligation.

26. Another difficulty cited with respect to the example was that the expression "a certain number of contacts" might be read as suggesting that the countertrade agreement should specify a number of unsuccessful contacts that would have to be shown in order to obtain an extension. It was suggested that such advice would be unduly rigid and might not take account of differing circumstances encountered in different transactions. Parties following it might encounter difficulties when, for example, the number of potential suppliers was fewer than the number of unsuccessful contacts required for an extension.

27. After deliberation, the Working Group agreed to retain the basic approach taken with regard to extension of the fulfilment period. However, it was also agreed that the chapter should make it clear that demonstration of efforts to fulfil the countertrade commitment, be those efforts called "good faith" or "reasonable", raised practical difficulties of proof and that clearer reference should be made to the role of negotiation in such extensions. It was further agreed that the example in the third sentence should be modified to address the concerns that had been raised by

the Working Group and to make clear that parties contemplating inclusion of a provision on extension would have to find appropriate language to fit the particular circumstances of each transaction.

#### *F. Monitoring and recording fulfilment of countertrade commitment*

28. A question was raised as to the import of the use of the term "shipments of goods" in paragraph 38 to describe the type of information to be recorded in an evidence account. It was pointed out that the use of that term might create uncertainty in view of the earlier discussion of the different possible points of time, such as the conclusion of a supply contract or some event in the performance of the supply contract, at which the countertrade commitment might be deemed to be fulfilled (see paragraph 20 above). In that light, the use of the term "shipment of goods" might be read as excluding the recording of the conclusion of supply contracts in an evidence account. The Working Group noted that the term had been intended to be read in a general sense, and not in relation to the point of time at which fulfilment was to be deemed achieved. The Secretariat was requested to select a more precise formulation.

29. It was proposed that the mention in paragraph 43 of the possibility that the parties might agree to the periodic verification of information entered into evidence accounts should be transformed into a recommendation to that effect. In support of that proposal it was stated that the earliest possible verification of information was a crucial element in the successful operation of an evidence account. The Working Group agreed that verification of information was useful, irrespective of the particular structure or administration of the account.

### **VIII. Participation of third parties** (A/CN.9/WG.IV/WP.51/Add.1)

#### *A. General remarks;*

#### *B. Purchase of countertrade goods*

30. The Working Group was agreed that in sections A and B a clearer distinction should be made between the cases in which the involvement of a third party required consent by the supplier and cases in which the involvement of a third party did not require such consent. It was pointed out that, according to general principles of contract law, a contract party was entitled to involve a third party in the performance of a contractual obligation without having to obtain the consent of the party entitled to the performance. Consent, however, was required under those general principles if, in the circumstances of the case, the party entitled to the performance had a legitimate reason to insist that the obligation should be performed by the party originally committed. Such a legitimate reason might exist in particular when, because of special properties or capabilities of the obligated party, the performance of the obligation by a third party would in some way diminish the value of the performance. It was also pointed out that according to the principles of contract law consent by the party entitled to the performance was required when the party originally

committed ceased to be responsible for the fulfilment of the contractual obligation as a result of a transfer or assignment of the contractual obligation to a third party.

31. The Working Group noted that the involvement of third parties in the fulfilment of a countertrade commitment was in some legal systems governed by mandatory rules. Such rules might make the participation of third parties subject to consent by the supplier of the goods, or subject to approval by an authority, even if according to the general principles of contract law consent by the supplier would not have been necessary.

32. It was agreed that the legal guide should discuss the position of the parties to the countertrade agreement in the situation in which the countertrade agreement did not address the possible participation of a third party in the fulfilment of the countertrade commitment. It was also agreed that the legal guide should advise the parties to address the possible participation of a third party, in particular when the parties might have differing expectations as to whether the party originally committed was free to involve a third party of its choice in the fulfilment of the countertrade commitment.

33. It was suggested that paragraph 5 should make it clear that, while the third party's agreement with the supplier to enter into a future contract might address the same types of issues as were addressed in the countertrade agreement between the supplier and the party originally committed, the content of the contractual solutions in the two agreements would not necessarily be the same. Different solutions might be adopted, for example, as to security for performance, liquidated damages or a penalty, the applicable law or the settlement of disputes.

34. As to paragraph 9, it was suggested that mention should be made of the desire to ensure proper implementation of the countertrade transaction as a frequent reason for mandatory rules referred to in that paragraph.

35. It was suggested to replace, in the third sentence of paragraph 12, the expression "It is advisable to indicate" by another expression such as "The parties may indicate".

36. As to the advice given in paragraph 17, it was noted that when the party originally committed assigned the countertrade commitment to the third party, the third party would be responsible to the supplier under the same terms as the party originally committed.

37. With respect to the discussion of the third party's fee (paragraphs 28 to 32), it was noted that when a governmental agency was engaging a third party to purchase goods or when a governmental agency was being engaged to purchase goods, in some legal systems such a governmental agency might not be free to pay a fee to the third party or to receive a fee. Payment of fees by or to governmental agencies for such a purpose might be subject to mandatory restrictions and it was considered appropriate to draw the attention of the parties to the existence of such restrictions.

### *C. Supply of countertrade goods*

38. No changes were suggested to section C.

### *D. Multi-party countertrade*

39. It was observed that, in the event of a failure to conclude or to perform one of the supply contracts in a multi-party countertrade transaction, the whole countertrade transaction might be affected. The Working Group was agreed that section D should discuss briefly the question of interdependence between contracts forming part of the transaction.

## *X. Restrictions on resale of countertrade goods* (A/CN.9/WG.IV/WP.51/Add.2)

### *A. General remarks*

40. It was agreed that mention should be made in the general remarks of the possibility of including in the countertrade agreement restrictions on the supplier of goods that would protect the purchaser's ability to resell the countertrade goods or would otherwise make the countertrade transaction more profitable for the purchaser. For example, a purchaser of goods in a countertrade transaction might be given exclusive distributorship rights with respect to those goods, and the countertrade agreement in such a case would include clauses restricting sales by the supplier that might infringe on the purchaser's exclusive rights. While it was recognized that such restrictions on the supplier would be less relevant to the many countertrade transactions that were of a one-off nature, it was also recognized that there might be transactions involving trademark goods in which restrictions on the supplier would be relevant.

41. A view was expressed that paragraph 3 should be broadened to refer to judicial decisions as a source of interpretation of rules governing restrictive business practices.

42. A proposal was made to delete paragraph 4 on the ground that the economic effect of imposing resale restrictions was a purely economic matter beyond the scope of the legal guide. In favour of retaining paragraph 4, it was stated that its retention would cause no harm and would provide a useful glimpse at the economic context of countertrade. It was suggested that, for readers without extensive experience in countertrade, guidance of the type provided in paragraph 4 and other portions of the legal guide referring to economic considerations and consequences would be particularly useful and would help to make the legal guide less abstract. It was further suggested that there was no apparent reason for deleting paragraph 4 while retaining other portions of the guide that touched on economic considerations. However, it was suggested that a basis might be found for distinguishing paragraph 4 from such other references in the legal guide on the ground that, unlike those other portions of the legal guide, which referred to economic reasons for a particular contractual provision, paragraph 4 dealt with the economic effects of a contractual provision. After deliberation, the Working Group decided to retain paragraph 4, but at the same time to include a somewhat less categorical warning as to the possible economic implications of resale restrictions.

43. It was agreed that paragraph 5 should be modified to state that, where third-party purchases were subject to a

resale restriction, it was advisable for the supplier to ensure that a third-party purchaser was aware that its purchases would be subject to the restriction.

#### *B. Duty to inform or consult*

44. No changes were suggested to section B.

#### *C. Territorial and related restrictions*

45. No changes were suggested to section C.

#### *D. Resale price*

46. No changes were suggested to section D.

#### *E. Packaging and marking*

47. It was generally felt that additional information should be provided concerning the statement in the first sentence of paragraph 21 concerning compliance with the law applicable in the place of resale. In particular, it was suggested that mention should be made of mandatory rules requiring origin marking, prohibitions against clandestine modification of marking and packaging, and requirements derived from consumer protection and environmental law.

#### *F. Application to third-party purchasers*

48. No changes were suggested to section F.

#### *G. Review of restrictions*

49. It was agreed that paragraph 24 should be modified so as to make it clear that, even in the absence of a contractual provision concerning review of resale restrictions in the event of major changes in the underlying circumstances, under some legal systems a review would be available in such circumstances. It was stated that such a change would be in line with other references in the legal guide to applicable law and would remove the unintended implication that, without a contractual provision on review, no review would be available.

### **XI. Liquidated damages and penalty clauses (A/CN.9/WG.IV/WP.51/Add.3)**

#### *A. General remarks*

50. It was suggested that the general remarks should allude to the fact that the discussion in chapter XI was not directly relevant to countertrade transactions such as barter in which goods were exchanged without the transfer of currency. Such an approach was said to have the advantage of recognizing that in countertrade transactions carried out in the context of cash shortages the parties would be more likely to agree on non-monetary means for dealing with the risk and effects of non-performance.

51. It was observed that there might be an apparent inconsistency between paragraph 2, which limited the scope of the chapter to clauses supporting fulfilment of countertrade commitment and excluded clauses supporting performance of supply contracts, and paragraph 3, which indicated that, in cases in which the countertrade commitment was deemed fulfilled only upon the performance of the supply contract, the obligation to pay an agreed sum for non-fulfilment of the countertrade commitment would be triggered by a failure to perform the supply contract. One suggestion for alleviating the inconsistency was the deletion of the second sentence of paragraph 2. The Secretariat was requested to review paragraphs 2 and 3 in light of the observations that had been made.

52. A view was expressed that there was duplication between chapter XI and paragraphs 10 to 13 of chapter XIII, which addressed monetary compensation in the case of breaches of contractual obligations and also mentioned liquidated damages and clauses. It was suggested that such duplication might cause confusion, and all discussion of liquidated damages and penalties should therefore be centred in chapter XI, with only a cross reference to chapter XI remaining in chapter XIII.

53. It was noted that payment under liquidated damages or penalty clauses was often through guarantees required to be posted to support the payment obligation. In that regard, it was pointed out that, when liquidated damages or penalty clauses were supported by first-demand independent guarantees, there was a risk of unjustified drawing under the guarantee. One method for dealing with that risk that was suggested was to link liability under the liquidated damages or penalty clause to the dispute-settlement provisions in the countertrade agreement. For example, it might be agreed that payment of the agreed sum would be due only upon an arbitral decision, which would be supported by an accessory rather than an independent guarantee. The utility of discussing arrangements involving accessory guarantees was considered in the light of their limited use in countertrade and in the light of the focus of chapter XII on independent guarantees. The Working Group decided that the general remarks should allude to the use of guarantees to support liquidated damages and penalty clauses and that mention should be made in the chapter of the fact that there were alternatives to independent guarantees, without advocating the use of accessory guarantees. It was felt that the addition of language to that effect, with a cross-reference to chapter XII, would be in line with the general agreement in the Working Group that the legal guide should focus on independent guarantees.

54. It was suggested that the third sentence of paragraph 7 needed to be reformulated since in its current form it might suggest that there was a positive rule in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) on release from the obligation to pay the agreed sum in the event of an exempting impediment. (Hereafter, this Convention will be referred to as the United Nations Sales Convention.)

55. Reference was made to the need to draw a clearer distinction between the discussion in paragraph 8 of clauses providing alternative obligations, which could

result in release from the countertrade commitment, and the discussion in paragraph 12 of the effect of payment under liquidated damages or penalty clauses, which also could result in release from the countertrade commitment. The distinction that drew particular attention was that under clauses providing for alternative obligations it was the obligated party who had the option of either performing or paying the agreed sum, while under liquidated damages or penalty clauses it was the party to whom the performance was owed that had the option.

56. It was suggested that the general remarks should draw the attention of the reader to the distinction between liquidated damages or penalty clauses covering non-fulfilment of the countertrade commitment and clauses covering delay in fulfilment.

57. A view was expressed that liquidated damages or penalties were only one method among a variety of methods in dealing with non-fulfilment of countertrade agreements and that the legal guide should not recommend the use of liquidated damages and penalty clauses.

#### *B. Relationship of recovery of agreed sum to recovery of damages*

58. No changes were suggested to section B.

#### *C. Effect of payment*

59. A concern was expressed that paragraph 12 appeared not to take adequate account of the fact that under the applicable law the effect of payment of the agreed sum might vary, depending in particular on whether the transaction involved only goods, or services or technology, or some combination, and whether any services could only be provided by the obligated party. It was also pointed out that there might be cases in which the liquidated damages or penalty clause did not cover the entire countertrade commitment. To address the concern as to services, it was agreed to add language to the effect that performance of an obligation to provide services might be unenforceable in some jurisdictions and might therefore have to be covered by damages.

#### *D. Amount of agreed sum*

60. The Working Group noted that the main focus of chapter XI was on liquidated damages and penalty clauses for non-fulfilment of the countertrade commitment, rather than for delay and that that focus reflected the predominance in countertrade of liquidated damages and penalty clauses for non-fulfilment. At the same time, the view was expressed that it was not clear which type of clause paragraphs 15 to 18 concerned. In that regard, the reference in paragraph 18 to the extent of the risk that the countertrade commitment would remain unfulfilled as a factor in determining the sum was said to be unclear.

61. A question was raised as to the need to retain the last sentence of paragraph 15, concerning the reduction of the

guarantee amount to track reductions in the liquidated damages or penalty amount. In support of deletion of the sentence, it was stated that in some legal systems such a reduction in the guarantee amount would be automatic. It was pointed out, however, that, while such reductions might be taken for granted in the case of accessory guarantees, independent guarantees of the type that were the focus of the legal guide could not be considered to reduce automatically. The Working Group agreed that it would be useful to recall to the reader that the last sentence assumed the use of an independent guarantee and that a reference to accessory guarantees for the purpose of clarity would not run counter to the approach taken in paragraph 5 of chapter XII (see also paragraph 53 above).

62. It was agreed that paragraph 17 should be aligned with paragraph 6 by replacing the words "is likely to be viewed" by the words "might be viewed", and by inserting, after the words "the parties should bear in mind that", the words "in some legal systems".

#### *E. Obtaining agreed sum*

63. It was observed that the use of the term "deduction" in paragraph 22 appeared to be intended to cover both deduction from available funds and setoff. It was generally felt that a distinction had to be drawn between those two techniques. It was suggested that attention should be drawn to the existence of legal rules covering their use. One such rule found in a number of legal systems was that a setoff was possible only if the claims to be set off arose from the commercial relationship between the parties.

### **XIII. Failure to complete countertrade transaction (A/CN.9/WG.IV/WP.51/Add.4)**

#### *A. General remarks*

64. The Working Group considered that chapter XIII should, in order to clarify the scope of the discussion of chapter XIII, mention the types of countertrade commitments to which the chapter referred. At the same time, it was felt that it would be useful to refer briefly also to countertrade agreements that did not constitute a firm commitment to conclude a supply contract and that fell outside the scope of the chapter. The Working Group recalled that the Commission decided at its twenty-third session, in discussing draft chapter III (Contracting approach), that the legal guide should focus on countertrade agreements involving a firm countertrade commitment and that the legal guide should not address itself to countertrade agreements containing a lower degree of commitment (e.g., a commitment merely to negotiate or to exercise "best efforts" to conclude a supply contract) (see A/45/17, annex I, paras. 9 and 24).

#### *B. Release from part or all of countertrade commitment*

65. It was suggested to include in the enumeration of the cases in which a party might be released from the

countertrade commitment the case mentioned in the last sentence of paragraph 19 of draft chapter XI (Liquidated damages and penalty clauses).

66. The Working Group considered that a party might be released from the countertrade commitment in the circumstances discussed in paragraph 6 even if no clause to that effect had been included in the countertrade agreement. That should be made clear in paragraph 6 so as to avoid giving the wrong impression that, for a party to be released from the countertrade commitment, a specific contractual provision was necessary.

67. Suggestions were made that the recommendation in paragraph 13 for the parties to agree on liquidated damages or a penalty was too strong since the advisability of the decision to include a liquidated damages or penalty clause in a countertrade agreement depended on a number of commercial circumstances. The description in draft chapter XI of the advisability of agreeing on liquidated damages or a penalty was considered more appropriate (see also paragraph 57 above).

### *C. Monetary compensation*

68. It was observed that the question of monetary compensation in barter contracts gave rise to particular considerations arising from the fact such contracts did not involve a commitment to enter into a future contract and that the purpose of using barter might be to avoid transfers of currency. The Working Group noted that its discussion of that question in the context of chapter XI (Liquidated damages and penalty clauses) (see paragraph 50 above) should be taken into account in chapter XIII (see also paragraph 52 above.)

### *D. Exempting impediments*

69. The Working Group basically agreed with the discussion in paragraph 16 of the freedom of the parties to allocate by agreement the risk that a particular type of event impeding fulfilment of the countertrade commitment might occur. It was, however, considered necessary to mention in paragraph 16 that in some legal systems there were mandatory limits to the freedom of a party to waive its right to rely on legal rules on exempting impediments.

70. The Working Group discussed the question of the inability of a party to carry out a countertrade commitment as a result of a refusal by a State organ to grant the required licence. Under one view it was appropriate to advise the parties, as it was done in paragraph 35 of draft chapter XIII, to agree in the countertrade agreement that the party who had a duty to obtain a licence should bear the consequences of the absence of the licence. Such advice was appropriate in view of the possibility that a party might be able to avoid a contractual obligation by not taking all the steps necessary to obtain the licence, and that it might be difficult for the aggrieved party to establish whether the licence was refused despite reasonable efforts to obtain it. The prevailing view, however, was

that the discussion in paragraph 35 should differentiate between various situations. On the one hand, there were the situations where the refusal of the licence was due to insufficient efforts by the party who had to obtain the licence or to reasons relating to the particular transaction. On the other hand, there were the situations where the Government imposed a licence requirement after the conclusion of the countertrade agreement or where the licence was refused because of a supervening change in the general policy of the Government. In those latter situations it would not be equitable to place the risk on the party who had to obtain the licence but was unable to do so despite good faith efforts.

71. It was noted that if the event impeding the fulfilment of the commitment met the requirements of the applicable law (such as that the event was unforeseeable and unavoidable) the parties would be released from the commitment even if they had not included an exemption clause in the countertrade agreement. It was agreed to make that clear in section D, in particular in paragraph 22.

72. It was considered that the discussion of elements of a general definition of exempting impediments in paragraph 22 should refer to article 79 of the United Nations Sales Convention.

73. With respect to paragraph 26, it was observed that, when an exhaustive list of impediments was combined by a definition of criteria which the impediments must meet in order to be regarded as exempting impediments, the definition should not be termed as general. The Working Group noted that the discussion of the various methods of defining exempting impediments was modelled on the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works and that it was desirable not to depart from the structure of that Legal Guide, but that it might be appropriate to review the language of paragraph 26, and possibly also paragraph 27, in light of the observation.

74. It was observed that the contractual provision suggested in the last sentence of paragraph 32 regarding strikes and similar labour actions was controversial and was likely to cause disagreements in its application. Reference was made to a national legal system in which the interpretation of a rule similar to the one mentioned in the last sentence of paragraph 32 gave rise to difficulties. It was pointed out that it might be difficult to establish whether a strike arose from labour relations between the party and its employees or whether the reasons for the strike concerned a group of companies or the whole industrial sector. The Working Group agreed that the advice given in the last sentence of paragraph 32 should be deleted.

75. It was observed that the obligation to mitigate losses, which was discussed in paragraphs 36 and 37, obtained under the general principles of contract law, even if the parties had not agreed on an obligation to give a written notice of the impediment. The Working Group agreed that a reference to those general principles of contract law should be the starting point for the discussion in paragraphs 36 and 37.

*E. Effect on countertrade transaction of failure to conclude or perform supply contract*

76. It was suggested to mention in section E, and possibly also elsewhere in chapter XIII, negotiations as an alternative to termination of a supply contract or of a countertrade commitment.

**XIV. Choice of law**  
(A/CN.9/WG.IV/WP.51/Add.5)

*A. General remarks*

77. The Working Group agreed with the approach taken in the draft chapter, advising parties to address the question of the law applicable to the various component contracts of the countertrade transaction. It was noted favourably that the draft chapter did not advise parties to decide at the outset of the transaction to subject all the component contracts to one law, but that such an approach might be one option for the parties to select in the appropriate circumstances.

78. The Working Group considered both the utility and the content of the definition in paragraph 1 of the expression "private international law". One view was that the definition was unnecessary since it was a widely understood term of art and that it injected an abstract or theoretical element into the paragraph. It was also suggested that the present definition was too narrow relative to the established understanding of the term. In response, it was stated that there would be readers who would be unfamiliar with the expression and that therefore the definition would be useful. The Working Group did not subscribe to a suggestion that the reference should be made simply to "law", thereby obviating the need for a definition. It was decided to retain use of the term "private international law", since it was a widely known term and, in view of the objections that had been raised, to delete the definition.

79. It was suggested that the focus of the chapter, as described in paragraph 3, should be expanded so as to encompass contractual arrangements entered into between a party to a countertrade agreement and a third party engaging the third party to purchase or supply goods within the framework of the countertrade transaction, since some of the discussion in the chapter might be relevant to such contractual arrangements.

80. Consideration was given to the manner in which paragraph 6 treated the question of the applicability of the United Nations Sales Convention to countertrade agreements. It was suggested that the legal guide should recognize that, if the countertrade agreement was enforceable as a sales contract because it contained all the essential terms of a supply contract, the Convention would apply. Additional clarity might be achieved by referring to the substance of the provisions of the Convention concerning its scope of application. It was said that any uncertainty that remained as to the applicability of the Sales Convention had to do with countertrade agreements that did not contain all the essential terms of a supply contract. Questions were also raised as to the necessity of charac-

terizing countertrade agreements as "pre-contractual", since a countertrade agreement might be enforceable as a contract.

*B. Choice of applicable law*

81. It was proposed that mention should be made of designating an international convention, such as the United Nations Sales Convention, as the applicable law, as well as non-legislative rules formulated by international organizations. It was generally felt that the right of parties from States that were not parties to a convention to designate that convention as the applicable law should be recognized. To this end, reference might be made to article 1(1)(b) of the United Nations Sales Convention, which provided for the application of the Convention by parties from States in which the Convention was not in force. At the same time the legal guide might point out that a convention that was in force in a State formed part of the law of that State.

82. The view was expressed that, in order to emphasize the advisability of choosing an applicable law, paragraph 8 should refer to the difficulties sometimes encountered in applying criteria applied by rules of private international law to determine the applicable law.

83. The Working Group noted that in some jurisdictions the choice of the law of a third country, in the absence of a link between the transaction and the State whose law had been selected, might not be upheld on the ground that there was no connection with the selected jurisdiction (sometimes referred to as the "nexus rule"). The view was expressed that the legal guide should point out to parties selecting the law of a third country that they should include a clause to the effect that the *nexus* rule should not be applied to their choice-of-law clause. It was pointed out that such clauses would not necessarily be upheld in all legal systems and it was suggested that paragraphs 12 and 13 should indicate that the likelihood that such clauses would be upheld would be greater in arbitration proceedings.

*C. Choosing more than one national legal system to govern countertrade agreement and supply contracts*

84. No changes were suggested to section C.

*D. Mandatory legal rules of public nature*

85. No changes were suggested to section D.

**XV. Settlement of disputes**  
(A/CN.9/WG.IV/WP.51/Add.6)

*A. General remarks*

86. It was proposed that paragraph 5 should be expanded to encompass contractual arrangements between the parties to the countertrade agreement and third parties engaging those third parties to act as purchasers or suppliers of

countertrade goods. A view was expressed that consideration might be given to strengthening the recommendation made in the third sentence that all of the supply contracts as well as the contractual agreement should be subject to one dispute settlement clause.

87. It was observed that the draft chapter did not contain a warning that special circumstances and difficulties with respect to dispute settlement might result when one of the contract parties is a State or an entity of a State. Reasons adduced for not addressing such issues included that a State, when it engaged in commercial activities, normally was regarded as having waived its sovereign immunity for the purposes of legal disputes arising out of those activities and that a discussion of the question was beyond the scope of the legal guide. It was further suggested that recommending the inclusion of contractual clauses on waiver of sovereign immunity might be interpreted as suggesting that in the absence of such contractual clauses, there was no waiver of sovereign immunity by a State engaging in commercial activities. The prevailing view was that the involvement of States as contracting parties had important implications for dispute settlement and that it would be useful for the legal guide to make a brief mention of the existence of the problem and the need for parties to investigate dispute settlement aspects in such cases. It was suggested that reference might be made, for example, to the restrictions applicable to participation in arbitration by the governmental entities of some States. It was also suggested that reference should be made to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965).

### *B. Negotiation*

88. The view was expressed that it was not immediately clear from the title of section B whether it referred to the negotiation of contractual terms at the outset of the transaction or to negotiation to settle a dispute. It was suggested that the difficulty might be solved, without altering the substance of section B, by modifying the title to read "amicable settlement" or "consultations". However, recalling that the present formulation was based on the UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works, the Working Group hesitated to modify the title of section B since to do so might inadvertently suggest that some substantive elements had been introduced. The Working Group also noted that the use of the term "negotiation" raised problems in only some language versions. It was further noted that understanding of the meaning of the title of section B might be enhanced by a more elaborate introduction in the general remarks of the concept of negotiation as a dispute settlement mechanism.

### *C. Conciliation*

89. It was suggested that reference should be made to the possibility of commencing conciliation proceedings even after the commencement of arbitral or judicial dispute settlement proceedings.

### *D. Arbitration*

90. It was suggested that the differences in the remedies that were available from arbitration, as opposed to judicial dispute settlement, should be added to the list of factors to be considered in deciding whether to select arbitration as a dispute settlement mechanism.

### *E. Judicial proceedings*

91. No changes were suggested to section E.

### *F. Multi-contract and multi-party dispute settlement*

92. No changes were suggested to section F.

### **Draft illustrative provisions (A/CN.9/WG.IV/WP.51/Add.7)**

93. The Working Group noted that the Commission had not made a definitive decision as to whether the legal guide should contain illustrative contract provisions (see A/45/17, annex I, para. 6) and therefore the Working Group engaged in a discussion on the utility of illustrative provisions in the legal guide. Reservations were expressed as to the appropriateness of attempting to illustrate the discussion in the legal guide by suggesting contract formulations. It was pointed out that an illustrative provision could have undesirable consequences if it was not in harmony with other contract provisions. Furthermore, the fact that an illustrative provision was contained in a publication of the United Nations might be perceived as an endorsement of the provision. In addition, the parties might include the text of an illustrative provision in their countertrade agreement without completing properly the missing elements. While the proponents of the reservations recognized that an appropriate warning would be included in chapter I (Introduction to Legal Guide) (paragraph 4 of A/CN.9/WG.IV/WP.51/Add.7), they pointed out that a reader might not read the introductory chapter before using an illustrative provision. It was therefore suggested that, if illustrative provisions were to be included in the legal guide, in each illustrative provision a reference should be made to the relevant explanation in the introductory chapter.

94. The prevailing view was that the legal guide should include a limited number of illustrative provisions. Such provisions usefully complemented the discussion in the legal guide. Support was expressed for the selection of the issues in the legal guide to be covered by illustrative provisions.

### *Draft chapter V, "Type, quality and quantity of goods"*

#### *Footnote to paragraph 13*

95. No changes were suggested to the illustrative provision.

*Draft chapter VI, "Pricing of goods"**Footnote to paragraph 37*

96. It was suggested to include in the illustrative provision, and in the accompanying text, a warning that the clause might not operate in the intended way if the exchange rate of the currency of payment and the reference currency was subject to administrative regulations.

*Draft chapter VIII, "Participation of third parties"**Footnote to paragraph 10*

97. The Working Group requested the Secretariat to revise the four illustrative provisions so as to ensure that the various scenarios for the involvement of a third-party purchaser discussed in the legal guide were illustrated.

*Draft chapter XIII, "Failure to complete countertrade transaction"*

98. No changes to the illustrative provisions were suggested.

*Draft chapter XIV, "Choice of law"**Footnotes to paragraph 20, second and fourth sentences*

99. It was suggested that an illustrative provision should be added to cover the situation in which the parties agreed

to settle the question of the law applicable to the various component contracts of a countertrade transaction by a single clause in the countertrade agreement. Such an approach might be used, in particular, when the countertrade agreement was concluded prior to the conclusion of the supply contracts in the two directions.

100. It was suggested that the illustrative provisions for chapter XIV should be expanded so as to reflect the discussion by the Working Group on the choice by the parties of international conventions and of non-legislative rules (see paragraph 81 above). As to the reference to international conventions, it was suggested that language illustrating the choice of an international convention, including the selection of the United Nations Sales Convention, could be added, either by expanding the existing illustrative provision or by including an additional provision.

*Draft chapter XV, "Settlement of disputes"**Footnotes to paragraphs 12 and 28*

101. It was suggested that the illustrative provisions should be broadened so as to indicate that a number of different conciliation and arbitration rules existed. Merely modifying the text of the relevant paragraphs in the legal guide to indicate that different rules were available was not considered sufficient if the illustrative provisions were not also modified.

- B. Working papers submitted to the Working Group on International Payments at its twenty-third session: draft chapters of legal guide on drawing up contracts in international countertrade transactions: sample chapters:\* report of the Secretary-General**  
(A/CN.9/332/Add.8 and A/CN.9/WG.IV/WP.51 and Add.1-7)  
[Original: English]

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\*The text contained herein is a first draft prepared by the Secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

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## VII. FULFILMENT OF COUNTERTRADE COMMITMENT

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#### A. General remarks

1. The countertrade agreement should address several questions related to the fulfilment of the countertrade commitment. One question concerns the types of supply contracts that are eligible to be counted towards fulfilment (paragraphs 2 to 9 below). Another question is whether the countertrade commitment is fulfilled at the moment when the parties enter into a supply contract or at some subsequent point during the performance of the supply contract (paragraphs 10 to 12 below). A further question is whether an amount equivalent to the price payable under a supply contract, or a greater or lesser amount, is to be subtracted from the outstanding countertrade commitment (paragraphs 13 to 16 below). Yet another question concerns the period of time during which the countertrade commitment is to be fulfilled (paragraphs 17 to 30 below). The parties may also wish to establish procedures for monitoring and recording fulfilment (paragraphs 31 to 44 below).

#### B. Defining eligible supply contracts

2. The parties normally define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts") by indicating in the countertrade agreement the type of goods to be purchased under those future supply contracts. In some cases, the parties include in the countertrade agreement additional criteria relating to the geographical origin of the goods, the identity of the supplier, or the identity of the purchaser. When the parties are not in a position to indicate the type of goods in the countertrade agreement, some of these criteria may be included for the purpose of defining eligible supply contracts.

##### 1. By type of goods

3. When the parties define the contracts eligible to be counted towards fulfilment by indicating the type of goods

to be purchased, it is advisable that they do so with as much precision as possible. Precision is particularly advisable when the goods to be purchased exist in different varieties. (For a discussion of clauses in the countertrade agreement concerning the type of goods, see chapter V, "Type, quality and quantity of goods", paragraphs 2 to 11.)

4. Sometimes the parties provide in the countertrade agreement that, in addition to the purchase of the countertrade goods, other related items are to be counted towards fulfilment of the countertrade commitment. Such ancillary items may be, for example, purchase of samples and prototypes in the course of selecting the countertrade goods, local contracting of labor, local purchase of goods and services essential for carrying out a supply contract, unbilled activities by the purchaser in the supplier's country (e.g., recruitment of personnel, training programs, secondment of staff and other forms of technical assistance), purchase from the supplier of transportation services, or performance by the purchaser of after-sales service on the countertrade goods. The countertrade agreement may provide that only a limited portion of the countertrade commitment may be fulfilled through such items.

5. When the purchaser has made prior purchases from the supplier, the countertrade agreement may provide that supply contracts must meet an "additionality" requirement in order to be counted toward fulfilment (see chapter V, paragraphs 26 and 27).

### 2. *By geographical origin*

6. Eligibility of supply contracts may be defined by a stipulation that countertrade goods must be produced in a particular geographical area. Stipulations of this type are sometimes found in indirect offset transactions where the importer wishes to channel the counter-purchases to a particular region. Furthermore, the countertrade agreement may stipulate a required minimum level of local content. Such stipulations may provide that particular components of the goods must be locally produced or that the value of local components must constitute a certain percentage of the total value. Local content requirements are sometimes found in governmental regulations.

### 3. *By identity of supplier*

7. The parties may agree that the exporter is to fulfil the countertrade commitment by purchasing goods from persons other than the importer. This is typically the case in indirect offset (see chapter II, paragraph 13). In such cases, it is advisable that eligible supply contracts be defined by identifying the suppliers from whom the goods are to be purchased. The countertrade agreement may list eligible suppliers or may stipulate criteria to be observed by the purchaser in selecting a supplier. It may be provided, for example, that a selected supplier must be from a particular economic sector, be of a certain size, have a particular production programme, be located in a particular region, or be locally owned. Where several eligible suppliers are identified, the purchaser may be left free to distribute purchases among various suppliers or a particular structure of

purchases from the identified suppliers may be stipulated. The identification of eligible suppliers does not necessarily mean that those suppliers have made a commitment to make countertrade goods available. In some cases the importer may provide an assurance that the eligible suppliers are prepared to negotiate the conclusion of a supply contract or promise to assist the purchaser in identifying a supplier who is willing to conclude a supply contract. (For a discussion of the participation of third persons as suppliers, see chapter VIII, paragraph \_\_\_\_.) The countertrade agreement may indicate the effect on the countertrade commitment if none of the eligible suppliers are prepared to conclude a supply contract.

### 4. *By identity of purchaser*

8. A restrictive element sometimes found in the definition of eligible supply contracts concerns the identity of the purchaser. For example, the countertrade agreement may provide that only purchases made by the party committed to purchase goods or by specified third persons (e.g., third persons from a particular country or geographical region) are to be counted towards fulfilment. For a discussion of restrictions on the participation of third persons as purchasers, see chapter VIII, paragraph \_\_\_\_.

### 5. *Non-conforming purchases*

9. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement would be counted towards fulfilment of the countertrade commitment. For example, non-conforming purchases could be counted if the good faith efforts of the purchaser to locate suitable goods from the eligible suppliers or in the geographical regions or economic sectors identified in the countertrade agreement were unsuccessful. A provision of that type could call upon the purchaser to provide evidence of efforts to make purchases of the type required by the countertrade agreement (for a discussion of the analogous case of a party requesting an extension of the fulfilment period, see paragraphs 23 to 26 below). It could be agreed that the specific prior consent of the party to whom the commitment is owed would be necessary for the purchases not meeting the eligibility requirements to be counted towards fulfilment. In order to foster efforts to comply with origin requirements, the countertrade agreement could limit the availability of an exception to the later stages of the fulfilment period. Furthermore, the parties may agree that purchases counted towards fulfilment that fall outside the eligibility provisions are to be counted at less than the full value of the purchases (see paragraphs 14 and 15 below).

### C. *Stage when commitment fulfilled*

10. It is advisable that the countertrade agreement indicate the specific events that must occur in order for the countertrade commitment to be fulfilled. The parties may choose between two basic approaches. Under one approach, the countertrade commitment is deemed to be fulfilled once a supply contract is concluded. In such cases, a breach of

an obligation under the supply contract would be subject to remedies available under the supply contract. The parties may agree that, if the supply contract is not performed due to a reason imputable to one party, the amount of the unperformed contract could, at the option of the other party, be reinstated in the countertrade commitment.

11. Under the other approach, the commitment is deemed to be fulfilled at an agreed stage in the performance of the supply contract. For example, it may be agreed that the commitment of the purchaser is fulfilled when the letter of credit is opened or when the funds have been transferred to the supplier and the corresponding commitment of the supplier is fulfilled when the goods are delivered or placed at the disposal of the purchaser in the agreed manner. In such cases, in the event of a breach of the supply contract, the non-breaching party might be able to invoke remedies not only for breach of the supply contract, but also for breach of the countertrade agreement if the countertrade commitment remained unfulfilled.

12. The parties may wish to address the effect on the countertrade commitment of a failure to conclude or perform a supply contract. It may be agreed, for example, that when the reason for such a failure is imputable to one of the parties, the outstanding countertrade commitment of the other party may, at the option of that other party, be deemed fulfilled in the amount of the unaccepted contract offer or unperformed contract (see chapter XIII, "Interdependence of obligations", paragraph —).

#### **D. Amount of fulfilment credit**

13. In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the amount deducted from the outstanding countertrade commitment is hereinafter referred to as "fulfilment credit"). Sometimes the parties agree that the fulfilment credit granted for a supply contract is to be an amount different than the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain costs (e.g., transportation and insurance) not included in the purchase price or to exclude from the fulfilment credit certain costs included in the purchase price. The supplier may agree to the crediting of such cost elements if, for example, they involve the purchase in the supplier's country of services related to the performance of the supply contract.

14. The countertrade agreement may provide that purchases are to be credited towards fulfilment of the countertrade commitment at different rates depending upon the type of goods purchased. For example, fulfilment credit could be granted at the rate of 50 per cent of the purchase value for one type of goods and 150 per cent for another. Such a variable rate of fulfilment credit could be desirable for a supplier who wishes to promote the purchase of certain types of goods. In an offset transaction, the countertrade agreement may provide that investments or technology transfer will be credited at more than the capital contribution of the investment or the monetary value of the technology transfer (e.g., 150 per cent). In direct offset, as well as in buy-back, the countertrade agreement may pro-

vide that a certain amount of fulfilment credit will be granted for export sales, other than those to the counter-importer, generated by the production facility supplied by the exporter. Credit may also be granted for a percentage of the value of sales to buyers in the counter-exporter's country.

15. The countertrade agreement may also provide for different rates of fulfilment credit depending upon the identity of the supplier, the geographical origin of the goods or the identity of the purchaser. The rationale behind such a provision is to steer the activities of the purchaser towards particular suppliers or regions, or to introduce the goods in certain markets.

16. The rate of fulfilment credit may also be made to vary according to the point of time when a purchase is made. Under a scheme of this type, the purchaser could fulfil the countertrade commitment by the purchase of a smaller quantity of goods if a supply contract was concluded at an early stage of the period for the fulfilment of the countertrade commitment. This approach is designed to give the purchaser an incentive for fulfilling the commitment earlier rather than later in the fulfilment period. In such a case it is particularly important that the countertrade agreement specify the point when fulfilment credit is to be given (e.g., when an order is placed or when payment is made).

#### **E. Time period for fulfilment of countertrade commitment**

##### **1. Length of fulfilment period**

17. The parties should specify in the countertrade agreement the length of time to be allowed for fulfilment of the countertrade commitment (hereinafter referred to as the "fulfilment period"). The countertrade agreement may determine the length of the fulfilment period by stipulating that the fulfilment period is to commence upon a fixed date and to expire on a fixed date.

18. Another method is to make the commencement of the fulfilment period contingent upon an event specified in the countertrade agreement and to set the length of the fulfilment period. Such an approach may be desirable in a variety of circumstances. For example, when the conclusion of the countertrade agreement precedes the entry into force of the export contract, the parties may agree that the fulfilment period will not begin until the export contract has entered into force. When there is uncertainty at the time of the conclusion of the countertrade agreement about the availability of countertrade goods or about the ability of the purchaser to utilize or market them, the parties may agree that the fulfilment period will commence upon the completion of certain preparatory activities (e.g., identification of goods, inspection by purchaser, certification of the technical capability of the factory producing the goods, agreement with a third-party purchaser or completion of joint marketing research). Where the exporter wishes to ensure that performance of the export contract is at an advanced stage or completed before performance of the countertrade commitment commences, the parties may stipulate in the countertrade agreement that commencement of the fulfil-

ment period is to be triggered by an event in the performance of the export contract such as the opening of the letter of credit, delivery of a specified portion of the goods or payment. In a buy-back transaction, an appropriate moment might be the beginning of production of buy-back products by the facility supplied under the export contract. In order to avoid uncertainty as to whether the conditions for commencement of the fulfilment period have been met, it is advisable that the countertrade agreement state those conditions and the related obligations of the parties as precisely as possible.

19. In determining the length of the fulfilment period the parties should consider a number of factors. One factor is the size and type of the transaction being contemplated. For example, where the countertrade commitment is large and involves a series of shipments, more time would normally be needed for fulfilment of the countertrade commitment than if the transaction were relatively small. Where the countertrade agreement defines the countertrade goods in broad terms, it may be that a longer fulfilment period would be needed in order to allow time for identifying suitable countertrade goods. The quality of the countertrade goods may affect the length of the fulfilment period. The better the quality, the more likely it will be that the purchaser will either be able to market or use them in-house, thus allowing a shorter fulfilment period.

20. In some cases, the length of the fulfilment period is set so that it extends beyond the date when payment is due under the export contract. Such an approach would allow the exporter time to fulfil the countertrade commitment after payment under the export contract is due. In such a case it is in the interest of the importer to include in the countertrade agreement effective sanctions for breach of the countertrade commitment.

21. The parties may agree that the fulfilment period for the shipment in one direction is to be of the same length as the fulfilment period for the shipment in the other direction. Such an approach may be appropriate when no particular importance is attached to the order of the shipments in the two directions (e.g., countertrade carried out within the framework of a setoff account (chapter IX, "Payment", paragraphs 35 to 52) or an evidence account (paragraphs 38 to 44 below)). Such an approach may also be appropriate in a counter-purchase transaction in which the counter-importer is prepared to begin fulfilling the countertrade commitment without waiting to be paid under the export contract.

22. The fulfilment period should be of a sufficient length to take into account difficulties the supplier may encounter in making the countertrade goods available. If the goods are not made available in time, the purchaser could object to the exercise by the supplier of remedies for non-fulfilment of the countertrade commitment by claiming that non-fulfilment was due to unavailability of the goods. If the purchaser is entitled to select the goods from a list of eligible countertrade goods, the length of time needed to make available each of the different goods listed should be taken into account calculating the length of the fulfilment period.

## 2. *Extension of fulfilment period*

23. The parties may require more time to fulfil the countertrade commitment than provided by the countertrade agreement. For example, a purchaser may encounter unanticipated difficulties in utilizing or reselling the goods to be purchased. A supplier may have difficulties in making agreed upon goods available on schedule.

24. The law applicable to the countertrade agreement may provide for an extension of the time allowed for the performance of a party's contractual obligations in the event that the possibility of performance is affected by circumstances beyond the control of that party. The parties may wish to include in the countertrade agreement clauses addressing such situations (see chapter XIII, paragraphs — to —, for a discussion of exemption and hardship clauses).

25. The countertrade agreement may provide that an extension would be granted if the party seeking an extension has made good faith efforts to fulfil the commitment. It is advisable that such a provision indicate how the purchaser could demonstrate good faith efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show a certain number of contacts with potential suppliers in search of suitable countertrade goods. The countertrade agreement may also provide that a supplier who was unable to make goods available due to circumstances specified in the countertrade agreement would be entitled to an extension. Such circumstances may include, for example, lateness of the purchaser's order or changes in the purchaser's specifications. The parties may agree that a party could request an extension of the fulfilment period only if that party had fulfilled a portion of the countertrade commitment.

26. If the fulfilment of the countertrade commitment is supported by a guarantee, it is advisable that the parties provide that the period of the guarantee should be extended to cover an extension of the fulfilment period (see chapter XII, "Security for performance", paragraphs 33 and 34).

## 3. *Subperiods within fulfilment period*

27. Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods. For example, a five year fulfilment period could be divided into five annual subperiods, with a specified portion of the total commitment to be fulfilled during each subperiod. Such an approach assists the parties in planning delivery and marketing of the countertrade goods, and helps to ensure that fulfilment does not fall so far behind that the parties would be unable at the latter stages of the fulfilment period to fulfil the outstanding countertrade commitment.

28. The countertrade agreement may allow flexibility in dealing with shortfalls in the fulfilment of the commitment assigned to individual subperiods by permitting the carry-over of all or a portion of a shortfall to the next subperiod.

In such a case, the purchaser would have, in the following subperiod, to fulfil the portion of the commitment allocated to that subperiod, as well as to fulfil the portion of the commitment carried over from the preceding period. The portion not carried over would be subject to sanctions for failure to fulfil the countertrade commitment (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance"). Such flexibility would allow the purchaser to adjust the quantity to be purchased in a given subperiod in response to circumstances such as short term market fluctuations. However, a high degree of flexibility might adversely affect the interests of the supplier if the proceeds of sales in each subperiod are to be used for payments under the supply contract in the other direction.

29. To address the possibility that the fulfilment achieved in a given subperiod exceeds the required level, the parties may agree that some or all of the extra purchases would be credited to the commitment due in the following subperiod. Alternatively, the parties may agree that the excess fulfilment in one subperiod would not affect the level of the commitment due in the following subperiod.

30. The parties may wish to set deadlines within the fulfilment period for completion of different actions related to fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, placing orders, shipping goods or opening letters of credit.

## **F. Monitoring and recording fulfilment of countertrade commitment**

31. The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment. Such arrangements may be particularly useful in long term countertrade transactions with multiple shipments in one or both directions.

### **1. Exchange of information**

32. The parties may wish to establish procedures for exchange of information on progress in the fulfilment of the countertrade commitment. Such procedures may be useful, in particular, in "indirect offset" transactions (chapter II, "Introduction", paragraph 13), since the countertrade commitment is owed to a person who does not act as the supplier of the countertrade goods and the potential suppliers are, therefore, not parties to the countertrade agreement. A system of exchange of information may also be useful when the parties are engaged in a large volume of mutual trade, especially when only a part of that trade stems from the countertrade agreement.

33. The parties may include in the countertrade agreement guidelines concerning the contents, frequency and timing of the information to be exchanged. The required information could cover, for example, contracts that have been concluded that are eligible to be counted towards fulfilment (especially when concluded with a third person), shipments

that have been made, payments effected in accordance with agreed upon procedures and purchases planned for an upcoming subperiod of the fulfilment period. Furthermore, the parties to the countertrade agreement sometimes find it useful to meet periodically to assess the progress that is being made towards fulfilment. Such meetings could be used to review the status of concluded contracts and those under negotiation and to consider possible modifications of the countertrade agreement. The countertrade agreement could address questions such as the frequency and location of meetings and the representation of the two sides.

34. In particularly complex transactions that require ongoing monitoring and coordination, the parties may wish to establish in the countertrade agreement a joint coordination committee. It is advisable that the parties address issues such as the frequency and location of meetings, representation of the two sides, the manner in which the results of the meetings will be reported and the mandate of the committee. The mandate of such a committee would typically be to assess progress in the implementation of the transaction, analyse difficulties and consider possible solutions, establish working groups for specific problems, and consider proposals to amend the countertrade agreement.

## **2. Confirmation of fulfilment of countertrade commitment**

35. The parties may agree that the purchaser has a right to obtain from the party to whom the countertrade commitment is owed a written confirmation of the fulfilment of the countertrade commitment. Such a confirmation may take the form of a statement from the supplier (sometimes referred to as a "letter of release"). The parties may agree that the letter of release is a condition for payment under the supply contract concluded in fulfilment of the countertrade commitment (e.g., the letter of credit terms may specify that the letter of release is to be among the documents presented to the bank in order to obtain payment). Fulfilment of the countertrade commitment may also be confirmed by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

36. Written confirmation of fulfilment is intended to avoid disagreements, which may occur after a particular supply contract has been performed, as to whether the contract counts towards fulfilment of the countertrade commitment. Written confirmation may also be helpful to a party who wishes to demonstrate (e.g., in negotiating other countertrade agreements) a record of fulfilling countertrade commitments.

37. Where written confirmations are envisaged in a multiparty transaction (see chapter VIII, "Participation of third parties", paragraphs \_\_\_\_ to \_\_\_\_), it is advisable that the countertrade agreement indicate whether the fulfilment of the commitment is to be confirmed by the supplier of the goods or by the party to whom the commitment is owed. Absent such an indication, a disagreement may arise between the purchaser and the party to whom the commitment is owed as to the significance of a statement by a third-party supplier that a supply contract fulfils the countertrade commitment, or of a clause in a supply contract with a third-party supplier to that effect.

### 3. Evidence accounts

38. The parties may agree that their mutual shipments of goods are to be recorded in a ledger kept by themselves, by a bank or by a controlling authority. Such a ledger is referred to herein as an "evidence account", a term frequently used in practice. An evidence account is not a payment mechanism. Rather, it is used only for recording the conclusion, performance and value of supply contracts, with financing and payment being arranged independently. With an evidence account, the parties undertake a countertrade commitment of a given value and then conclude supply contracts in the two directions without having to negotiate a countertrade commitment for each individual supply contract. Evidence accounts may accommodate multiple parties on one or both sides. An evidence account may be particularly useful in a long-term countertrade transaction to monitor the cumulative value of the purchases in the two directions and thereby to assist the parties in dealing with imbalances that may develop.

39. The use of an evidence account may be subject to governmental regulations. Such regulations may determine the manner in which an evidence account is to operate and require administration of the account by a controlling authority such as the central bank or foreign trade bank. An evidence account administered by a controlling authority may provide the purchaser access to a wider variety of countertrade goods and trading partners than might be available without an evidence account administered by the controlling authority. Government regulations may also require authorization of evidence accounts. It may be provided that such authorization would be given only for countertrade transactions exceeding a minimum turnover and to parties with an established presence in a given country. In some cases, an evidence account is authorized with the restriction that purchases by third parties will not be counted towards fulfilment of the countertrade commitment; such a restriction may be imposed when the motive for permitting an evidence account is to establish a long term trading relationship with a particular party. The countertrade goods may be limited to those agreed upon by the parties or those that the controlling authority has an interest in promoting.

40. When the parties are free to establish an evidence account, they may decide to administer the account themselves or to engage a bank or banks to do so. A variety of structures are possible depending on whether the account is administered by one or both of the parties or by one or two banks engaged by the parties. For example, parallel accounts could be established by a party or a bank on each side of the transaction in which supplies are credited and purchases are debited. Each parallel account could in turn consist of two ledgers, one listing contracts concluded in each direction and the other recording payments. If banks are to administer the evidence account, the parties may wish to use the banks that handle payment for the supply contracts.

41. The countertrade agreement should specify the documentation required for triggering entries in the evidence account (e.g., copies of contracts, evidence of letters of credit, or shipping documents). Such documentary require-

ments should be in line with the provisions in the countertrade agreement concerning the stage when the countertrade commitment is deemed fulfilled (see paragraphs 10 to 12 above). In order to minimize administrative burden, the parties may wish to align to the degree possible the documentary requirements for the evidence account with those of any governmental authority monitoring the countertrade transaction.

42. It is advisable that the parties address in the countertrade agreement deviations from the agreed upon ratio between the values of the shipments to be made in the two directions. It is advisable to agree that during the fulfilment period the values of the shipments may deviate from the agreed ratio, with the agreed upon ratio to be achieved upon the conclusion of the fulfilment period or at specified points in the fulfilment period. The parties may further agree that deviations during the fulfilment period must remain within a specified range. For example, during the fulfilment period the value of the shipments in one direction should be not less than 60 and not more than 120 per cent of the value of the shipments in the other direction. It may be agreed that failure by a party to conclude the supply contracts necessary to achieve the agreed upon ratio may be subject to sanctions (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance"). It is advisable to define in the countertrade agreement small deviations from the ratio that would be tolerated.

43. In order to minimize errors or discrepancies in the evidence account, the parties may agree to verify at fixed points of time the information entered in the account.

44. Where two banks are involved in administering the evidence account, the technical details of the account may be the subject of an interbank agreement. The countertrade parties have an interest in the contents of the interbank agreement, though they are not normally parties to it. It is therefore advisable that the parties consult with the banks to ensure that the evidence account established by the banks is acceptable to the parties.

[A/CN.9/WG.IV/WP.51]

#### INTERNATIONAL COUNTERTRADE: DRAFT CHAPTERS OF LEGAL GUIDE ON DRAWING UP CONTRACTS IN INTERNATIONAL COUNTERTRADE TRANSACTIONS: REPORT OF THE SECRETARY-GENERAL

1. The Commission, at its nineteenth session (1986), in the context of its discussion of a note by the Secretariat entitled "Future work in the area of the new international economic order" (A/CN.9/277), considered its future work on the topic of countertrade. There was considerable support in the Commission for undertaking work on the topic, and the Secretariat was requested to prepare a preliminary study on the subject.<sup>1</sup>

<sup>1</sup>Report 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.

2. At its twenty-first session (1988), the Commission had before it a report entitled "Preliminary study of legal issues in international countertrade" (A/CN.9/302). The Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up countertrade contracts. In order for the Commission to decide what further action might be taken, the Commission requested the Secretariat to prepare for the twenty-second session of the Commission a draft outline of such a legal guide (A/43/17, paras. 32-35).

3. At its twenty-second session (1989), the Commission considered the report entitled "Draft outline of the possible content and structure of a legal guide on drawing up international countertrade contracts" (A/CN.9/322). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare for the next session of the Commission draft chapters of the legal guide (A/44/17, paras. 245-249).

4. At its twenty-third session (1990), the Commission considered the following materials prepared by its secretariat: a proposed structure of the legal guide (A/CN.9/332, para. 6); an outline of the introductory chapter to the legal guide (A/CN.9/332/Add.1); draft chapter II, "Scope and terminology of legal guide" (A/CN.9/332/Add.1); draft chapter III, "Contracting approach" (A/CN.9/332/Add.2); draft chapter IV, "General remarks on drafting" (A/CN.9/332/Add.3); draft chapter V, "Type, quality and quantity of goods" (A/CN.9/332/Add.4); draft chapter VI, "Pricing of goods" (A/CN.9/332/Add.5); draft chapter IX, "Payment" (A/CN.9/332/Add.6); and draft chapter XII, "Security for performance" (A/CN.9/332/Add.7). Draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), was submitted to the Commission but was not considered by the Commission.<sup>2</sup>

5. There was general agreement in the Commission with the overall approach taken in preparing the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein (A/45/17, para. 16).

6. The Commission decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them, together with draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), to the Working Group on International Payments. The Commission also decided that the Secretariat should redraft the chapters considered by it at its twenty-third session and the chapters to be submitted to the Working Group on International Payments in the light of the discussion at those sessions. The Commission also decided that the final text of the legal guide should be submitted to its twenty-fifth session, to be held in 1992 (A/45/17, paras. 17 and 18).

7. Addenda 1 to 6 to the present document contain draft chapters VIII, X, XI, XIII, XIV and XV, prepared pursuant to the above decision of the Commission. Addendum 7

contains sample draft illustrative provisions that may be used in drawing up a countertrade agreement; such illustrative provisions are expected to be set forth in footnotes to chapters of the final text of the legal guide. In preparing those draft chapters and sample draft illustrative provisions, the Secretariat has taken into account a broad range of relevant documents, contracts, books and articles. In addition, the Secretariat has benefited from the comments of an expert group that was convened by the Commission's secretariat at Vienna from 12 to 15 December 1989.

8. The Working Group may wish to consider the structure of these chapters, whether they cover the relevant issues, whether the statements made appropriately take into account the needs of countertrade practice and whether advice given is appropriate.

9. The proposed structure of the legal guide is as follows:

- I. Introduction to Legal Guide. This draft chapter, which will describe the origin, purpose, approach and structure of the legal guide, will be prepared for the twenty-fifth session of the Commission (an outline of this draft chapter is contained in A/CN.9/332/Add.1).
- II. Scope and terminology of Legal Guide (A/CN.9/332/Add.1)\*
- III. Contracting approach (A/CN.9/332/Add.2)\*
- IV. General remarks on drafting (A/CN.9/332/Add.3)\*
- V. Type, quality and quantity of goods (A/CN.9/332/Add.4)\*
- VI. Pricing of goods (A/CN.9/332/Add.5)\*
- VII. Fulfilment of countertrade commitment. This draft chapter, contained in A/CN.9/332/Add.8, the Commission referred to the Working Group on International Payments.
- VIII. Participation of third parties (addendum 1 to the present document)
- IX. Payment (A/CN.9/332/Add.6)\*
- X. Restrictions on resale of countertrade goods (addendum 2 to the present document)
- XI. Liquidated damages and penalty clauses (addendum 3 to the present document)
- XII. Security for performance (A/CN.9/332/Add.7)\*
- XIII. Problems in completing countertrade transaction (addendum 4 to the present document)
- XIV. Choice of law (addendum 5 to the present document)
- XV. Settlement of disputes (addendum 6 to the present document).

<sup>2</sup>A summary of the discussion in the Commission on the draft chapters (A/CN.9/332/Add.1-7) is contained in annex I to the report of the Commission on the work of its twenty-third session (A/45/17).

\*This draft chapter, submitted to the twenty-third session of the Commission (1990), will be revised in the light of the discussion at that session and any observations made at the twenty-third session of the Working Group on International Payments (1991), and will be submitted to the twenty-fifth session of the Commission in 1992.

[A/CN.9/WG.IV/WP.51/Add.1]

## VIII. PARTICIPATION OF THIRD PARTIES

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## A. General remarks

1. This chapter deals with cases in which a party, instead of itself purchasing or supplying goods in a particular direction, engages a third party to do so. Section B discusses the case in which a party originally committed to purchase goods engages a third party to make those purchases. Section C discusses the case in which a third party is designated to supply goods. This chapter also discusses cases in which a supplier of goods in one direction does not assume a commitment to purchase goods in the other direction, but instead a third-party purchaser assumes such a commitment from the outset of the transaction; such cases are dealt with in section D. Section D also discusses cases in which a purchaser of goods in one direction does not assume a commitment to supply goods in the other direction, but instead a third-party supplier assumes such a commitment from the outset.

2. The Legal Guide does not discuss the case in which a party committed to purchase goods engages a third person only to locate persons to whom the goods could be resold or to represent the committed party in the resale of the goods. In such cases the third person does not purchase the goods in its own name. The use by the purchaser of such services by third persons is not discussed since the consent of the supplier is normally not required and such involvement of third persons therefore does not have to be addressed in the countertrade agreement.

3. Cases in which the party committed to purchase goods makes those purchases itself and then resells the goods are not within the subject-matter of this chapter. Various restrictions that may be placed on the resale of countertrade goods are discussed in chapter X.

## B. Purchase of countertrade goods

4. A party committed to purchase goods frequently cannot use the goods to be purchased, or lacks the marketing capacity or knowledge necessary to resell them. In these cases the party committed to purchase may wish to engage

one or more third parties to make the purchases necessary to fulfil the commitment. The third party may be, for example, an end-user of the goods or a trading company specializing in the purchase and resale of certain types of goods.

5. A third-party purchaser who agrees to become involved in the countertrade transaction makes a commitment to the party originally committed (i.e., only to the party who engages the third party) to purchase goods from the supplier within an agreed period of time. In some cases, the third party also makes a commitment to the supplier to enter into future contracts. Since the third party's commitment relates to the conclusion of future contracts, that commitment would address issues such as the type, quality, quantity and price of the goods to be the subject of the future contracts, period for fulfilment of the commitment, restrictions on resale of the goods, security for performance, liquidated damages or a penalty, and settlement of disputes. (Implications of the commitment by the third party are discussed below in paragraphs 15 and 16; the terms of the third party's commitment are discussed below in paragraph 20.)

6. When a third-party purchaser is to be engaged, it is often the case that payment obligations under the supply contracts in each direction are to be settled independently. Such cases do not raise payment issues specific to countertrade. It may be agreed, however, to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 61 to 67.

7. Sometimes the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser may have to assume in the future. Alternatively, a purchaser accumulating such excess fulfilment credit may be permitted to transfer the excess fulfilment credit to a third party (for a discussion of fulfilment

credit, see chapter VII, "Fulfilment of countertrade commitment", paragraphs 13 to 16). The transfer of the fulfilment credit to a third party would entitle that third party to sell goods to the party who originally granted the fulfilment credit and to reduce any countertrade commitment by the amount of the transferred fulfilment credit. Such a transfer may involve the payment of a fee by the third party to the transferor of the fulfilment credit. In some countries, the right of transfer of countertrade credit is regulated by law.

### 1. Countertrade agreement

8. When the parties at the outset of the transaction foresee the possibility that the party committed to purchase will wish to engage a third-party purchaser, it is advisable to address that possibility in the countertrade agreement. Absent a provision authorizing the engagement of a third party, a disagreement may arise as to whether the party originally committed is entitled to engage a third party to fulfil the countertrade commitment. The party originally committed to purchase goods may consider that the commitment is not a personal obligation and that, even without the consent of the supplier, the commitment may be fulfilled by purchases made by a third party engaged by the party originally committed. The supplier, on the other hand, may take the position that the purchases must be made by the party originally committed to purchase the goods. The supplier may be prompted to take such a position, for example, by a belief that the resale of the goods by the party with whom the countertrade agreement has been concluded would establish a place for the goods in the market or maintain the market image of the goods.

9. The participation of third parties in the fulfilment of countertrade commitments may be subject to mandatory rules. Such rules may impose guidelines as to the acceptability of third parties or require governmental authorization of third-party participation. A frequent reason for such restrictions is the desire to prevent the marketing of the goods in traditional export markets of the State in question.

#### (a) Selection of third party

10. Clauses in the countertrade agreement permitting the engagement of third parties may be formulated in such a way that the party originally committed to purchase goods is free to select the third party. In such clauses it is advisable to provide that notice of the engagement of a third party must be given to the supplier in advance of the purchases by the third party.

11. Sometimes the countertrade agreement limits the freedom of the party originally committed to purchase goods to select the third party. Various types of limitations may be used. For example, the countertrade agreement may name the third party, list acceptable third parties, or stipulate the criteria to be followed in selecting the third party. Where the countertrade agreement names the third party or contains a short list of potential third parties, the countertrade agreement may provide for the selection of another party if the identified third parties are not in a position to purchase the goods.

12. Another way of limiting the freedom to select a third party is to provide that the party originally committed to purchase goods is not permitted to engage a third party without the consent of the supplier. To expedite the designation of the third party, it may be agreed that the supplier will be deemed to have consented to the designation unless an objection is raised within a specified period of time. It is advisable to indicate in the countertrade agreement the type of information about a proposed third party that the party originally committed to purchase is obligated to furnish to the supplier (e.g., financial standing of the proposed third party and type and quantity of goods to be purchased). In order to limit the discretion of the supplier, the countertrade agreement may identify the types of objections that would be acceptable. Such acceptable objections might be, for example, that the proposed third party is already the supplier's trading partner, that the third party is selling goods produced by competitors of the supplier, or that the third party previously has failed to meet an obligation owed to the supplier or has been involved in a dispute with the supplier.

13. The supplier may have various reasons for wishing to limit the freedom of the party originally committed to purchase in the selection of a third party. One category of reasons is aimed at preventing the selection of certain third parties. For example, restrictions may be designed to prevent sales to existing customers from being counted towards fulfilment of the countertrade commitment, to prevent the engagement of persons active in a particular market (e.g., because of existing distributorship agreements in the market or because of rules applicable to trade with that country), or to ensure that goods requiring special precautions in their use are not purchased by parties not trained to handle them. The other category of reasons is aimed at bringing about the selection of certain third parties. For example, a restriction may be designed to obtain the selection of a third party from a particular country or market or of a third party with experience in particular products or markets (e.g., because the supplier wishes to introduce the goods in a market).

14. The parties should bear in mind, however, that a limitation on the purchaser's freedom to select a third party may have disadvantages. For example, the party originally committed to purchase goods might have to factor into the costs of the transaction the risk that the fee charged by the third party in connection with the purchase of the countertrade goods (see paragraphs 28 to 31 below) might be higher than fees charged by other third parties or the risk that the third party will fail to make the purchases. The parties may agree that some of these risks will be assumed by the supplier who insists on the selection of a particular third party. For example, it may be agreed that the liability of the party originally committed under the liquidated damages or penalty clause would be reduced to the amount that that party could recover from the third party.

#### (b) Liability for fulfilment of countertrade commitment

15. It is advisable for the parties to the countertrade agreement to consider the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade

commitment. The answer to that question depends on whether the third party has made a commitment to purchase goods only to the party engaging the third party or whether the third party has also made a commitment to the party who is to supply the goods (see paragraph 5 above).

16. When the third party's commitment is made only to the party originally committed, the party originally committed remains liable to the supplier for its countertrade commitment even though the third party has been engaged. When, however, the third party makes the commitment both to the party originally committed and to the supplier, two approaches with respect to the commitment of the party originally committed may be considered. One approach is to stipulate in the countertrade agreement that the commitment of the party originally committed to purchase is to be maintained; in such a case, both the party originally committed and the third party will be liable to the supplier for the fulfilment of the commitment, and, ultimately, the party originally committed and the third party would settle the question of responsibility between themselves pursuant to their contract. Such an approach might be appropriate where the third party's commitment to the supplier to conclude future purchase contracts is not supported by the same guarantees as is the countertrade commitment of the party originally committed, or where the supplier has had no experience or has had unsatisfactory experience in dealing with the third party. The other approach is to stipulate that, upon the assumption of the commitment by the third party, the party originally committed will be released from the countertrade commitment, leaving only the third party liable to the supplier for the conclusion of future contracts. In order to implement such a substitution of the party liable to the supplier, the parties may agree on a transfer of the countertrade commitment from the party originally committed to the third party. The general contract law of most countries contains rules on transfers of contractual obligations that would be relevant to a transfer of a countertrade commitment. An alternative method of substituting the party liable to the supplier would be for the party originally committed and the supplier to agree to terminate their countertrade commitment at the moment the third party assumes a commitment to conclude future contracts with the supplier. To ensure that the original countertrade commitment is not terminated before the third party's commitment becomes effective, it is advisable to stipulate in the countertrade agreement that the termination would not take effect until the third party's commitment had become effective.

17. As noted in paragraph 20 below, third parties sometimes limit their commitment to a promise to exercise "best efforts" to make the purchases. When the third party is to replace the party originally committed as the party liable to the supplier, it is advisable that the countertrade agreement stipulate that the commitment of the third party to the supplier should be a commitment to actually purchase goods rather than a "best efforts" type of commitment. If the third party were to make only a "best efforts" commitment, the supplier would have limited assurance that the conclusion of the supply contract would take place.

18. Guarantees issued to support fulfilment of countertrade commitments are normally formulated in such a way that they cover only the obligation of the party origi-

nally committed. Therefore, if the supplier wishes to have the third party's commitment secured, it is advisable that the countertrade agreement require that the guarantee be modified or that a new guarantee be issued. It is also advisable that there be an indication of the consequences if the guarantee cannot be modified or an appropriate new guarantee cannot be procured.

## *2. Contractual relationship between party originally committed and third party*

### *(a) Third party's commitment to purchase goods*

19. When the party originally committed to purchase intends to engage a third party to make the purchases, those two parties should reach an understanding as to the type of commitment to be made by the third party.

20. Two types of commitment by third parties to parties originally committed are used in practice. One type is a promise that, subject to the terms of the engagement of the third party, the countertrade goods will actually be purchased. The other type of commitment is a promise by the third party that an effort will be made to purchase goods without an assurance that the effort will be successful. The third party may not be willing to make a full commitment because of uncertainty as to whether an end-user for the goods could be found or whether the purchase price of the goods would be competitive. Such a promise only to make an effort may be described by terms such as "serious intention", "best efforts", or "good-faith efforts" or by a clause to the effect that the third party will purchase the goods if an end-user for the goods can be found. If the third party fails to purchase the goods, it can exonerate itself from the consequences of the failure merely by showing a good faith effort to carry out its mandate. The party originally committed to purchase the goods may find the participation of the third party on a "best efforts" basis acceptable if there is reason to expect that the third party will fulfil the mandate (e.g., because of the third party's record or because the anticipated purchase and resale prices are likely to make the purchase commercially attractive).

21. Sometimes the terms of the contract engaging the third party require the third party to make a commitment directly to the supplier to conclude future contracts (see paragraphs 5 and 15 above).

22. The terms under which the third party is engaged should be coordinated with the terms of the countertrade agreement. The need for coordination exists in particular with respect to the type, quality, quantity and price of the countertrade goods. A problem may arise, for example, if the third party commits itself to purchase goods of a standard quality at a world market price, while the countertrade agreement specifies a different level of quality or price. In such a case, it may occur that the supplier makes available goods that conform to the countertrade agreement but that the third party is justified in refusing to purchase because the goods do not conform to the terms of the contract between the party originally committed and the third party. That would leave the party originally committed to purchase liable to the supplier for non-fulfilment of

the countertrade commitment without the possibility of indemnification from the third party.

23. Furthermore, a problem may arise when the countertrade agreement does not contain an assurance as to the availability of the goods but the third party, relying on its contract with the party originally committed, expects the goods to be made available. When such inconsistency exists, the party engaging the third party may be liable to the third party for a failure on the part of the supplier to make the goods available.

24. When the countertrade agreement and the terms of the engagement of the third party both contain an assurance as to the availability of goods, the party originally committed may be liable to the third party for a failure by the supplier to make the goods available. In such a case, it would be in the interest of the party originally committed to obtain the agreement of the supplier to pay liquidated damages or a penalty or to provide a guarantee to support the assurance of the availability of the goods.

25. It is advisable for the contract by which the third party is engaged to reflect any restriction on the resale of goods set out in the countertrade agreement. Otherwise, the party originally committed to purchase may be liable for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement without the benefit of indemnification from the third party.

26. In some cases, the party originally committed may wish to have an opportunity to make alternative arrangements to fulfil the countertrade commitment in the event that the third party fails to make the necessary purchases. This could be achieved by setting a deadline for purchases to be made by the third party that precedes the deadline for the fulfilment of the countertrade commitment that is binding upon the party originally committed. If the party originally committed wishes to have such an opportunity, it would be advisable, in negotiating the countertrade agreement, to ensure that the fulfilment period is of a sufficient length so as to allow the third party adequate time to make the purchases, as well as to allow the party originally committed to make alternative arrangements should the third party fail to make those purchases.

27. It is advisable to make it clear in the contract for the engagement of the third party whether it is up to the third party to carry out all aspects of the negotiation with the supplier relating to the conclusion of the future contract, or whether the party originally committed to purchase the goods should participate in some way in the conclusion or performance of the contract. It may be provided, for example, that the party originally committed to purchase must approve or at least be informed of a particular aspect of the purchase of the goods (e.g., the price or the destination of the goods).

#### (b) *Third party's fee*

28. In return for the third party's commitment to purchase goods, the party originally committed may have to pay a fee to the third party. A fee is normally required when the price of goods to be purchased by the third party is not

competitive and the resale of the goods would therefore not be profitable to the third party without the payment of a fee. Such a fee is referred to in practice by expressions such as "commission", "*disagio*", "subsidy", "discount", "premium", or "compensation". The amount of the fee would depend in particular on the expected difference between the purchase price and the resale price of the goods. The amount of the fee may also be affected by the cost of any guarantee that the third party would have to procure to cover its liability either to the party originally committed or to the supplier, or to both, for a failure to make the necessary purchases.

29. The fee may be calculated as a percentage of the price of the purchases to be effected by the third party or as an absolute amount per unit or quantity of goods. Sometimes a combination of the two methods is used. If the fee is calculated as a percentage of the price of the goods, it is advisable for the parties to be clear as to the amount on the basis of which the fee is to be calculated (e.g., whether any transport or insurance costs form part of that price).

30. At the time the third party is engaged to conclude the future supply contracts, it may be difficult, due to price fluctuations, to predict the resale price. The parties may therefore provide for a variable fee, to be determined on the basis of the actual difference between the prices, increased by an agreed percentage or amount to cover the third party's costs. Depending upon the underlying commercial circumstances, the parties may wish to consider the possibility that the resale price might rise to a level at which the resale of the goods is profitable for the third party. If this possibility is taken into account, the third party would have to pay an amount to the party originally committed to purchase the goods corresponding to the extent to which the actual resale price increased above the anticipated resale price. Such an amount due from the third party is sometimes referred to as a "negative *disagio*".

31. It is advisable to specify the point of time when the fee becomes due. It may be provided, for example, that the fee becomes due when the third party is engaged, upon the conclusion of the supply contract between the supplier and the third party, upon the opening of a letter of credit on the instructions of the third party in favour of the supplier, or at the time of payment by the third party to the supplier. Sometimes it is agreed that specified percentages of the fee are payable at different points of time. For example, it may be agreed that a certain percentage of the fee is payable upon the engagement of the third party, a certain percentage upon the conclusion of the contract between the third party and the supplier, and the remainder upon payment by the third party for the goods. When the fee is to be paid subsequent to the conclusion of the contract between the party originally committed and the third party, the third party may request a bank guarantee to secure the obligation to pay the fee.

32. It is advisable for the contract engaging the third party to stipulate whether the contractual relationship between the third party and the party originally committed would be affected by a termination or reduction of the countertrade commitment of the party originally committed. A termina-

tion or reduction of the countertrade commitment may result, for example, from the termination of the export contract (see chapter XIII, "Problems in completing countertrade transaction", paragraph \_\_\_\_). The third party may be interested in completing the purchase and earning the fee irrespective of the fate of the countertrade commitment of the party originally committed, particularly when expenses have been incurred in locating an end-user, when an end-user has been promised the goods or when the goods have actually been purchased and resold. The party engaging the third party, on the other hand, may be interested in being able to terminate the engagement of the third party in the event that the countertrade commitment is terminated.

(c) *"Hold-harmless" clause*

33. The party originally committed to purchase goods may be liable to the party to whom that commitment is owed when the third party fails to make the anticipated purchases (see paragraphs 15 and 16 above). A party originally committed to purchase goods engaging a third party may therefore wish to include in its contract with the third party a "hold-harmless" clause. According to such a clause, the third party would have to indemnify the party originally committed to purchase for any liability to the supplier resulting from non-fulfilment of the countertrade commitment for reasons imputable to the third party. The parties may also stipulate that the "hold-harmless" clause would protect the party originally committed to purchase goods in the event of a violation by the third party of a restriction on the resale of the goods set out in the countertrade agreement and reflected in the contract engaging the third party. It may be agreed that the party originally committed to purchase the goods is to give the third party notice when a claim is raised that may result in the third party's liability under the "hold-harmless" clause.

(d) *Exclusivity of third party's mandate*

34. It is advisable for the party originally committed and the third party to indicate in their contract whether the third party is to be the only party engaged or whether the party originally committed reserves the right to engage an additional third party for the purpose of fulfilling the same countertrade commitment. A third party could be given an exclusive mandate with respect to all the purchases to be made in fulfilment of the countertrade commitment or exclusivity could be given only with respect to a particular type of goods, a particular supplier, or a particular territory where the goods are to be purchased or resold.

35. When the third party is given an exclusive mandate, the party originally committed may wish to reserve the right to declare the mandate as non-exclusive if by a specified time before the end of the fulfilment period the third party has not purchased an agreed quantity of goods.

36. When the quantity of goods to be purchased is particularly large, it might be agreed that during a specified period of time the third party is not to be permitted to purchase the same type of goods from other sources. A rationale for such a restriction may be the desire to avoid

a temporary oversupply in the market in which the third party plans to resell the goods, or a desire to compel the third party to concentrate its efforts on the fulfilment of the commitment in question.

C. *Supply of countertrade goods*

37. Sometimes, a party who purchases goods in one direction does not supply goods in the other direction. Instead, one or more third parties are designated to supply the goods. There are two types of transactions in which such an approach may be used. One type is a transaction in which the party purchasing goods in one direction assumes a commitment for the supply of goods in the other direction, but because of difficulties in making the agreed goods available designates a third party to supply the agreed goods. The other type is an indirect offset transaction as described in chapter II, "Scope and terminology of Legal Guide", paragraph 13. In indirect offset transactions it is foreseen at the time of the conclusion of the export contract and of the countertrade agreement that the importer (often a governmental agency) will not counter-export goods and that the party committed to counter-import will have to locate third parties willing to supply goods. Those third parties are normally not bound by any commitment to conclude supply contracts with the counter-importer.

38. In a transaction involving a third-party supplier, payment obligations under the supply contracts in the two directions are often settled independently. Payment in such a manner does not raise issues specific to countertrade. However, issues specific to countertrade do arise when the parties decide to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 61 to 67.

39. When the possibility exists that a third party may be involved in the supply of goods, it is advisable for the countertrade agreement to address the means by which the third-party supplier is to be selected and the consequences of a failure by the third party to make the agreed goods available.

40. Different approaches may be used for the selection of the third-party supplier. One approach is for the countertrade agreement to name the third party. Another approach is for the countertrade agreement to stipulate that the third-party supplier is to be agreed upon at a later date. Yet another approach is to leave the selection of the third-party to one of the parties to the countertrade agreement.

41. It often occurs in offset transactions that the selection of the third-party supplier is left to the party committed to purchase. That selection may be restricted by guidelines established in the countertrade agreement requiring the selection of suppliers from particular geographical regions or industrial sectors, or of suppliers of specific types of products or services. Such guidelines are referred to in chapter VII, "Fulfilment of countertrade commitment," paragraph 7.

42. When the party committed to purchase is to select the third-party supplier, it is advisable to clarify in the

countertrade agreement the effect of a failure by a potential third-party supplier to conclude a supply contract. When the selection is to be made from a large number of potential suppliers, it may be stipulated that the refusal by a potential third-party supplier would not result in a release from the commitment to purchase. When the third-party supplier is to be selected from a list of identified suppliers, it may be agreed that a refusal by all the suppliers on the list to conclude a supply contract in conformity with the terms of the countertrade agreement would release the party committed to purchase from its commitment. (For a further discussion of release from the countertrade commitment, see chapter XIII, "Problems in completing countertrade transaction", paragraphs ———)

43. In some cases, the selection of third-party suppliers is left to the party who has a right under the countertrade agreement to supply goods. This may be the case when the party purchasing goods in one direction does not engage in the sale of goods (e.g., when a government agency purchases goods in an offset transaction), does not have goods of interest to the party committed to purchase, or is uncertain as to whether it will have suitable goods at the time the supply contract is to be concluded and therefore wishes to have the option of designating a third-party supplier.

44. When the selection of the third-party supplier is left to the party who is to supply goods under the countertrade agreement, it is advisable to provide that the third party must be in a position to make available goods that conform to the terms of the countertrade agreement. It is also advisable for the countertrade agreement to be clear as to the consequences of a failure by the third party to make the agreed goods available. It may be agreed that such a failure would release the party committed to purchase from the countertrade commitment to the extent that the third party failed to make goods available, or it may be agreed that a new supplier would be selected. When the obligation of the party originally committed to supply is supported by a liquidated damages or penalty clause, or by a guarantee, it may be agreed that a failure by the third party to make the goods available would entitle the party committed to purchase to payment under the liquidated damages or penalty clause or under the guarantee. Alternatively, an obligation to pay liquidated damages or a penalty in case of a failure to make goods available, or to obtain a guarantee to cover such an eventuality, would be assumed by the third-party supplier.

#### D. Multi-party countertrade

45. There are three types of countertrade transactions that involve more than two parties but are distinct from the transactions covered in sections B and C of this chapter.

46. One type is a tripartite transaction in which a party who supplies goods in one direction does not, at any point in the transaction, make a commitment to purchase goods in the other direction; instead, that commitment to purchase is assumed from the outset by a third party. By contrast, section B covers cases in which a party, after having assumed a commitment to purchase goods, engages a third party to make those purchases. A tripartite structure of this first type may be used, for example, in a buy-back transac-

tion in which the exporter of the production facility does not wish to become involved in the purchase of the resultant products and there is a need, in order to secure financing, to have, at the outset, a third party committed to purchase those products. A tripartite transaction of this type may be initiated through the conclusion by the three parties of an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract for the supply of goods in one direction, while at the same time the third-party purchaser (counter-importer) and the counter-exporter enter into a commitment to conclude a future contract for the supply of goods in the other direction.

47. A second type of multi-party transaction is a tripartite arrangement in which a party who purchases goods in one direction does not, at any point in the transaction, assume a commitment to supply goods in the other direction; instead, a third-party supplier assumes, at the outset, a commitment to supply goods. This type of tripartite transaction is distinct from two types of transactions covered in section C: transactions in which a party, after having assumed a commitment to supply goods, designates a third party to supply those goods, and indirect offset transactions, in which the counter-importer makes a commitment to the importer to negotiate supply contracts with potential suppliers who have not made a commitment to conclude supply contracts with the counter-importer. One contractual approach for this type of tripartite transaction is for the three parties to conclude an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract in one direction simultaneously with the assumption by the third-party purchaser (counter-importer) and the counter-exporter of a commitment to conclude a future contract for the supply of goods in the other direction.

48. In many cases, a feature of the tripartite transactions described in paragraphs 46 and 47 is the linkage of payments for the supply contracts in the two directions. The use of such linked payment mechanisms is discussed in chapter IX, "Payment", paragraphs 61 to 67.

49. In a third type of multi-party transaction, the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties. Such a four-party countertrade transaction may be established when the parties to a contract for the supply of goods in one direction are not themselves in a position to conclude a supply contract in the other direction but are interested in the conclusion of such a supply contract. There may be interest in such an arrangement because the conclusion of the second supply contract would enable the parties to link payments for the contracts in the two directions so as to avoid or reduce cross-border currency transfers (linkage of payments in four-party transactions is discussed in chapter IX, "Payment", paragraphs 61 to 67). Another reason for being interested in such an arrangement may be that the supply of goods in one direction is subject to a mandatory requirement of a purchase of goods in the other direction.

[A/CN.9/WG.IV/WP.51/Add.2]

## X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS

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## A. General remarks

1. Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of all or of a portion of the goods purchased pursuant to the countertrade commitment. The agreed restrictions may, for example, limit the territory where the purchaser may resell goods, set a minimum resale price, or prescribe packaging and marking of goods to be resold. Such restrictions may be applied to the resale of the goods within the country of the purchaser or to the re-export of the goods. A countertrade agreement or supply contract may contain a combination of different types of resale restrictions.

2. Resale restrictions of this type are not particular to countertrade transactions. However, such restrictions are dealt with in the legal guide because they may take on a special importance in countertrade. Resale restrictions may be part of the strategy of a supplier of countertrade goods or of a government that has mandated countertrade when the purpose of requiring the countertrade commitment was to increase the volume of exports to a particular market or to develop new markets for the goods without affecting adversely existing markets for those goods.

3. The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Such mandatory rules may be set forth in a statute, and in various types of administrative regulations. The mandatory rules of more than one country may apply. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices. For example, many legal systems provide that agreements restricting the right of resale are prohibited or may be invalidated if the supplier imposing the restriction has a dominant market position, if the restriction has the effect of limiting access to markets or otherwise unduly restraining competition or if the restriction has or may have other adverse effects on trade or

economic development. Agreements setting a minimum price are prohibited outright in some legal systems. In other legal systems, minimum price agreements may be permitted only for certain types of goods (e.g., brand-name or luxury goods) or if specified conditions are met (e.g., the price-setting agreement is approved by the competent authority or it is shown that buyers have sufficient possibility to obtain the same or similar goods at prices not subject to a price-setting agreement).

4. In negotiating a restriction on the resale of countertrade goods the parties should be aware that such a restriction may lower the price that the countertrade party purchasing and reselling countertrade goods will be able to offer to the countertrade party supplying the goods. Such is likely to be the effect of a clause prohibiting the resale of the goods in the most attractive market, or of a clause requiring resale terms that result in additional costs to the party reselling the goods.

5. When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction. Absent a provision in the countertrade agreement on resale restrictions, a demand that the purchase of countertrade goods be subject to a resale restriction may complicate negotiation of a supply contract and may make it difficult to attribute to one of the parties responsibility for a failure to conclude a supply contract. When it is possible that a third party will be engaged to make the purchases necessary to fulfil the countertrade commitment, the supplier may wish to ensure that the third party is aware that the purchases made by the third party will be subject to that restriction (see paragraphs 22 and 23 below).

6. The degree to which the countertrade agreement can be specific depends on factors such as whether the type of goods to be purchased has been identified, the nature of the restriction, or the length of time during which the supply contracts will be concluded, and the possibility of third parties being involved in the resale of the goods. In some cases it may be possible to formulate in the countertrade agreement the resale restriction clause that would apply to all purchases made pursuant to the countertrade agreement.

In other cases the supplier may not have the necessary information at the time of the conclusion of the countertrade agreement to determine whether a resale restriction would be desirable, but would not wish to be precluded from raising the question of resale restrictions at a later stage. In such cases, the countertrade agreement may identify only the type or commercial purpose of a resale restriction being contemplated. For example, it may be agreed that the parties would negotiate a limitation of the territories in which the purchaser is permitted to resell goods in order to avoid sales of the goods in the supplier's existing markets.

7. In some exceptional circumstances, the countertrade agreement may contain a stipulation that the purchaser may only use the goods in-house and may not resell them. Such a restriction may be imposed, for example, when the goods are supplied on preferential terms (e.g., in order to help the purchaser in a hardship situation) or when the supplier is under an obligation to restrict distribution of the goods because of their particularly sensitive nature or when the resale of the goods would entail disclosure of information that the supplier wishes to keep under its control.

#### **B. Duty to inform or consult**

8. The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods. Information of this kind may be useful to the supplier in monitoring compliance with resale restrictions binding upon the purchaser, in determining whether resale of the goods by the purchaser is achieving the goal of introducing the goods into new markets, in deciding whether to continue to offer those goods in countertrade transactions, in deciding whether the goal of opening new markets or the goal of increasing sales in traditional markets would be served by engaging in further countertrade transactions with the purchaser, or in planning its own marketing or production of the same or similar type of goods. Such an obligation to inform may be agreed upon also when the parties do not agree on a specific resale restriction because the type of goods to be purchased has not been specified at the time of the conclusion of the countertrade agreement.

9. The countertrade agreement should be clear as to whether an obligation to inform or consult is limited to giving information or is intended to provide an opportunity for consultations between the purchaser and the supplier prior to the resale. It is advisable to stipulate the point of time when the supplier is to be informed. If the parties intend to allow for consultations prior to resale, it should be made clear that the purchaser must inform the supplier in sufficient time to allow consultations to take place.

#### **C. Territorial and related restrictions**

10. The parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods under the countertrade agreement may

resell the goods. A territorial restriction may be based on the supplier's desire, for example, to generate sales in new markets, to protect the supplier's existing markets, to ensure that the goods comply with the rules applicable in the markets in which they are to be resold, or to avoid violating restrictions arising from patents held by third persons or from licensing arrangements between third persons and the supplier for technology used to produce the countertrade goods. A further reason may be to prevent interference with exclusive distributorships granted by the party supplying goods under the countertrade agreement. If the supplier has granted an exclusive distributorship in a particular territory, it is inherent in such an arrangement that the supplier would be under a duty not to enter into contractual arrangements that undermine the exclusive distributorship. Sometimes exclusive distributorship agreements provide that the exclusive distributor is entitled to a commission if goods in question are sold in the restricted territory. In such cases the parties to the countertrade agreement might require the purchaser to pay a commission to the exclusive distributor.

11. Identification of the territories where the goods may be resold can be done either by specifying the territories where the goods are not permitted to be resold or by specifying those territories where the goods are permitted to be resold. A provision specifying territories where the goods may be resold should make clear that resale is prohibited in territories that are not listed. The parties should pay attention to the need to use precise terminology. General expressions such as "Caribbean States", "Latin America", "Pacific region", or "Western Europe" may be interpreted differently and therefore may be inadequate. The territory in which the goods are permitted to be resold may also be limited to those territories in which after-sale service is available either from the purchaser or some other source. In drafting clauses concerning territories of resale, the parties should bear in mind that the right to resell in particular territories is distinct from the question whether the right to resell in those territories is exclusive or non-exclusive.

12. In some cases, the countertrade agreement may provide that only a specified quantity of goods is permitted to be resold in particular territories or that only a specified quantity of goods is permitted to be resold without restriction as to territory. Such an approach may be motivated, for example, by the existence of governmental import quotas, by a desire to avoid oversupply in existing markets or by a desire to introduce the goods into new markets.

13. When the countertrade transaction is likely to result in the resale of goods in markets in which the supplier usually does not sell, the supplier may wish to permit the resale of the goods only in territories in which the goods are covered by product liability insurance for claims arising from personal injury or property damage caused by the goods. It may be agreed that the party purchasing the goods under the countertrade agreement and reselling them is to obtain the insurance. Such insurance may be in the interest of the supplier because claims for damage resulting from the use of the goods may be made against the supplier. A clause permitting the resale of the goods only in territories in which the goods are covered by product liability insurance may be considered in particular when the products pur-

chased under the countertrade transaction are to be resold in a market where the standard of liability or the level of compensation awarded under product liability laws is considerably higher than in the markets in which the products are traditionally sold.

14. Suppliers sometimes prohibit purchasers from selling to particular customers or classes of customers. Such restrictions may be motivated by a desire on the part of the supplier to retain certain customers for itself (e.g., bulk buyers). An aim of this type of restriction may be to prevent competition in the supply of the goods that might result in a lowering of the price. It should be noted that such resale restrictions may violate mandatory rules mentioned in paragraph 3 above, prohibiting certain types of restrictive business practices. Another possible motivation for such restrictions may be the prevention of resale of goods of a sensitive or hazardous nature to certain buyers.

15. The parties sometimes agree that the resale of goods requires the consent of the supplier. This approach might be taken, for example, when the nature of the goods requires a restriction on their transfer (e.g., hazardous substances or equipment whose use requires special training) or when the supplier contemplates granting exclusive distribution rights in the future and therefore wishes to retain the right to restrict the resale of the goods by the purchaser once those distributorships have been granted. The requirement of consent may be limited to specified territories or to specified classes of customers. The exercise by the supplier of the right to withhold consent may be made subject to objective criteria. It may be agreed, for example, that consent may be withheld only where the goods are to be resold in a market in which an exclusive distributorship has been established, or where existing sales of the goods in question by the supplier or its distributors have reached a specified threshold.

#### D. Resale price

16. Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. As pointed out in paragraph 3 above, the parties should bear in mind that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is permitted only in limited circumstances.

17. The supplier may wish to set a minimum resale price when the goods to be supplied pursuant to the countertrade agreement are of such a quantity that their resale might destabilize or depress the price for goods of that type. While in many countertrade transactions the quantities of goods involved are such that they would not adversely affect the market price, there are countertrade transactions that result in an abrupt and large increase in the supply of goods of a particular type and that may therefore cause price instability. Minimum resale prices may also be intended to prevent sales at discount prices that might harm the image of a product.

18. A minimum resale price may be stipulated in the countertrade agreement or it may be agreed that a minimum resale price is to be set at a time subsequent to the

conclusion of the countertrade agreement (e.g., at the time of the conclusion of the supply contract or after a specified volume of the goods have been resold). In the case of a long-term countertrade transaction, the parties may agree that a minimum resale price is to be set periodically. The countertrade agreement should be clear as to the charges and costs that are to form part of the stipulated minimum resale price (e.g., transportation costs, insurance premiums, or taxes). If the minimum price is to be set subsequent to the conclusion of the countertrade agreement, the parties may wish to link the determination of the minimum to an objective standard of the type used in setting a price for the goods as between the parties to the countertrade agreement. Such standards include the price quoted in a market of goods of the type in question, competitor's price or the price charged to the supplier's most favoured customer (see chapter VI, "Pricing of goods", paragraphs 11 to 20).

19. The parties may not wish to set a specific minimum resale price in the countertrade agreement when the goods are of a standardized quality, such as commodities, that are sold in public markets because of the possibility that the market price may fall below a specific minimum resale price set in the countertrade agreement. A purchaser bound by a minimum resale price higher than the market price would find it difficult or impossible to resell the goods. In order to avoid such difficulties, the parties may wish to provide that the minimum resale price is to track movements in the market price for the goods in question. This could be done by linking the determination of the minimum price to objective standards of the type referred to in the preceding paragraph.

#### E. Packaging and marking

20. The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. Such requirements may obligate the purchaser to repackage or re-mark the goods or to resell the goods with their original packaging or marking. The question of packaging and marking may be important because a goal of many countertrade transactions is to introduce goods in non-traditional markets. The packaging and marking of the goods may be intended to affect the marketability of the goods in those markets, or to comply with legal rules governing packaging and marking. For example, the countertrade agreement may require that the goods be sold under the supplier's trade name, that the goods be sold in a particular form of packaging, that the packaging list the ingredients and composition of the goods, that the packaging indicate the origin of the goods, or that packaging include instructions for use and that the instructions be in a particular form.

21. The parties should ensure that any packaging or marking requirements in the countertrade agreement do not conflict with legal rules applicable where the goods are to be resold. Even when the countertrade agreement does not prescribe repackaging or re-marking, the purchaser may have to repackage or re-mark the goods when packaging and marking of the goods by the supplier do not conform to the rules applicable in the country where the goods are to be resold.

## F. Application to third-party purchasers

22. When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in seeing that a resale restriction stipulated in the countertrade agreement will be observed by the third party. For that purpose, the supplier may wish to include in the countertrade agreement a provision obligating the party originally committed to purchase goods to incorporate the resale restriction in the contract through which the party originally committed engages the third party. Furthermore, it is advisable that the supplier include that resale restriction in the supply contract concluded with the third party or in the agreement with the third party by which the third party makes a commitment to the supplier to conclude a future supply contract (see chapter VIII, "Participation of third parties", paragraphs 15 and 16). In this way the third party would be responsible directly to the supplier for compliance with the resale restriction.

23. As noted in chapter VIII, "Participation of third parties", paragraph 25, the party originally committed to purchase may be liable under the countertrade agreement for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement. Therefore, the party originally committed would itself have an interest in reflecting in the contract with the third party any resale restriction set out in the countertrade agreement. Furthermore, the party originally committed to purchase goods may wish to include in its contract with the third party a

"hold-harmless" clause committing the third party to indemnify the party originally committed to purchase for any liability to the supplier resulting from a violation by the third party of a resale restriction (for a discussion of "hold-harmless" clauses, see chapter VIII, paragraph 33).

## G. Review of restrictions

24. Large-scale countertrade transactions often involve purchase and resale of goods over a long period of time during which the underlying commercial circumstances and interests of the parties may change significantly. The possibility of such changes may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions. A periodic review or a review upon the request of a party may be agreed upon. When the review is to be upon the request of a party, the countertrade agreement may identify the types of changes in the underlying circumstances that would entitle a party to a review.

25. The extent to which a review procedure is advisable would depend upon the nature of the resale restriction in question. For example, a restriction as to the territory or price of resale linked to a particular type of goods may entail a greater need for possible future modification than a restriction of a less stringent sort such as a requirement that the purchaser consult with the supplier prior to reselling the goods.

[A/CN.9/WG.IV/WP.51/Add.3]

# XL. LIQUIDATED DAMAGES AND PENALTY CLAUSES

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### A. General remarks

1. Liquidated damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties establish their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or both.<sup>1</sup>

<sup>1</sup>Studies on the nature and operation of liquidated damages and penalty clauses in international contracts are contained in *Yearbook of the United*

*Nations Commission on International Trade Law, volume X: 1979, part two, I, C, and ibid., volume XII: 1981, part two, I, B, 1. "Uniform Rules on Contract Clauses for an Agreed Sum due upon Failure of Performance" (hereinafter referred to as "Uniform Rules") adopted by the Commission are set forth in the Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, annex 1 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law, volume XIV: 1983, part one, I, A*). By its resolution A/RES/38/135 of 19 December 1983, the General Assembly recommended that States should, where appropriate, implement the Uniform Rules in the form of either a model law or a convention. The Uniform Rules may be used to assist in resolving certain issues that arise in regard to liquidated damages and penalty clauses.*

2. This chapter focuses on liquidated damages and penalty clauses included in countertrade agreements to cover a failure to fulfil the countertrade commitment. Such a failure may take the form of non-fulfilment or delayed fulfilment of the countertrade commitment. This chapter does not address directly the use of liquidated damages or penalty clauses to support performance of supply contracts that form part of a countertrade transaction. Liquidated damages and penalty clauses are frequently used in sales contracts and other types of supply contracts, and the presence of such clauses in supply contracts that form part of a countertrade transaction does not raise issues specific to countertrade. Nevertheless, the discussion in this chapter of the general characteristics of liquidated damages and penalty clauses is relevant to the use of such clauses in supply contracts.

3. Since liquidated damages or penalty clauses in countertrade agreements stipulate that the agreed sum is payable in case of a failure to fulfil the countertrade commitment, the obligation to pay the agreed sum is determined with reference to the provisions in the countertrade agreement stipulating the actions that must be taken in order to fulfil the countertrade commitment. For example, if the countertrade agreement provides that the countertrade commitment is to be deemed fulfilled upon the conclusion of a supply contract, failure to conclude the supply contract will result in liability under the liquidated damages or penalty clause in the countertrade agreement. If the countertrade commitment is to be fulfilled upon payment for the supply contract, failure to pay for the supply contract will result in liability under the liquidated damages or penalty clause in the countertrade agreement. (Concerning clauses in the countertrade agreement stipulating actions that must be taken in order to fulfil the countertrade commitment, see chapter VII, "Fulfilment of countertrade commitment", paragraphs 10 and 11.)

4. The purchaser's commitment to purchase goods may be covered by a liquidated damages or penalty clause in the countertrade agreement, as may be the supplier's commitment to make goods available. In many countertrade transactions it is only the party who has exported and is committed to counter-import whose commitment is covered by such a clause. That is because that party may be primarily interested in exporting its own goods and may not have the same degree of interest in purchasing goods in return. However, when the party committed to purchase has a particular interest in obtaining the goods, it may be agreed that the party committed to supply the goods would pay an agreed sum in the event that the party committed to supply fails to conclude a supply contract. When both the party committed to purchase and the party committed to supply have a strong interest in the future conclusion of a supply contract, it may be agreed that the commitments of both parties are to be subject to a liquidated damages or penalty clause.

5. Agreement on a sum to be paid upon a failure to fulfil the countertrade commitment has certain advantages. Firstly, the sum constitutes agreed compensation for such a failure, thereby allowing the parties to avoid the difficulties and expenses that might be involved in proving the extent

of resulting losses. Those expenses might be considerable, especially if the aggrieved party had to establish the losses in judicial or arbitral proceedings. Furthermore, the amount of damages that might be awarded in judicial or arbitral proceedings may be uncertain (see chapter XIII, "Failure to complete countertrade transaction", paragraphs 12 and 13). An agreed sum is certain, and this certainty may be of benefit to both parties in assessing the risks to which they are subject under the countertrade agreement. Secondly, the agreed sum may serve as the limit to the liability for a failure to fulfil the countertrade commitment. The party whose commitment is covered by the clause is assisted by knowing in advance the maximum liability likely to be incurred in the event of its failure to fulfil the countertrade commitment (see, however, the discussion in paragraph 11, below, as to the possibility of a claim for damages in excess of the agreed sum).

6. Many legal systems have rules regulating liquidated damages and penalty clauses, and those rules will often restrict what the parties may achieve through those clauses. Under some legal systems, clauses fixing an agreed sum to stimulate performance are invalid, and the party who fails to perform is liable only for the damages recoverable under the general law. Those legal systems recognize only clauses by which the parties, at the time of contracting, fix an agreed sum payable as compensation for losses caused by a failure to perform. Under other legal systems, however, clauses fixing an agreed sum payable as compensation, or fixing an agreed sum to stimulate performance, or fixing a sum which has both those purposes, are in principle valid. The courts may have the power to reduce the agreed sum in specified circumstances, in particular if the amount is grossly excessive in the circumstances or if there has been part performance. The courts may also have the power to award additional damages when the actual damages exceed the agreed sum. In those legal systems the parties may not be permitted to derogate from the power of the court to reduce the agreed sum or to award additional damages.

7. A committed party may fail to fulfil its countertrade commitment due to a permanent or temporary impediment for which it is not responsible (for a discussion of such impediments, see chapter XIII, "Failure to complete countertrade transaction", paragraphs 14 to 37). The rule in many legal systems is that the agreed sum is not due if the failure to perform the obligation in question is caused by a permanent impediment for which the obligated party is not responsible. Such an approach is followed in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79 (see also Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance, article 5 (see note 1)). If an impediment prevents performance of an obligation only temporarily, according to a rule found in many legal systems, the time period for performance of the obligation is extended. In the case of temporary impediments, payment under the liquidated damages or penalty clause would be due only for the countertrade commitment remaining unfulfilled after the lapse of the extended fulfilment period. The countertrade agreement may maintain the applicability of those rules and may contain provisions defining exempting impediments and providing a rule for determining when an impediment is

deemed permanent (see chapter XIII, "Failure to complete countertrade transaction", paragraphs 18 to 35).

8. Liquidated damages or penalty clauses should be distinguished from two other types of clauses, i.e. clauses limiting the amount recoverable as damages, and clauses providing alternative obligations. A clause limiting the amount recoverable as damages fixes a maximum amount payable if liability is proved. A plaintiff must prove the amount of its losses, and, if the amount falls below the maximum, only the amount proved is recoverable. In the case of liquidated damages or penalty clauses, the agreed sum is recoverable without proof of loss. A clause providing an alternative obligation gives the obligated party the option either of performing a specified obligation or paying an agreed sum. By exercising either option, the obligated party discharges the obligation. Under liquidated damages or penalty clauses in countertrade agreements, the parties do not usually intend that the committed party has the option of paying the agreed sum in place of fulfilling the countertrade commitment. If there is any doubt as to whether the committed party would have such an option, it is advisable that the question be settled in the clause.

9. Clauses discussed in this chapter should also be distinguished from provisions in countertrade agreements establishing the obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing claims for payment are to be set off. Such payments to liquidate imbalances serve the function of payment for goods delivered in one direction that were not compensated by deliveries in the other direction. Furthermore, the amounts of such payments are not set in advance as is the case with liquidated damages or penalties. (For a discussion of clauses concerning the settlement of imbalances in barter, see chapter III, "Contracting approach", paragraph 6, and in setoff arrangements, see chapter IX, "Payment", paragraphs 50 to 52.)

10. As discussed in chapter VIII, "Participation of third parties", the countertrade party committed to purchase or to supply goods may have the right to engage a third party to fulfil that commitment. In some of those cases, it is agreed that the party originally committed is to remain liable for fulfilment of the countertrade commitment. When this is the case, the contract by which the third party is engaged may provide that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods. The purpose of payment of the agreed sum would be to indemnify the party originally committed for its liability for non-fulfilment of the countertrade commitment due to reasons imputable to the third party. The indemnification by the third party of the party originally committed could also take the form of a "hold-harmless" clause of the type discussed in chapter VIII, paragraph 33. Any commitment to conclude future supply contracts that is made by the third party directly to the countertrade party with whom those supply contracts are to be concluded may also be covered by a liquidated damages or penalty clause. (For a related discussion of the engagement of third parties, see chapter VIII, "Participation of third parties", paragraphs 5, 15 and 16 (third-party purchasers), and paragraph 44 (third-party suppliers).)

## B. Relationship of recovery of agreed sum to recovery of damages

11. Legal systems often regulate the relationship between the recovery of the agreed sum and the recovery of damages. Since one of the objectives of a liquidated damages or penalty clause is to avoid the difficulties of an inquiry into the extent of recoverable damages (see paragraph 5 above), under some legal systems the party to whom the agreed sum is owed is not permitted, in cases where recoverable damages under the rules relating to damages exceed the agreed sum, to waive the agreed sum and claim damages. Nor is the party owing the agreed sum permitted, in cases where the amount recoverable as damages is less than the agreed sum, to assert that that party should only be liable for damages. Under other legal systems, however, the party to whom the agreed sum is owed is permitted to prove that the losses exceed the agreed sum. In those legal systems the aggrieved party can, in addition to the agreed sum, recover damages to the extent that the loss exceeds the agreed sum, either unconditionally or subject to satisfying certain conditions (for example, that the failure of performance was negligent, or was committed with an intention to cause loss, or that there was an express agreement that damages for the excess are to be recoverable). In view of such disparities among legal systems, and the differing perspectives from which a liquidated damages clause may be interpreted, it is advisable that the parties, to the extent permitted by the applicable law, settle in the clause the question whether the aggrieved party would be entitled to any damages beyond the agreed sum (Uniform Rules, article 7 (see note 1)). (For further discussion of monetary compensation for failure to fulfil the countertrade commitment, see chapter XIII, "Failure to complete countertrade transaction", paragraphs 12 and 13.)

## C. Effect of payment

12. An important question for the parties to consider is whether the payment of the agreed sum has the effect of releasing the obligated party from the countertrade commitment. Often the intention of the parties is that payment of the agreed sum terminates the countertrade commitment. However, since sometimes the parties intend that the agreed sum is to be payable for delay in fulfilment of the countertrade commitment and that the obligated party is not to be released from the countertrade commitment upon payment of the agreed sum, it is advisable for the liquidated damages or penalty clause to contain a clear provision on the effect of payment of the agreed sum. Absent such a provision, the effect of payment would be determined by the applicable law. In some legal systems, absent an express provision by the parties on the effect of payment, a determination of the effect of payment may be made on the basis of circumstances that indicate the intent of the parties (e.g., the amount of the agreed sum) (Uniform Rules, article 6 (see note 1)).

13. The parties may wish to provide for payment of an agreed sum for delay when it is particularly important for the countertrade commitment to be fulfilled by a specified date or for portions of the countertrade commitment to be fulfilled according to an agreed time schedule. The supplier

may be interested in such a clause, for example, when the timely fulfilment of the countertrade commitment in one direction is essential for its ability to meet its payment obligations under the supply contract in the other direction. The purchaser may be interested in such a clause, for example, when a commitment has been made to resell the goods by a particular date. (Concerning the amount of the agreed sum payable for delay, see paragraphs 18 and 19 below.)

14. The question of the effect of payment of an agreed sum would also arise when payment is due for a failure to fulfil the portion of a countertrade commitment allocated to a subperiod of the fulfilment period. In such cases it is advisable to make clear whether any payment is due under the liquidated damages or penalty clause for any unfulfilled portion of the countertrade commitment that is not carried over or that remains unfulfilled upon the expiry of the overall fulfilment period, or whether any payment is due for any unfulfilled portion of the countertrade commitment that is carried over from one subperiod to the next.

#### D. Amount of agreed sum

15. The amount of the liquidated damages or penalty may be expressed as an absolute amount or as a percentage of the value of the outstanding commitment. Calculating the amount on the basis of a percentage of the outstanding commitment has the advantage of automatically reducing the amount as the countertrade commitment is fulfilled. If there is a guarantee to secure payment of the agreed sum (see paragraph 23 below), it is advisable for the terms of the guarantee to provide that any reduction in the amount of the agreed sum is to result in a corresponding reduction in the amount of the guarantee (see chapter XII, "Security for performance", paragraphs 23 and 24).

16. Determining the appropriate amount for the agreed sum presents certain difficulties. In a long-term countertrade transaction, it may be difficult to estimate at the time of the conclusion of the countertrade agreement the losses that may be suffered at the time of a breach of the countertrade commitment, and accordingly it may be difficult to quantify the amount of the agreed sum that would make it either truly compensatory, or adequate to stimulate performance. From the point of view of the beneficiary of the liquidated damages or penalty clause, the agreed sum should not be fixed at such a low level that the beneficiary will suffer serious uncompensated losses upon a failure of the other party to fulfil the countertrade commitment. Furthermore, a sum that is less than what the obligated party would save by failing to fulfil the countertrade commitment would not serve as a stimulus to fulfil properly and on time. Indeed, it may serve as a stimulus not to do so.

17. In setting the amount of the agreed sum, the parties should bear in mind that the amount of the agreed sum is likely to be viewed by a court as an important factor in determining whether the obligation to pay the agreed sum is intended to compensate for damages or to stimulate performance (see paragraph 6 above).

18. If the applicable law so permits, the beneficiary of the liquidated damages or penalty clause may find it useful for the countertrade agreement to fix an agreed sum at an amount that provides both reasonable compensation and a moderate pressure to fulfil the commitment. In determining what sum is reasonable, parties may consider such factors as the price the supplier would obtain in a substitute sale, the price the purchaser would have to pay in a substitute purchase, losses that might result from non-fulfilment of the countertrade commitment, the extent of the risk that the countertrade commitment will remain unfulfilled and the fact that the sum should be substantial enough to induce performance. Excessive sums should be avoided, as they may deter some potential trading partners from entering into a countertrade agreement. Excessive sums may also make it more difficult to find a third party willing to become involved in the fulfilment of the countertrade commitment subject to a "hold-harmless" clause (see paragraph 10 above, as well as chapter VIII, "Participation of third parties", paragraph 33). An excessive sum may also have no special deterrent effect if it can be predicted that in all likelihood it will be declared invalid or reduced in legal proceedings (see paragraph 6 above). Furthermore, a party committed to purchase goods and requested to accept an agreed sum set at a particularly high level may as a counterbalance seek a lower price for the goods that party is to purchase, or that party may seek a higher sale price for its own goods. Where the applicable law permits an agreed sum to serve only as compensation, parties should attempt to estimate as accurately as possible the losses the purchaser is likely to suffer. Any records relating to the basis of the estimate and the calculations should be preserved as evidence that the sum was not fixed arbitrarily. In addition, the parties may wish to include a statement in the countertrade agreement that the amount set in the clause represents a good faith estimate of the damages that would be suffered as a result of non-fulfilment of the countertrade commitment.

19. When the clause for the payment of liquidated damages or a penalty covers delay, an agreed sum to be paid is often fixed by way of increments, a specified amount being due for a specified time unit of delay. In such cases it is advisable that a limit be placed on the cumulative amount of the increments. The parties may wish to address the possibility that the failure to fulfil the commitment would continue after the limit is reached. One approach would be to provide that the beneficiary of the liquidated damages or penalty clause is not entitled to recover either further increments in the liquidated damages or penalty, or damages for losses suffered as a result of non-fulfilment of the countertrade commitment after the date on which the limit was reached. Under another approach, after the limit is reached, the beneficiary of the liquidated damages or penalty clause is still entitled to claim fulfilment of the commitment. In this case the parties may agree that if the committed party fails to fulfil the countertrade commitment within an agreed period after the cumulative limit has been reached, the beneficiary of the liquidated damages or penalty clause is entitled to claim an additional agreed sum for non-fulfilment of the commitment. Under either approach it is advisable to provide that the beneficiary of the liquidated damages or penalty clause is entitled to terminate the countertrade commitment once the cumulative amount of the payments for delay is reached.

### E. Obtaining agreed sum

20. The parties may wish to provide that the aggrieved party loses the right to claim the agreed sum if a claim is not made within a specified period of time following the expiry of the fulfilment period (e.g., thirty days). The purpose of such a provision is to resolve questions of liability for non-fulfilment of the countertrade commitment within a reasonable period of time following the expiry of the fulfilment period. The period of time for making a demand should be sufficient to permit the parties to determine whether fulfilment of the countertrade commitment has taken place. This would be of particular importance where actions fulfilling the countertrade commitment might be taken shortly before the close of the fulfilment period or where supply contracts are to be concluded with persons other than the party to whom the commitment is owed.

21. In the case of a fulfilment period divided into subperiods, it is advisable that the countertrade agreement indicate whether payment of the agreed sum is due following each subperiod in which there has been a failure to fulfil or only at the end of the entire fulfilment period. If payment is due following each subperiod, a period of time following the expiry of each subperiod could be provided during which payment of the agreed sum could be claimed (see the preceding paragraph).

22. Legal proceedings that might be necessary to recover the agreed sum often entail time and expense. The need to institute legal proceedings may be reduced if the countertrade agreement authorizes the beneficiary to deduct the agreed sum from funds of the other party in the hands of the beneficiary or from funds due by the beneficiary to that party. For example, when it is agreed that the proceeds of the export contract are to be held to pay for the counter-export contract, it may be agreed that the counter-exporter may withhold an amount equivalent to the agreed sum if the counter-importer fails to honour its commitment to enter into a contract for the purchase of counter-export goods (see chapter IX, "Payment", paragraphs 9 and 57). Where the beneficiary of the liquidated damages or penalty clause does not retain the proceeds of a shipment in such a manner, the objective of securing payment of the agreed

sum may be achieved by authorizing deduction from funds or claims that are unrelated to the countertrade transaction in question. It may be noted, however, that under some legal systems provisions authorizing deductions are regulated by mandatory rules. Furthermore, a deduction might later be invalidated if the agreed sum deducted was later held by a court to be excessive, and was reduced.

23. The beneficiary of the liquidated damages or penalty clause may wish to include a provision in the countertrade agreement requiring the other party to arrange for a financial institution to give a guarantee in respect of the agreed sum. The beneficiary could then claim the agreed sum from the financial institution according to the terms of the guarantee (possible terms of a guarantee securing payment of the agreed sum are discussed in chapter XII, "Security for performance").

### F. Termination of countertrade commitment and clauses for payment of agreed sum

24. Parties may wish to provide that, where an agreed sum for delay is payable by way of increments with a limit on the cumulative amount recoverable (see paragraph 19 above), the countertrade commitment may not be terminated until the limit is reached on the ground of the failure to fulfil for which the agreed sum is provided.

25. The parties may also wish to provide that termination after the limit is reached is not to affect any obligations to pay liquidated damages or penalties that became due prior to the termination. This would avoid the ambiguity that may result due to the rule in some legal systems that the termination of a contract affects obligations that became due prior to the termination of the contract. If, however, the countertrade commitment is terminated before the limit is reached (e.g., when the beneficiary of the liquidated damages or penalty clause terminates the countertrade commitment for a failure other than the one for which the agreed sum has been stipulated), the parties may wish to provide that the termination does not affect the right to recover an agreed sum due on the date of termination, but that no amount becomes due as the payment of an agreed sum after the termination.

[A/CN.9/WG.IV/WP.51/Add.4]

## XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION\*

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\*A different title is used in the present addendum for draft chapter XIII than was used in the proposed structure of the legal guide (A/CN.9/WG.IV/WP.51, para. 9) and in some other draft chapters.

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#### A. General remarks

1. This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). It also discusses circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (section D). A further issue discussed in the present chapter is the effect of a failure to fulfil the countertrade commitment or of the failure to perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section E). Not discussed are remedies for non-performance of a supply contract concluded pursuant to the countertrade agreement, since such remedies are of a type available under contract law generally and therefore do not raise issues specific to countertrade.

2. Failure by a party to fulfil its obligations under the countertrade transaction could have serious repercussions for the other party. The repercussions may be, for example, that a prospective supplier will not earn convertible funds planned to be used for purchase of other goods, that a prospective supplier will be hampered in carrying out its plan to introduce countertrade goods into new markets, or that a prospective purchaser will not receive goods to be resold in order to pay for goods shipped in the other direction.

3. It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National legal systems generally do not contain rules specifically tailored to countertrade, and general rules applicable to contractual obligations may not provide satisfactory answers when problems occur in fulfilling the countertrade commitment. The remedies that the parties might wish to address in the countertrade agreement include release from the countertrade commitment and liquidated damages or a penalty (see paragraphs 5 to 13 below). It is also advisable that the countertrade agreement define

the circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (see paragraphs 14 to 37 below).

4. The remedies for non-fulfilment of the countertrade commitment that the parties have decided to include in a countertrade agreement may not be appropriate in every circumstance. Therefore, while a party has the right to insist upon the remedies set forth in the countertrade agreement, the parties may find it desirable to negotiate in the light of the available remedies before resorting to the procedures available to enforce them (see discussion on negotiation in chapter XV, "Settlement of disputes", paragraphs — to —).

#### B. Release from part or all of countertrade commitment

5. There are different circumstances in which a party may be released from its obligations under the countertrade commitment. Such a release can result from a payment of liquidated damages or a penalty stipulated in the countertrade agreement for non-fulfilment of the countertrade commitment (see paragraph 10 below, as well as chapter XI, "Liquidated damages and penalty clauses", paragraph —). A release of a party may also result when an action or omission by the other party causes the failure to fulfil the commitment (see paragraph 6 below). A further ground for a release may be the occurrence of circumstances that the applicable law or the countertrade agreement defines as exempting impediments (see paragraphs 14 to 37 below). Yet another situation in which a party may be released is when the supply contract in the other direction is terminated (see paragraph 48 below). A party may be released from all of the unfulfilled countertrade commitment or from only a portion thereof. If the circumstances that give rise to the release affect only a portion of the unfulfilled countertrade commitment, the remaining portion of the countertrade commitment remains in effect.

6. The parties may wish to agree that, if the party committed to supply breaches its obligation to make available a portion or all of the goods in accordance with the terms of the countertrade agreement, the party committed to purchase is released from an equivalent portion or all of the countertrade commitment. Similarly, the parties may wish to agree that, if the party committed to purchase breaches its obligation to purchase a portion or all of the goods made available in accordance with the terms of the countertrade agreement, the party committed to supply is released from an equivalent portion or all of the countertrade commitment. When the parties so agree, they may wish to establish a notice requirement. Such a requirement might specify that the aggrieved party has to deliver a notice to the party in breach specifying the breach and informing the party in breach that the aggrieved party would be released from its obligations under the countertrade commitment to the extent that the breach was not remedied within a period of time specified in the notice or in the countertrade agreement. The period of time should be of a sufficient length to allow the remedying of the breach. The parties may wish to provide that the period of time commences to run from the date of the delivery of the notice. The parties may wish to consider whether it would be desirable to provide that, for the release to take effect, a second written notice would have to be delivered by the party claiming release.

7. Sometimes the countertrade agreement sets subperiods within the fulfilment period in which specified portions of the countertrade commitment must be fulfilled (for a discussion of such subperiods, see chapter VII, "Fulfilment of countertrade commitment", paragraphs 27 to 29). Such schemes often provide that a committed party that fails to fulfil the commitment allocated to a given subperiod may carry over a portion of the unfulfilled commitment to the following subperiod and that the party in breach must pay liquidated damages or a penalty on the unfulfilled portion that is not carried over. In such cases it may be provided that the party in breach is to be given an additional period of time, after the expiry of the subperiod, to remedy the breach (see the preceding paragraph).

8. It should be noted that some legal systems contain special requirements for the termination of a contract as a result of a breach. For example, it may be required that additional time be granted to remedy the breach, that notice of intent to terminate be given, or that judicial consent be given. Were a release from a countertrade commitment to be interpreted as falling under those rules, such requirements might be applicable.

9. The countertrade agreement may provide that, if a release results from circumstances not attributable to either party (e.g., an exempting impediment), each party is to bear its own expenses and losses.

### C. Monetary compensation

10. The countertrade agreement may provide that a breach by a party of the countertrade commitment entitles the aggrieved party to receive from the party in breach an agreed sum as liquidated damages or a penalty (liquidated damages and penalty clauses are discussed in chapter XI). It is desir-

able that the countertrade agreement specify whether a party paying liquidated damages or a penalty is released from the obligations under the countertrade commitment (for a discussion of the effect of payment of liquidated damages or a penalty, see chapter XI, paragraphs — to —).

11. Liquidated damages and penalties should be distinguished from the obligation found in legal systems generally to pay damages as compensation for loss suffered due to a breach of a contractual obligation. Liquidated damages or a penalty involve an amount agreed upon at the time the contractual obligation is entered into and are payable by a party who failed to perform the obligation without proof of loss by the aggrieved party (chapter XI, paragraph —). By contrast, damages are assessed after the failure to perform a contractual obligation so as to compensate for the losses proved to have been suffered by the aggrieved party.

12. It might be possible for the party who suffered loss as a result of a failure to fulfil a countertrade commitment to claim, on the basis of legal rules generally applicable to a breach of a contractual obligation, damages from the party who failed to fulfil the commitment. The problem of liability for failure to fulfil a countertrade commitment raises the question of pre-contractual liability. The answer to this question is often not clear in legal systems, the approaches to the question differ under various legal systems, and the law of pre-contractual liability is undeveloped in some countries. A further source of uncertainty is the basis on which the extent of the damages would be calculated. If the important terms of the future supply contract (in particular type, quality and price of goods) are not sufficiently defined in the countertrade agreement, there would be an insufficient basis on which to calculate damages resulting from a failure to conclude that contract.

13. It is therefore advisable that the parties not leave the question of damages for non-fulfilment of the countertrade commitment to the applicable law. Instead, it is recommended that the parties include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalty clauses").

### D. Exempting impediments

14. During the course of the period for fulfilment of the countertrade commitment, events may occur that impede a committed party to conclude an envisaged supply contract. An impediment may be of a legal nature, such as a change of regulations in the purchaser's or the supplier's country prohibiting the import or export of certain types of goods. An impediment may also be of a physical nature, such as a natural disaster preventing the production, transport or taking delivery of countertrade goods. Such impediments may prevent fulfilment of the countertrade commitment permanently or only temporarily. The party who fails to fulfil its countertrade commitment due to an impediment may, subject to the applicable law and to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or be released altogether from the countertrade commitment, and be exonerated from liability to pay damages. Impediments that give rise to such an exemption are referred to in the Legal Guide as "exempting impediments".

15. Many legal systems contain rules concerning exempting impediments. However, those rules may lead to results that are incompatible with the circumstances and needs of international countertrade transactions or do not allocate the risk of occurrence of exempting impediments as desired by the parties. Therefore, the parties may wish to include in their countertrade agreement an exemption clause defining exempting impediments and specifying the legal consequences of those impediments. It is advisable for the parties to select terminology that is, in the light of the applicable law, consistent with their intentions (see chapter IV, "General remarks on drafting", paragraph 6).

16. In the negotiation of the clause in the countertrade agreement on exempting impediments, it is in the interest of each party to have included in the clause the types of exempting impediments that could affect the ability of that party to take the actions required to fulfil the countertrade commitment. For example, the party committed to purchase would be interested in covering impediments such as import restrictions and physical impediments to the taking of delivery or the use of the goods. The party committed to supply goods would be interested in covering impediments such as restrictions on goods permitted to be exported in countertrade transactions and other export restrictions and certain impediments affecting the ability to produce the goods. It should be noted that, under the generally accepted principle of freedom of contract, the parties have latitude to agree on which of the parties is to bear the risk that a particular type of event impeding performance may occur. Accordingly, they would be free to exclude from the list of exempting impediments events that would be treated as exempting impediments by the applicable law and to include other events that would not be so treated by the applicable law.

17. The treatment in various legal systems of the subject of exemption differs with respect to the conceptual underpinnings of the subject and the terminology used. In relation to exemptions in the context of sales contracts, those differences have been bridged by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79.<sup>1</sup> The approach adopted in that Convention has been designed to take into account the particular circumstances and needs of international trade. The parties may find that approach to be a useful guide in formulating an exemption clause in a countertrade agreement. The discussion in this chapter of the legal consequences of exempting impediments and the definition of exempting impediments (sections 1 and 2 below, respectively) is based upon the approach taken in the Convention.

### 1. Legal consequences of exempting impediments

18. The parties may wish to provide that, when fulfilment of the countertrade commitment is prevented by exempting impediments not exceeding a specified duration (e.g., 6 months), the fulfilment period would be extended for a period of time corresponding to the duration of the impediment.

The purpose of such a provision would be to ensure that exempting impediments of a limited duration would not release the parties from the countertrade commitment. The parties may wish to stipulate in the countertrade agreement that, if an exempting impediment invoked by a party lasts longer than a specified duration, the other party may claim release from the countertrade commitment, or it may be agreed that either party may do so. The parties may wish to include in such a stipulation the obligation to engage in negotiations aimed at modifying the countertrade agreement in order to preserve the countertrade commitment.

19. As discussed in chapter XI, "Liquidated damages and penalty clauses", paragraph —, in order to eliminate any uncertainty, the parties may wish to provide expressly that a party failing to fulfil the countertrade commitment due to an exempting impediment is exempt from the payment of liquidated damages or penalties, or of any damages that would otherwise be due under the applicable law.

### 2. Defining exempting impediments

20. The parties may wish to include in the countertrade agreement a definition of exempting impediments. The parties may wish to adopt one of the following approaches: (a) providing only a general definition of exempting impediments; (b) combining a general definition with a list of exempting impediments; (c) providing only an exhaustive list of exempting impediments.

#### (a) General definition

21. A general definition of exempting impediments would enable the parties to ensure that all events having the characteristics set forth in the definition would be considered as exempting impediments. The purpose of a general definition is also to exclude events that do not meet those characteristics. This approach would avoid the need to compile a list of exempting impediments, and would avoid the risk of omitting from the list events that the parties would have considered as exempting impediments. On the other hand, it could be difficult in some cases to determine whether or not a particular event was covered by the general definition.

22. The parties may wish to include in the definition the stipulation that fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see paragraph 14 above), and not, for instance, only made inconvenient or more expensive. It should be noted, however, that a change in circumstances may occur that makes fulfilment of the countertrade commitment, while still physically possible, excessively costly, beyond what a party could be expected to have foreseen and to have to bear. Such an extreme change in circumstances may be regarded under the applicable law as an exempting impediment. In addition, the parties may wish to provide that the impediment must be beyond the control of the party failing to fulfil a countertrade commitment and that that party could not reasonably be expected to have taken the impediment into account at the time the countertrade agreement was entered into or to have avoided or overcome the impediment or its consequences.

<sup>1</sup>Official Records of the United Nations Conference on Contracts for the International Sale of Goods (document A/CONF.97/18, annex 1); Yearbook of the United Nations Commission on International Trade Law, vol. XI:1980, part three, B.

23. Contractual clauses on exempting impediments sometimes merely list a number of exempting impediments and indicate that other similar events would also be considered as exempting impediments. In such a clause, the listed events serve as an indication whether an event not included in the list should be regarded as an exempting impediment. Nevertheless, inclusion of a general definition in the clause is likely to reduce uncertainty whether an event not included in the list should be regarded as an exempting impediment.

(b) *General definition with list of exempting impediments*

24. A general definition of exempting impediments might be followed by either an illustrative or exhaustive list of events that are to be regarded as exempting impediments. This approach would combine the flexibility afforded by a general definition with the certainty arising from the specification of exempting impediments.

(i) *General definition with illustrative list*

25. Examples of exempting impediments to be included in an illustrative list may be chosen so as to clarify the scope of the general definition. Such an approach could give guidance as to the intended scope of the general definition and ensure that the events set forth in the list would be treated as exempting impediments if they meet the criteria set forth in the general definition.

(ii) *General definition with exhaustive list*

26. A general definition of exempting impediments might be followed by an exhaustive list of events that are to be regarded as exempting impediments if they meet the criteria contained in the general definition. An exhaustive list may be inadvisable unless the parties are certain that they can foresee and list all events which they would wish to be regarded as exempting impediments.

(iii) *General definition with list of exempting impediments whether or not they come within definition*

27. A general definition of exempting impediments might be followed by a list of events that are to be regarded as exempting impediments whether or not they come within the general definition. This approach may be useful where parties choose a narrow general definition of exempting impediments, but wish certain events that do not fall within the scope of that definition to be regarded as exempting impediments. Since those events would constitute exempting impediments independently of the general definition, the remarks in paragraph 28 below, concerning safeguards that may be adopted when providing a list of exempting impediments without a general definition, are also applicable here.

(c) *Exhaustive list of exempting impediments without general definition*

28. It is possible for an exemption clause simply to provide an exhaustive list of events that are to be considered

exempting impediments, without a general definition. This approach has the disadvantage of not providing general criteria in a definition that the listed events must meet in order to be regarded as exempting impediments. Since such general criteria are not provided, it is advisable for the parties to describe the exempting impediments on the list as precisely as possible. The advantage of such precision is certainty as to the allocation of risk between the parties.

(d) *Possible exempting impediments*

29. If the parties set forth in the exemption clause a list of events that are to be considered exempting impediments, with or without a general definition, they may wish to consider whether it is desirable to include events such as fire, explosion, and trade embargo. Furthermore, the parties may wish to narrow the scope of the events listed below.

30. *Natural disasters.* Natural disasters such as storms, cyclones, floods or sandstorms may be normal conditions at a particular time of the year at the relevant location. In such cases, the countertrade agreement might preclude a party from invoking them as exempting impediments if they were foreseeable and if effective counter-measures could have been taken (see paragraph 23 above).

31. *War (whether declared or not), other military activity or civil unrest.* It may be difficult to determine when a war, other military activity or civil unrest can be considered as preventing performance of an obligation. For instance, hostilities may be taking place in the country of a party, but, if commercial activities by that party continue, the hostilities may not actually prevent a party from fulfilling the countertrade commitment. If the countertrade agreement does not contain a general definition of exempting impediments, it may be desirable to specify clearly when a war, other military activity or civil unrest is considered to prevent fulfilment of a countertrade commitment.

32. *Strikes, boycotts, go-slows and occupation of factories or premises by workers.* The parties may wish to consider whether and the extent to which these events are to be considered as exempting impediments. On the one hand, such events could in a real sense prevent a party from fulfilling its commitment. On the other hand, the parties might consider that it would not be advisable for a party to be exempted from the consequences of a failure to fulfil a commitment when the failure resulted from the conduct of its own employees. In addition, it may be difficult to determine whether or not strikes by employees and other labour disputes are avoidable by a party, and what measures the party might reasonably be expected to take to avoid or to end the strike or dispute (e.g., meeting the strikers' demands). In that connection, the parties may wish to provide that only strikes that do not arise from labour relations between the party and its employees (e.g., sympathy strikes) are to be regarded as exempting impediments.

33. *Shortages of raw materials needed in production.* The parties may wish to consider whether this is to be considered as an exempting impediment. They might, for example, consider that it is the obligation of a party to procure raw materials in time and, therefore, preclude a claim for

an exemption if the raw materials had not been procured. In some cases, the party may fail to have the materials available on time due to a delay by its supplier. For those cases, however, it would be advisable for the party to ensure that the contract with its supplier of the materials provides for damages for failure to supply the materials.

#### (e) *Exclusion of impediments*

34. Whichever approach to defining exempting impediments is adopted, the parties may wish further to clarify the scope of an exemption clause by expressly excluding some events. For example, the parties may wish to exclude from exempting impediments events that occur after a breach of the countertrade commitment by a party and that, but for the breach, would not have prevented fulfilment of the commitment by that party.

35. The parties may wish to consider whether certain acts of a State or of State organs are to be regarded as exempting impediments. A party may be required to secure a licence or other official approval for the conclusion of a supply contract. The countertrade agreement might provide that if the licence or approval is refused by a State organ, or if it is granted but later withdrawn, the party that was required to obtain the licence or approval cannot rely on the refusal or withdrawal as an exempting impediment. The parties might consider that it is equitable for the consequences of the absence of the licence or approval to be borne by the party that had the duty to obtain it, since that party undertook the countertrade commitment knowing of the necessity to obtain the licence or approval and the possibility of its being refused. Moreover, it might be difficult for the other party to determine whether the measures taken to obtain the licence or approval were reasonable (see paragraph 23 above).

### 3. *Notification of impediments*

36. It is desirable for the countertrade agreement to obligate a party invoking an exempting impediment to give written notice of the impediment to the other party without undue delay after the party invoking the impediment learned or could reasonably have been expected to learn of the occurrence of the impediment. This notification could facilitate the taking of measures by the other party to mitigate any loss. It may be required that the notice specify details of the impediment, together with evidence that the fulfilment of a countertrade commitment by the party is prevented or is likely to be prevented, and, if possible, the anticipated duration of the impediment. The party invoking the exempting impediment might also be required to continue to keep the other party informed of all circumstances that may be relevant for an ongoing appraisal of the impediment and its effects, and to notify the other party of the cessation of the impediment. It may be provided that a party who fails to notify the other party in time of the exempting impediment loses the right to invoke the exempting impediment. Alternatively, it may be provided that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the failure.

The countertrade agreement might also provide that an exempting impediment, or certain types of exempting impediments, must be verified, for example, by a public authority, notary public, a consulate or chamber of commerce in the country where the impediment occurred.

37. Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to meet and consider what measures to take in order to prevent or limit the effects of the impediment, and to prevent or mitigate any loss that may be caused by it. These measures might include renegotiation of the countertrade agreement (see paragraph 18 above).

#### E. *Effect on countertrade transaction of failure to conclude or perform supply contract*

38. A feature of a countertrade transaction is the link between the supplies of goods in the two directions in that the conclusion of the contract for the supply of goods in one direction is conditioned upon the conclusion of the contract for the supply of goods in the other direction (see chapter II, "Scope and terminology of legal guide", paragraph 1). In view of this link, a question may arise whether a failure to conclude a supply contract or a failure to perform an existing supply contract in one direction should have an effect on the obligation to conclude a supply contract or to perform an existing supply contract in the other direction. For example, if in a counter-purchase transaction the export contract is terminated, the question may arise whether the exporter is entitled to be released from its obligations to purchase goods pursuant to the countertrade commitment. Similarly, if in a counter-purchase transaction the exporter fails to take the action necessary to fulfil the countertrade commitment, the question may arise whether the counter-exporter is entitled to suspend payment under the export contract or to terminate the export contract.

39. Many national legal systems contain general rules of contract law that provide an answer regarding interdependence of obligations incorporated in one contract. The general principle usually expressed in those rules is that non-performance by one party of its contractual obligations under a contract authorizes the other party not to perform its obligations under that contract, and that in some circumstances the other party is authorized to terminate the contract. Usually non-performance of one's own contract obligations and termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National legal systems normally do not provide a specific answer to the question of interdependence of obligations involved in various types of countertrade transactions and also do not clarify to what extent the above-mentioned general principles of contract law can be applied in a countertrade transaction.

40. It is often suggested that the particular contract structure of the countertrade transaction is an important element in determining the interdependence of obligations in countertrade transactions. If the obligations in a countertrade transaction are merged into a single contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (the single-

contract approach is discussed in chapter III, "Contracting approach", paragraphs 2 to 9). If, however, separate contracts are used for the shipments in the two directions, it has been suggested that in many legal systems the two sets of obligations would likely be regarded as independent, except to the extent specific contract provisions establish interdependence (the separate-contracts approach is discussed in chapter III, "Contracting approach", paragraphs 10 to 21) [Note to the Working Group: paragraphs 9, and 16 to 18, of chapter III would have to be aligned with the present text.] On the other hand, it has been suggested that despite the use of separate contracts, the obligations in a countertrade transaction could be regarded as interdependent on the ground that those obligations embodied in separate contracts are commercially interrelated and thus form part of a single transaction.

41. Because there is a dearth of judicial and arbitral decisions on the question of interdependence of obligations in countertrade transactions, generalizations cannot be made. The extent of interdependence will depend on the circumstances and contractual provisions of each case. In order to avoid disagreements as to whether a party is entitled to withhold fulfilment of its obligation as regards the supply of goods in one direction on the ground that the other party has failed to fulfil its obligation as regards the supply of goods in the other direction, the parties might wish to include in the countertrade agreement specific provisions indicating the extent of interdependence of obligations. Provisions determining the extent of interdependence of obligations may be included to address in particular the following problems in the fulfilment of the countertrade transaction: (i) failure to conclude a supply contract as stipulated in the countertrade agreement, (ii) termination of a supply contract, (iii) failure to meet a payment obligation under a supply contract, and (iv) failure to deliver goods under a supply contract.

#### *1. Failure to conclude supply contract*

42. In transactions in which the parties first conclude the supply contract in one direction (export contract) and leave the conclusion of the supply contract in the other direction (counter-export contract) to a later time (see chapter III, "Contracting approach", paragraphs 12 to 18), the parties may wish to consider whether the failure of the exporter (counter-importer) to take an action necessary to fulfil the countertrade commitment should entitle the importer to suspend payment for the imported goods, or even to terminate the export contract. Such interdependence may be viewed favourably by an importer whose ability to meet payment obligations under the export contract depends on the proceeds of the counter-export contract to be concluded pursuant to the countertrade agreement.

43. In considering whether to establish such interdependence between the countertrade commitment and the export contract, the parties may wish to take into account the possible amount of the counter-exporter's loss arising from the failure to fulfil the countertrade commitment and the possible amount of the exporter's loss arising from the suspension of payment under the export contract or from the termination of the export contract. It may not be desir-

able to allow a problem in the fulfilment of the countertrade commitment to disrupt the performance of the export contract. The parties may make such an assessment when the price to be paid under the export contract or the possible loss from the termination of the export contract is considerably higher than the possible loss from the failure by the counter-importer to fulfil the countertrade commitment. Furthermore, interdependence may not be desirable because of the possibility that the parties would disagree as to responsibility for the failure to conclude a supply contract. The possibility of suspension of payment under the export contract until the resolution of such a disagreement might introduce an unacceptable degree of uncertainty in the transaction. Moreover, the risk of non-payment under the export contract because of a problem in the fulfilment of the countertrade commitment may make it difficult for the exporter to find a financial institution to finance the export or to insure a non-payment risk. A reason for the financial institution's reluctance may be the fact that a possible difficulty the exporter may face in fulfilling the countertrade commitment is a circumstance extraneous to the export contract and difficult for the financial institution to assess. For reasons discussed in paragraphs 39 to 41 above, the parties may wish to express in the countertrade agreement such independence of the export contract from the fulfilment of the countertrade commitment.

44. However, in order to protect the interests of the counter-exporter, it may be appropriate to provide in the countertrade agreement for compensation of the loss expected to be suffered as a result of a failure to conclude the counter-export contract. The obligation to provide such compensation may be established by a liquidated damages or penalty clause in the countertrade agreement (see paragraphs 10 to 13 above, as well as chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance"). Furthermore, the countertrade agreement may grant the counter-exporter the right to deduct from payments due under the export contract the amount of liquidated damages or a penalty due for the failure to fulfil the countertrade commitment (see chapter IX, "Payment", paragraphs 9 and 57, and chapter XI, "Liquidated damages and penalty clauses", paragraph —).

45. In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", paragraph 19), the parties may not find it useful to entitle a party to suspend performance of, or to terminate, a concluded supply contract in one direction in response to a failure by the other party to take an action necessary to conclude a supply contract in the other direction. In such transactions, the countertrade agreement often provides for the conclusion of a series of supply contracts in both of the two directions. Making the performance of contracts that have already been concluded in one direction dependent on the conclusion of contracts in the other direction may disrupt rather than stimulate orderly implementation of such a countertrade transaction. Accordingly, for reasons discussed above in paragraphs 39 to 41, the parties may wish to indicate expressly in the countertrade agreement that the obligations under the supply contracts in one direction are independent from the fulfilment of the countertrade commitment in the other direction.

46. In some cases the countertrade agreement may provide that a failure by a party to conclude supply contracts in one direction entitles the other party to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction. Such an approach may be used in particular when it is agreed that during the course of the countertrade transaction the value of the goods supplied in one direction should not exceed the value of the goods supplied in the other direction by more than an agreed amount or percentage. This approach may be agreed upon when the parties stipulate that their mutual payment claims arising from the supply contracts in the two directions are to be set off and that the imbalance in the value of goods shipped in the two directions should not exceed an agreed limit (see chapter IX, "Payment", paragraphs 35 to 52, in particular paragraph 49). In order to monitor the level of trade between the parties and to specify the situations in which a party is entitled to suspend conclusion of contracts or supplies of goods, the parties might agree that their mutual supplies of goods are to be recorded in an "evidence account" (see chapter VII, "Fulfilment of countertrade commitment", paragraphs 38 to 44).

47. When the countertrade agreement provides that the countertrade commitment in one direction should not affect obligations under existing supply contracts in the other direction, the countertrade agreement may nevertheless establish sanctions for the failure to fulfil the countertrade commitment. For example, in transactions in which countervailing claims for payment for the supply of goods in the two directions are to be set off, the countertrade agreement may provide that a party that receives more goods than it ships is to liquidate the imbalance either through cash payments or through the shipment of additional goods (see chapter IX, "Payment", paragraphs 49 to 51). When the goods supplied in the two directions are to be paid for independently, the countertrade agreement may contain a liquidated damages or penalty clause or provide for the issuance of a bank guarantee or stand-by letter of credit covering non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

## 2. Termination of supply contract

48. A supply contract may be terminated, for example, as a result of a breach of the contract by one party or as a result of an exempting impediment. For reasons discussed in paragraphs 39 to 41 above, the parties may wish to clarify in the countertrade agreement whether such a termination of a supply contract in one direction is to affect the obligations of the parties to conclude a future supply contract in the other direction or to perform an existing supply contract in the other direction. Various solutions can be considered:

- (i) not to allow the termination of a supply contract in one direction to affect the countertrade commitment stipulating the conclusion of a supply contract in the other direction, or any obligations under an existing supply contract in the other direction;
- (ii) to provide that termination of a supply contract in one direction is to release the parties from the

countertrade commitment stipulating the conclusion of a supply contract in the other direction, but that, if a supply contract in the other direction has already been concluded, that supply contract is not to be affected;

- (iii) to provide that termination of the supply contract in one direction is to result in the release from the countertrade commitment to conclude a supply contract in the other direction as well as in the termination of any existing supply contract in the other direction, unless specified actions for performance of the existing supply contract have already been taken (e.g., goods have been prepared for shipment or have been shipped).

49. The solution under (i) may be appropriate in transactions in which the countertrade agreement provides for the conclusion of a series of supply contracts in both directions. In counter-purchase and buy-back transactions, it may also be appropriate to provide that the termination of a given counter-export contract should not affect the export contract. In these cases it may be possible for the parties to conclude a substitute supply contract for a terminated supply contract (see paragraph 54 below). Because of this possibility, as well as the possibility of exercising remedies available under the terminated supply contract, the parties may not wish that the termination of a given supply contract in one direction should affect the conclusion or performance of contracts in the other direction.

50. As to the possible effects of the termination of the export contract in a counter-purchase, buy-back or indirect offset transaction, the solution under (i) may be preferred by the importer (counter-exporter). An important objective of the importer for engaging in countertrade is often to find an outlet for its goods, and the need to find such an outlet would usually not be diminished by termination of the export contract. This solution may also be favoured by a third-party purchaser engaged by the exporter to fulfil the exporter's countertrade commitment; the third-party purchaser may be interested in the countertrade commitment remaining effective in order to be able to earn the fee agreed upon with the exporter or in order to recoup expenses incurred in anticipation of the purchase and resale of the countertrade goods (see chapter VIII, "Participation of third parties", paragraph 32). The exporter (counter-importer), on the other hand, is likely to favour solution (ii), in particular if the exporter does not expect a profit through the purchase and resale of the countertrade goods. In these types of transactions the exporter usually assumes a countertrade commitment in order to be able to export its own goods and would therefore not wish to remain subject to the countertrade commitment upon termination of the export contract, but at the same time would not wish to terminate existing counter-export contracts. In indirect offset transactions there is an additional reason for adopting the solution under (ii), namely, that the exporter (counter-importer) concludes counter-import contracts with third-party suppliers and it would be undesirable to terminate those contracts due to circumstances that do not concern those third parties.

51. The question may arise whether, despite the release from the countertrade commitment, pursuant to the solution in (ii), of the party originally committed to purchase, a

third-party purchaser engaged by the exporter (counter-importer) would continue to be entitled to receive a fee from the exporter (counter-importer) for purchases made from the counter-exporter after the release. As discussed in chapter VIII, "Participation of third parties", paragraph 32, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

52. The solution under (iii) might be adopted when the parties consider that the countertrade transaction cannot proceed if a supply contract in one direction is terminated. This might be the case, for example, when the parties agree to link their payment obligations so that the proceeds of the supply contract in one direction would be used to pay for the supply contract in the other direction (chapter IX, "Payment"), or when, as in a direct offset transaction, the goods supplied by one party are to be incorporated in the goods to be supplied in the other direction. The solution under (iii) would also be indicated in buy-back transactions in which the possibility of fulfilling the countertrade commitment is contingent upon the performance of the export contract.

53. When solution (ii) or (iii) is adopted, the parties may wish to clarify in the countertrade agreement that a party would be released from its obligations under the countertrade commitment or an existing counter-export contract on the basis of the termination of the export contract only if that party was not responsible for the termination of the export contract. The countertrade agreement may further provide that when one of the parties is responsible for the termination of the export contract (e.g., because of delivery of defective goods, because of a failure to obtain administrative approval for the contract, or because of the failure to obtain the issuance of a letter of credit), the other party has an option either of maintaining in effect the countertrade commitment or the counter-export contract or of being released from its obligations thereunder.

54. Paragraphs 48 to 54 above addressed the question whether a termination of a supply contract in one direction is to affect the obligations of the parties to conclude or perform a supply contract in the other direction. The parties may also wish to consider whether the termination of a supply contract in a given direction should obligate the parties to conclude a substitute supply contract in that same direction. An obligation to conclude a substitute supply contract may be considered appropriate in particular when the countertrade agreement provides for the conclusion of multiple supply contracts or when the countertrade agreement lists different types of countertrade goods.

### 3. Failure to pay

55. In many countertrade transactions it is agreed that payment under the supply contract in one direction is to be made independently from payment under the supply contract in the other direction. For example, if under a counter-purchase or buy-back transaction the importer would delay its payments to the exporter, the exporter (counter-importer) would not be entitled to withhold payment under the counter-import contract or to set off its claim under the export contract against its payment obligation under the counter-import contract. Similarly, if the counter-importer would delay payment to the counter-exporter, the counter-

exporter (importer) would not be entitled to withhold payment under the export contract or to set off the payment claims in the two directions. It is advisable that such agreement on independence of payment obligations be expressed in the countertrade agreement.

56. It may be agreed, however, that, if a supplier has not been paid for goods delivered in one direction, that supplier is entitled to withhold payment for goods delivered in the other direction up to the amount of the outstanding claim or to set off the two countervailing claims.

57. The advantage of independence of payment obligations is that the risk of non-payment under a supply contract in one direction is not increased by making the payment obligation under that contract dependent on the successful performance of a supply contract in the other direction. With such an approach, financing for a supply contract may be easier to obtain because the financing institution, in assessing the risk of non-payment, would not have to take into account circumstances extraneous to the supply contract to be financed (see also paragraph 43 above).

58. The advantage of making the payment obligations interdependent is that of additional security to a party who does not receive payment for the goods it has supplied. If that party withholds payment or sets off the claims for payment under the supply contracts in the two directions, the result would be similar to a linked payment mechanism discussed in chapter IX, "Payment" (i.e., retention of funds, blocking of funds or setoff of countervailing claims for payment). The difference is that in the case discussed in this section the withholding of payment or setoff of claims is a fall-back right given to a party who does not receive payment, whereas under the linked payment mechanisms discussed in chapter IX, the linkage of payments is the anticipated method of payment.

59. When it is agreed that a party is entitled to withhold payment or to set off the two countervailing payment obligations, it is sometimes also stipulated that the party who delivered goods first (exporter) is entitled to take possession of the goods that are to be delivered by the other party (importer). Taking possession of the goods would enable the exporter, who is holding the outstanding claim, to obtain value and establish a payment obligation that could be set off against the outstanding claim. Such a stipulation is possible where the countertrade agreement specifies the goods that are to be counter-exported. In order to implement such an approach, it is advisable to identify clearly the goods and their location and to consider taking such additional measures as granting the exporter a security interest in those goods and giving the exporter an express right to claim their possession. A further measure may be for the countertrade parties to agree that the counter-exporter is to deposit the goods with a third person and to provide for the release of those goods to the counter-importer under specified conditions.

### 4. Failure to deliver goods

60. The parties may wish to clarify in the countertrade agreement the consequences for the countertrade transaction of a failure to deliver, delayed delivery, or delivery of non-

conforming goods under a supply contract in one direction. For delivery problems that result in the termination of a supply contract in one direction, the parties may wish to clarify in the countertrade agreement, as discussed in paragraphs 48 to 54 above, whether the termination is to affect the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. For delivery problems under a supply contract in one direction that do not result in termination of that supply contract, the par-

ties may wish, for reasons explained in paragraphs 39 to 41 above, to provide expressly in the countertrade agreement that there should be no effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. Such an independence of the obligations with respect to the shipments in the two directions may not be appropriate in buy-back transactions in which the counter-export of goods is contingent upon the proper implementation of the export contract.

[A/CN.9/WG.IV/WP.51/Add.5]

#### XIV. CHOICE OF LAW

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##### A. General remarks

1. The legal rules that govern the contractual obligations of the parties involved in a countertrade transaction are referred to in the legal guide as the "applicable law". Under the rules of private international law of many national legal systems, the parties are permitted to choose the applicable law by agreement, though under some of those systems there are certain restrictions on that choice. (The term "private international law" refers to the body of rules of a State that determine which national legal system is to apply to a contractual relationship having an international character. In some legal systems, rules of private international law are referred to as "conflict of laws" or "choice of law" rules.) If the parties do not choose the applicable law, the applicable law is determined by the application of the rules of private international law.

2. It should be noted that by choosing the applicable law the parties are not making a choice as to jurisdiction for settlement of any disputes. Issues relating to jurisdiction are discussed in chapter XV, "Settlement of disputes".

3. This chapter focuses on the choice by the parties to the countertrade transaction of the law applicable to the countertrade agreement and the supply contracts in the two directions. This chapter does not discuss the law applicable to other related arrangements in which a person who is not a party to the countertrade transaction is involved. Such other arrangements may include a guarantee supporting fulfilment of a countertrade commitment, an agreement between countertrade parties and their banks concerning linked payment arrangements, and an interbank agreement between banks involved in carrying out payment arrange-

ments. Certain aspects of the law applicable to such arrangements are discussed in chapter XII, "Security for performance", paragraphs 3, 5 and 13, and chapter IX, "Payment", paragraphs 4, 7, 16, 18, 19, 24 and 37.

4. Whatever be the law applicable to the countertrade agreement or the supply contracts, particular aspects of the countertrade transaction may be affected by mandatory legal rules of an administrative or other public nature in force in the countries of the parties and in the country where their obligations are to be performed. Those mandatory legal rules may regulate certain matters in the public interest, for example, international transfers of funds, the types of goods that may be traded in countertrade transactions, and restrictive business practices (see section D, paragraphs 29 to 32 below).

5. In addition, the extent to which the parties may designate particular issues to be governed by the chosen law may be limited. For example, regardless of the choice by the parties, the law of the State where goods are situated may govern the transfer of ownership of those goods, and the law of the State in which the bank holding funds is located may govern disposition of the funds. The question of which national legal system's procedural law is to govern arbitral or judicial proceedings for the settlement of disputes arising in connection with the countertrade transaction is discussed in chapter XV, "Settlement of disputes".

6. The question might arise as to the relevance to countertrade agreements of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). The Convention applies to contracts of sale of goods when the parties have their places of business in different

States and those States are parties to the Convention, or when the rules of private international law lead to the application of the law of a Contracting State (article 1). Countertrade agreements that commit the parties to the future conclusion of a sales contract are pre-contractual arrangements that often do not set out the contractual terms governing a sale of goods with the same degree of definiteness as would be necessary for a sales contract. There is a divergence of opinion as to whether pre-contractual arrangements fall within the scope of application of the Convention. However, when the countertrade agreement specifies all the essential terms of the supply contract to be concluded, the possibility exists that in some legal systems such an agreement would be regarded as a sales contract subject to the Convention (see chapter III, "Contracting approach", paragraph \_\_\_\_). [Note for the Working Group: it is suggested that chapter III, paragraphs 43 to 48, contain a discussion of the implications of setting forth in the countertrade agreement the essential terms of the contract to be concluded. That discussion would note that, under some legal systems, when a countertrade agreement committing the parties to conclude a sales contract contains the essential terms of the contract to be concluded, the countertrade agreement may be regarded as a sales contract. The parties would be advised, when concluding a countertrade agreement that contains the essential terms of the future contract, to stipulate clearly whether a separate contract is to be executed pursuant to the countertrade agreement.]

7. For a discussion of contract drafting in the light of applicable law, see chapter IV, "General remarks on drafting", paragraph 6.

## B. Choice of applicable law

8. It is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts. Such an identification of the applicable law is useful because it enables the parties to gear the actions they take to fulfil their contractual obligations, or the actions taken pursuant to their contractual rights, to the requirements found in the applicable law. If the parties do not choose the applicable law, the result provided by rules of private international law may not be satisfactory to the parties. For example, absent a contrary choice by the parties, sales contracts in a counter-purchase or offset transaction are likely to be, according to the rules of private international law, subject to the law of the seller. If in such a transaction the countertrade agreement is not subject by the rules of private international law to the same law as the sales contract to be concluded pursuant to that countertrade agreement, contractual terms common to both the countertrade agreement and the supply contract may not be given the same meaning (see paragraph 24 below).

9. An express choice of the law applicable to the countertrade agreement and the supply contracts is advisable also to avoid uncertainty as to what law applies. Uncertainty in the absence of a choice of law may arise from two factors.

10. First, the applicable law is determined by the application of rules of private international law of a national legal

system. When a dispute arises concerning the countertrade agreement or a supply contract that is to be settled in judicial proceedings, the rules of private international law applied by the court settling the dispute will determine the applicable law. A court will apply the rules of private international law of its own country. If there is no exclusive jurisdiction clause agreed upon by the parties (see chapter XV, "Settlement of disputes", paragraph \_\_\_\_), the courts of several countries may be competent to decide the dispute (e.g., the countries in which the parties to the dispute have their places of business or the country in which the obligation in question is to be performed). There may therefore be several possible systems of private international law that could determine the law applicable to the countertrade agreement or the supply contract. When disputes are to be settled in arbitral proceedings, the arbitral tribunal will determine what law is applicable, unless the parties have chosen the applicable law. Usually, the arbitral tribunal will determine the applicable law according to the private international law rules that it considers appropriate. Since the arbitral tribunal may decide that the appropriate private law rules are not those of the place of arbitration, it may sometimes be difficult to predict which private international law rules the arbitral tribunal will consider to be appropriate.

11. The second factor producing uncertainty as to the applicable law is that, even if it is known which system of private international law will determine the applicable law to govern the countertrade agreement and the supply contracts, the rules of that system may be too general or vague to enable the parties to predict with reasonable certainty which law will be determined to be applicable. This difficulty is compounded in the case of countertrade agreements because of possible uncertainty as to the legal nature of the countertrade agreement and the consequent uncertainty as to which rule of private international law should determine the applicable law.

12. The extent to which the parties are allowed to choose the applicable law will be determined by the rules of the system of private international law being applied. Under some systems of private international law, the autonomy of the parties is limited and they are permitted to choose only a national legal system that has some connection with the contract, such as the legal system of the country of one of the parties or of the place of performance. Since a court that is to settle a dispute will apply the rules of private international law in force in its country, the parties should agree upon a choice of law that would be upheld by the rules of private international law in the countries whose courts might be competent to settle their disputes. If the parties are considering an exclusive jurisdiction clause, they should pay particular attention to whether courts in the contemplated jurisdiction would uphold their choice of law.

13. Under other systems of private international law, the parties are permitted to choose the applicable law to govern the countertrade agreement and the supply contracts without those restrictions. If a dispute is settled in arbitral proceedings, the law chosen by the parties will normally be applied by the arbitral tribunal.

14. When choosing the law to govern the countertrade agreement or the supply contracts, it is in general advisable

for the parties to choose the law of a particular country. The rules of private international law of a country where legal proceedings may be instituted in the future may not recognize the validity of a choice of general principles of law or of principles common to several legal systems (e.g., of the countries of both parties). Even if such a choice would be valid, it may be difficult to identify principles of law that could resolve disputes of the type arising in connection with a countertrade agreement or a supply contract. Nevertheless, such a choice may be feasible in certain circumstances.

15. In many national legal systems a choice-of-law clause is interpreted as not to include the application of the rules of private international law of the chosen legal system even if the clause does not expressly so provide. However, if that interpretation is not certain, the parties may wish to indicate in the clause that the substantive legal rules of the legal system they have chosen are to apply. Otherwise, the choice of the legal system may be interpreted as including the private international law rules of that legal system and those rules might provide that the substantive rules of another legal system are to apply.

16. The parties may wish to choose as the applicable law the law of the country of one of the contracting parties. Alternatively, they may prefer to choose the law of a third country which is known to both parties and which deals in an appropriate manner with the legal issues arising from the countertrade agreement or from the supply contract. If the countertrade agreement or a supply contract provides for the exclusive jurisdiction of the courts of a particular country to settle disputes between the parties, the parties may wish to choose the law of that country as the applicable law. This could expedite judicial proceedings and make them less expensive, since a court will normally have less difficulty in ascertaining and applying its own law than the law of a different country.

17. In the case of countries where there are several legal systems applicable to contracts (as in some federal States), it is advisable to specify which one of those legal systems is to be applicable in order to avoid uncertainty.

18. The parties may also wish to take the following factors into consideration in choosing the applicable law: (a) the parties' knowledge of, or possibility of gaining knowledge of, the law; (b) the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship between the parties (for example, the parties may wish that their countertrade commitment to enter into future contracts would be given effect under the chosen law); (c) the extent to which the law contains mandatory rules that would prevent the parties from settling by agreement questions that arise in their contractual relationship.

19. Changes legislated in the law chosen by the parties to govern the countertrade agreement and the supply contract may or may not affect contracts in existence at the time those changes are made. If the parties wish that only the legal rules in force at the time the countertrade agreement or supply contracts are entered into are to apply, it is advisable that they expressly so provide. However, parties should be aware that such a restriction will not be effective

if the application of the changes in the legislation to existing contracts is mandatory.

20. Different approaches are possible with respect to the drafting of a choice-of-law clause. One approach may be merely to provide that the contract is to be governed by the chosen law. This approach may be sufficient if it is clear that the body chosen to settle disputes between the parties will apply the chosen law to all the issues that the parties desire to be regulated by it. A second approach may be to provide that the chosen law is to govern the contract in question (i.e., countertrade agreement or supply contract), and also to include an illustrative list of the issues that are to be governed by that law. This approach may be useful if the parties consider it desirable to ensure that the issues contained in the illustrative list in particular will be governed by the chosen law.

21. Under the systems of private international law of some countries a choice-of-law clause may be considered to be agreement separate from the rest of the contract between the parties. Under those systems, the choice-of-law clause may remain valid even if the rest of the contract is invalid, unless the grounds for invalidity also extend to the choice-of-law clause. Where the contract is invalid but the choice-of-law clause remains valid, the formation, the lack of validity, and consequences of the invalidity of the contract will be governed by the chosen law.

22. Under most systems of private international law the chosen law may govern the prescription of rights, while under some systems rules relating to prescription (limitation of actions) are of a procedural character and cannot be chosen by the parties in their contract; in those cases the procedural rules of the place where the legal proceedings are brought will apply. The Convention on the Limitation Period in the International Sale of Goods (New York, 1974) provides in its article 3 that, unless the Convention provides otherwise, the Convention applies irrespective of the law which would otherwise be applicable by virtue of the rules of private international law. As discussed in paragraph 6 above, it may be uncertain whether countertrade agreements committing the parties to the future conclusion of a sales contract fall within the scope of application of the United Nations Convention on Contracts for the International Sale of Goods. Similarly, it may be uncertain whether such countertrade agreements fall within the scope of application of the Convention on the Limitation Period in the International Sale of Goods.

23. The parties may include in the countertrade agreement a choice-of-law clause that will designate the applicable law not only for the countertrade agreement but also for the future supply contracts to be concluded pursuant to the countertrade agreement. In this way the parties may settle in the countertrade agreement an issue that they would otherwise address in each supply contract.

### C. Choosing more than one national legal system to govern countertrade agreement and supply contracts

24. In making an express choice of the applicable law, the parties may wish to consider whether the countertrade agreement and any future supply contracts to be concluded

in one direction or in both directions pursuant to that countertrade agreement should be made subject to a single national legal system or to different legal systems. The application of a single legal system may be desirable when the countertrade agreement stipulates terms of the future supply contracts and the parties wish to ensure that the legal meaning of terms stipulated in the countertrade agreement would remain the same when those terms are subsequently incorporated in a supply contract. Consistency of legal meaning may be desirable in particular with regard to terms concerning payment mechanisms (see chapter IX, "Payment", paragraph 16), quality of the goods, and terms of delivery.

25. If the parties have structured their obligations in such a way that their obligations arising from the supply contracts in the two directions are interrelated to a high degree, they may find it appropriate to subject all their mutual rights and obligations to a single national legal system. The obligations of the parties are closely interrelated, in particular, in barter transactions (see chapter III, "Contracting approach", paragraphs 3 to 7) and in direct offset transactions (see chapter II, "Scope and terminology of Legal Guide", paragraph 13). The application of more than one legal system to such transactions may lead to inconsistency between obligations of the parties.

26. In the case of counter-purchase, buy-back and indirect offset transactions, the obligations of the parties arising, on the one hand, under the supply contract in one direction (export contract) and, on the other hand, under the countertrade agreement and the supply contract in the other direction (counter-export contract) are usually not interrelated to the same degree as the obligations are interrelated in barter or direct offset transactions. In these cases, no generally valid advice can be given as to whether it would be preferable for the parties to subject their obligations to one national legal system or to different national legal systems. In some of these cases, the parties may wish to subject all their obligations to one law. They may wish to do so since it may be simpler to administer the countertrade transaction and to obtain the necessary legal advice with a view to a single legal system rather than to have to take into account more than one legal system. There may, however, be situations in which the parties decide to subject the export contract to one law and the counter-export contract to another law. The parties might choose different laws when, on the one hand, there are special reasons for making one of the contracts subject to the law of a particular State and, on the other hand, the parties do not wish to subject the entire transaction to that law. Such special reasons concerning one of the contracts may be, for example, mandatory rules of a State of a party requiring certain types of contracts to be subject to the laws of that State, trade practice according to which one of the contracts is traditionally made subject to a particular legal system, or the conclusion of the contracts by different sets of parties. If the parties decide to subject the supply of goods in the two directions to different legal systems, the parties may wish to consider, as noted in paragraph 24 above, to subject the countertrade agreement and the supply contract to be concluded pursuant to it to the same law.

27. When the party originally committed to purchase engages a third party to fulfil that commitment, the party

originally committed and the third party may wish to subject the contract by which the third party is engaged to the law governing the countertrade agreement. Such a choice would help to ensure that terms found both in the countertrade agreement and the contract engaging the third party would be given the same meaning. (The need for coordination between the contract engaging a third party and the countertrade agreement is discussed in chapter VIII, "Participation of third parties", paragraphs 22 to 25. Certain other aspects of the law applicable to participation by third parties are mentioned in paragraphs 7, 9, 13 and 16 of chapter VIII.)

28. When the countertrade agreement is incorporated in an export contract (see chapter III, "Contracting approach", paragraph 16), a choice-of-law clause in the export contract would, absent a contrary provision, cover the clauses making up the countertrade agreement.

#### D. Mandatory legal rules of public nature

29. In addition to the applicable law, mandatory rules of an administrative or other public nature in force in the countries of the parties and in other countries (e.g., the country of a third-party purchaser or of a third-party supplier or the country in which the proceeds of the supply in one direction are being held) may affect certain aspects of the countertrade transaction. These mandatory rules may be addressed to residents or citizens of the State that issued the rules, or to certain business activities being carried out or having an effect in the territory of the State. They may be enforced primarily by administrative officials. Their purpose is to ensure compliance with the economic, social, financial or foreign policy of the State. The parties should take these mandatory rules into account in drafting the countertrade agreement and the supply contracts. (Mandatory governmental regulations are also discussed in chapter II, "Scope and terminology of Legal Guide", paragraphs 27 and 28.)

30. Such rules may be of a general nature, applicable to various types of commercial transactions, or they may be specific to countertrade. Rules of a general nature often relate to safety requirements, environmental protection, health and labour conditions, consumer protection, employment of local personnel, restrictive business practices (see chapter X, "Restrictions on resale of countertrade goods", paragraph 3), customs duties, taxes, and restrictions on exports, imports, transfer of technology and payment of foreign exchange.

31. Mandatory rules specific to countertrade may provide, for example, that: (a) specified types of countertrade transactions require governmental approval; (b) importing of certain types of goods may be carried out only within the framework of specified forms of countertrade; (c) only certain types of goods are permitted to be offered in a countertrade transaction (see chapter V, "Type, quality and quantity of goods", paragraphs 2 and 28); (d) goods purchased in fulfilment of a countertrade commitment must meet origin requirements (see chapter V, paragraph 3, and chapter VII, "Fulfilment of countertrade commitment", paragraph 6); (e) evidence accounts are permitted to be used only under specified conditions (see chapter VII, paragraph 39); (f) the purchase of certain types of goods is to be cred-

ited towards the fulfilment of the countertrade commitment at specified rates (see chapter VII, paragraphs 13 to 16); (g) prior governmental authorization is required for linked payment arrangements restricting foreign currency payments into the country (see chapter IX, "Payment", paragraphs 5 and 18); (h) specified financial institutions must be used for payment (see chapter IX, paragraphs 24 and 37).

32. The parties may wish to address in the countertrade agreement the possibility that fulfilment of the countertrade commitment would be impeded by the promulgation or modification of a mandatory rule after the conclusion of the countertrade agreement. Such clauses are discussed in chapter XIII, "Problems in completing countertrade transaction", paragraphs \_\_\_\_ to \_\_\_\_.

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## XV. SETTLEMENT OF DISPUTES

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#### A. General remarks

1. Disputes may arise in a countertrade transaction with respect to the countertrade agreement, and with respect to the supply contracts concluded pursuant to the countertrade agreement. It is advisable that the parties agree on the manner in which any future disputes arising out of the countertrade agreement and the related supply contracts are to be settled.

2. In general, it is desirable for the parties initially to attempt to settle their disputes through negotiation (see section B below). If negotiation is not successful, the parties might wish to refer their dispute to an independent conciliator, who is to make recommendations to the parties on how to settle the dispute (see section C below). If those methods of dispute settlement fail, there are basically two methods available of obtaining an enforceable decision: arbitration and judicial proceedings. Arbitration is a process by which parties refer disputes that might arise between them or that have already arisen for binding decision by an arbitral tribunal composed of one or more impartial persons (arbitrators) selected by them (see section D below). Generally, arbitral proceedings may be initiated only on the basis of an arbitration agreement. In general, the parties are obligated to accept the decision of the arbitral tribunal (arbitral award) as final and binding. The arbitral award is usually enforceable in a manner similar to a court decision. In the absence of an arbitration

agreement, disputes between the parties will have to be settled in judicial proceedings (see section E below).

3. This chapter does not deal with procedures agreed upon by the parties for determining terms of a supply contracts to be concluded that have been left open in the countertrade agreement. Such methods include procedures to be observed by the parties in negotiating supply contract terms, standards and guidelines to be used in setting the terms, designation of a third person to determine a contract term, or authorizing one of the parties to determine a contract term within agreed parameters. Such methods are discussed generally in chapter III, "Contracting approach", paragraphs 39 to 61, and with respect to specific types of contract terms in chapter V, "Type, quality and quantity of goods", paragraphs 13, 20, 25, and 27, chapter VI, "Pricing of goods", paragraphs 11 to 36, and chapter VII, "Fulfillment of countertrade commitment", paragraph 25.

4. The implementation of a countertrade transaction usually includes ongoing discussions between the parties that may permit many problems and misunderstanding to be resolved without recourse to dispute settlement proceedings. The parties may wish to require that, if a party intends to have recourse to dispute settlement proceedings other than negotiation, that party must notify the other party of that intention.

5. When the parties embody all of their contractual obligations in the two directions in a single contract (see chap-

ter III, "Contracting approach", paragraphs 2 to 9), a broadly worded dispute settlement clause in that contract would, absent a contrary provision, govern all disputes arising from the contract. However, it is usually the case that the parties embody their obligations in the two directions in more than one contract (see chapter III, paragraphs 10 to 21). In multi-contract countertrade transactions, the parties may wish to agree that all of the supply contracts, as well as the countertrade agreement, are subject to one dispute settlement clause. When the countertrade agreement provides for the future conclusion of supply contracts, the parties may stipulate in the countertrade agreement that all of those contracts are to be subject to a particular method of dispute settlement. In this way the countertrade agreement may settle an issue that would otherwise be addressed in each supply contract.

### B. Negotiation

6. The most satisfactory method of settling disputes is usually by negotiation between the parties. An amicable settlement between the parties reached through negotiation may avoid disruption of their business relationship. In addition, it may save the parties the considerable cost and the generally greater amount of time that are normally required for the settlement of disputes by other means. Furthermore, negotiation may be a particularly attractive approach in long-term countertrade transactions in which the countertrade agreement indicates the terms of the future supply contracts in a general rather than in a specific manner.

7. Even though the parties may wish to attempt to settle their disputes through negotiation before invoking other means of dispute settlement, it may not be desirable for the dispute settlement clause to prevent a party from initiating other means of settlement until a period of time allotted for negotiation has expired. If the clause stipulates that other dispute settlement proceedings may not be initiated during the negotiation period, it is advisable to permit a party to initiate other proceedings even before the expiry of that period in certain cases, e.g., where a party states in the course of negotiations that it is not prepared to negotiate any longer, or where the initiation of arbitral or judicial proceedings before the expiry of the negotiation period is needed in order to prevent the loss or prescription of a right. It is advisable to require a settlement reached through negotiation to be reduced to writing.

8. Since the outcome of a dispute between two parties to a countertrade transaction might affect the interests of a third party, it might be provided that a third party, though not directly involved in a dispute, may be permitted to participate in the negotiations. Such a situation may arise when a third party is engaged to purchase countertrade goods and the dispute occurs between the third party and the supplier. In this case the party originally committed to purchase goods may be liable for payment of an agreed sum in the event that the intended purchase by the third party fails to take place and the countertrade commitment is not fulfilled. Similarly, a party committed to supply who engages a third-party supplier may be interested in the outcome of the dispute between the third-party supplier and the purchaser. The right to such participation in the negotiation of a settlement may be limited to the case in which

the party that engages the third party remains liable for the fulfilment of the countertrade commitment.

9. In long-term countertrade transactions, the parties may establish a joint committee to coordinate and monitor implementation of the countertrade transaction (see chapter VII, "Fulfilment of countertrade commitment", paragraph 34). Such committees may permit the parties to detect possible sources of difficulties and disputes at an early stage and may be appropriate vehicles for settling disputes through negotiation.

### C. Conciliation

10. If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceedings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator respected by both parties. In contrast to an arbitrator or judge, the conciliator does not decide a dispute; rather, the conciliator assists the parties in reaching an agreed settlement, often by proposing solutions for their consideration.

11. Conciliation is non-adversarial. Consequently, the parties are more likely to preserve the good business relationship that exists between them than in arbitral or judicial proceedings. Conciliation may even improve the relationship between the parties, since the scope of the conciliation and the ultimate agreement of the parties may go beyond the strict confines of the dispute that gave rise to the conciliation. Conciliation may also permit the participation in the settlement of the dispute of parties that are not directly involved in the dispute but who have an interest in the outcome of the dispute. On the other hand, a potential disadvantage of conciliation is that, if the conciliation were to fail, the money and time spent on it might have been wasted. That disadvantage might be reduced to some extent if the contract did not require the parties to attempt conciliation prior to initiating arbitral or judicial proceedings. It is advisable that, before initiating conciliation, the parties consider carefully whether there exists a real likelihood of reaching a settlement.

12. If the parties provide for conciliation, they will have to settle a number of issues for the conciliation to be effective. It is not feasible to settle all of those issues in the body of the countertrade agreement; rather, the parties may incorporate into their agreement by reference a set of conciliation rules prepared by an international organization, such as the UNCITRAL Conciliation Rules.<sup>1</sup>

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the work of its thirteenth session (1980), *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 106 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XI: 1980, part one, II, A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads: "Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules has been recommended by the United Nations General Assembly in its resolution 35/52 of 4 December 1980.

13. When the parties have referred a dispute to conciliation and arbitral or judicial proceedings are thereafter initiated, they might still find it useful to continue with the conciliation.

#### D. Arbitration

14. There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions. Arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the countertrade agreement. The parties can choose as arbitrators persons who have expert knowledge of the subject-matter in dispute. The parties may choose the place where the arbitral proceedings are to be conducted. They may also choose the language or languages to be used in the arbitral proceedings. In addition, the parties can choose the law applicable to the contract in question, and that choice will almost always be respected by the arbitral tribunal; the same is not always true of judicial proceedings (see chapter XIV, "Choice of law", paragraphs 12 and 13). Where parties agree to arbitration, neither party submits to the courts of the country of the other party. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Arbitral proceedings tend to be more expeditious and, in some cases, less costly than judicial proceedings. It may be noted, however, that some legal systems provide for summary judicial proceedings for certain types of disputes (e.g. those involving a sum of money not exceeding a certain amount), although most disputes arising in countertrade transactions will not qualify for settlement under such proceedings. Finally, as a result of international conventions that assist in the recognition and enforcement of foreign arbitral awards, those awards are frequently recognized and enforced more easily than foreign judicial decisions. On such convention to which many States are parties is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).<sup>2</sup>

15. On the other hand, an arbitral award may be set aside in judicial proceedings. The initiation of those proceedings will delay the final settlement of the dispute. However, under many legal systems, an arbitral award may be set aside only on a limited number of grounds, for example that the arbitral tribunal lacked authority to decide the dispute, that a party could not present its case in the arbitral proceedings, that the rules applicable to the appointment of arbitrators or to the arbitral procedure were not complied with, or that the award was contrary to public policy. It may also be noted that, in some legal systems, it is not possible for parties to preclude courts from settling certain types of disputes.

#### I. Scope of arbitration agreement and mandate of arbitral tribunal

16. In general, arbitral proceedings may be conducted only on the basis of an agreement by the parties to arbitrate. The agreement may be reflected either in an arbitra-

tion clause included in the countertrade agreement or supply contract, or in a separate arbitration agreement concluded by the parties before or after a dispute has arisen. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction. However, under some legal systems, an agreement to arbitrate is procedurally and substantively effective only if it is concluded after a dispute has arisen.

17. The arbitration agreement should indicate what disputes are to be settled by arbitration. For example, the arbitration clause may stipulate that all disputes arising out of or relating to the countertrade agreement or the breach, termination or invalidity thereof are to be settled by arbitration. In some cases, the parties may wish to exclude from that wide grant of jurisdiction certain disputes that they do not wish to be settled by arbitration.

18. If permitted under the law applicable to the arbitral proceedings, the parties may wish to authorize the arbitral tribunal to order interim measures pending the final settlement of a dispute. However, under some legal systems arbitral tribunals are not empowered to order interim measures. Under other legal systems where interim measures of protection can be ordered by an arbitral tribunal, they cannot be enforced; in those cases it may be preferable for the parties to rely on a court to order interim measures. Under many legal systems a court may order interim measures even if the dispute is to be or has been submitted to arbitration.

19. It is desirable for the arbitration agreement to obligate the parties to implement arbitral decisions, including decisions ordering interim measures. The advantage of including such an obligation in the agreement is that under some legal systems, where an arbitral award is not enforceable in the country of a party, a failure by the party to implement an award when obligated to do so by the agreement might be treated in judicial proceedings as a failure by the party to perform a contractual obligation.

20. If judicial proceedings are instituted in respect of a dispute that is covered by a valid arbitration agreement, upon a timely request the court will normally refer the dispute to arbitration. However, the court may retain the authority to order interim measures and will normally be entitled to control certain aspects of arbitral proceedings (e.g., to decide on a challenge to arbitrators) and to set aside arbitral awards on certain grounds (see paragraph 15 above).

21. Parties that are considering authorizing the arbitral tribunal to decide disputes *ex aequo et bono* or to act as *amiable compositeur* should bear in mind that arbitrators are not permitted to do so under some legal systems. In addition, such authorizations may be interpreted in different ways and lead to legal insecurity. For example, the terms might be interpreted as authorizing the arbitral tribunal to be guided either only by principles of fairness, justice or equity, or, in addition, by those provisions of the law applicable to the contract regarded in the legal system of that law as fundamental. If the parties wish to authorize

<sup>2</sup>United Nations, *Treaties Series*, vol. 330, No. 4739 (1959), p. 38.

the arbitral tribunal to decide disputes without applying all legal rules of a State to the agreement, they may wish to specify the standards or rules according to which the arbitral tribunal is to decide the substance of the dispute. In order to avoid any misunderstanding, the parties may wish to make it clear that the arbitral tribunal is to decide in accordance with the terms of the contract and the relevant usages of trade applicable to the transaction.

## 2. *Type of arbitration and appropriate procedural rules*

22. The parties are able to select the type of arbitration that best suits their needs. It is desirable that they agree on appropriate rules to govern their arbitral proceedings. There is a wide range of arbitration systems available, with varying degrees of involvement of permanent bodies (e.g., arbitration institutions, courts of arbitration, professional or trade associations and chambers of commerce) or third persons (e.g., presidents of courts of arbitration or of chambers of commerce). At one end of the spectrum is the pure ad hoc type of arbitration, which does not involve a permanent body or third person in any way. This means, in practical terms, that no outside help is available (except, perhaps, from a national court) if, for example, difficulties are encountered in the appointment or challenge of an arbitrator. Moreover, any necessary administrative arrangements have to be made by the parties or the arbitrators themselves. At the other end of the spectrum there are arbitrations fully administered and supervised by a permanent body, which may review terms of reference and the draft award and may revise the form of the award and make recommendations as to its substance.

23. Between these two types of arbitration there is a considerable variety of arbitration systems, all of which involve an appointing authority but differ as to the administrative services that they provide. The essential, although not necessarily exclusive, function of an appointing authority is to compose or assist in composing the arbitral tribunal (e.g., by appointing the arbitrators, deciding on challenges of an arbitrator or replacing an arbitrator). Administrative or logistical services, which may be offered as a package or separately, could include the following: forwarding written communications of a party or the arbitrators; assisting the arbitral tribunal in establishing and notifying the date, time and place of hearings and other meetings; providing, or arranging for, meeting rooms for hearings or deliberations of the arbitral tribunal; arranging for stenographic transcripts of hearings and for interpretation during hearings and possibly translation of documents; assisting in filing or registering the arbitral award, when required; holding deposits and administering accounts relating to fees and expenses; and providing other secretarial or clerical assistance.

24. Unless the parties opt for pure ad hoc arbitration, they may wish to agree on the body or person to perform the functions that they require. Among the factors worthwhile considering in selecting an appropriate body or person are the following: willingness to perform the required functions; competence, in particular in respect of international matters; appropriateness of fees measured against the ex-

tent of services requested; seat or residence of the body or person and possible restriction of its services to a particular geographic area. The latter point should be viewed in conjunction with the probable or agreed place of arbitration (see paragraphs 33 to 37 below). However, certain functions (e.g., appointment) need not necessarily be performed at the place of arbitration, and certain arbitral institutions are prepared to provide services in countries other than those where they are located.

25. In most cases, the arbitral proceedings will be governed by the law of the State where the proceedings take place. Many States have laws regulating various aspects of arbitral proceedings. Some provisions of these laws are mandatory; others are non-mandatory. In selecting the place of arbitration (see paragraph 33 to 37 below), the parties may wish to consider the extent to which the law of a place under consideration recognizes the special needs and features of international commercial arbitration and, in particular, whether it is sufficiently liberal to allow the parties to tailor the procedural rules to meet their particular needs and wishes while at the same time ensuring that the proceedings are fair and efficient. A recent trend in this direction, discernible from modern legislation in some States, is being enhanced and fortified by the UNCITRAL Model Law on International Commercial Arbitration.<sup>3</sup> The UNCITRAL Model Law is becoming increasingly accepted by States of different regions and different legal and economic systems.

26. Since the procedural rules in the arbitration laws of some States are not necessarily suited to the particular features and needs of international commercial arbitration, and since, in any case, those laws do not contain rules settling all procedural questions that may arise in relation to arbitral proceedings, the parties may wish to adopt a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution, and may refuse to administer a case if the parties have modified provisions of those rules that the institution regards as fundamental to its arbitration system. Most arbitral institutions, however, offer a choice of two or sometimes more sets of rules and usually allow the parties to modify any of the rules. If the parties are not required by an institution to use a particular set of arbitration rules or to choose among specified sets of rules, or if they choose ad hoc arbitration, they are free to choose a set of rules themselves. In selecting a set of procedural rules, the parties may wish to consider its suitability for international cases and the acceptability of the procedures contained in them.

27. Of the many arbitration rules promulgated by international organizations or arbitral institutions, the UNCITRAL

<sup>3</sup>Report of the United Nations Commission on International Trade Law on the work of its eighteenth session (1985), *Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17)*, para. 332 and annex I (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XVI: 1985, part three, I (United Nations publication, Sales No. E.87.V.4)). The United Nations General Assembly, in its resolution 40/72 of 11 December 1985, recommended "that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice".

Arbitration Rules<sup>4</sup> deserve particular mention. These Rules have proven to be acceptable in the various legal and economic systems and are widely known and used in all parts of the world. Parties may use them in pure ad hoc arbitrations as well as in arbitrations involving an appointing authority with or without the provision of additional administrative services. A considerable number of arbitration institutions in all regions of the world have either adopted these Rules as their own institutional rules for international cases or have offered to act as appointing authority in conjunction with the use of those Rules. Most of them will provide administrative services in cases conducted under the UNCITRAL Arbitration Rules.

28. Where a model clause accompanies the arbitration rules to govern arbitrations under the countertrade agreement or is suggested by an arbitral institution, adoption of that clause by the parties may help to enhance the certainty and effectiveness of the arbitration agreement. Some model clauses, such as the one accompanying the UNCITRAL Arbitration Rules, invite the parties to settle certain practical matters by agreement. These include the involvement of an appointing authority, as well as the number of arbitrators (see paragraphs 29 to 31 below), the appointment of arbitrators (see paragraph 32 below), the place of arbitration (see paragraphs 33 to 37 below) and the language or languages to be used in the arbitral proceedings (see paragraphs 38 and 39 below).

### 3. Number of arbitrators

29. The parties may wish to specify in the arbitration clause the number of arbitrators who are to comprise the arbitral tribunal. If the parties fail to do so, the chosen arbitration rules or, in some cases, the law applicable to the arbitral proceedings will either specify that number or the manner by which it is to be determined. Agreement by the parties on the number of arbitrators will enable the parties to ensure that the number conforms to their particular needs and wishes, and will provide certainty in respect of that aspect of the appointment process. However, parties should be aware that some national laws restrict their freedom to agree upon the number of arbitrators by, for example, prohibiting an even number of arbitrators.

30. Other than the possible legal restriction just referred to, the considerations that may be relevant to the question of the number of arbitrators are essentially of a practical nature. In order to ensure the efficient functioning of the arbitral proceedings and the taking of decisions, it is usually desirable to specify an uneven number, i.e. one or three, although in practice parties sometimes specify two-member panels, coupled with a mechanism for calling in a third arbitrator, "umpire" or "referee", to overcome any impasse between the two.

<sup>4</sup>Report of the United Nations Commission on International Trade Law on the work of its ninth session (1976), *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17 (A/31/17)*, para. 57 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. VII: 1976, part one, II, A (United Nations publication, Sales No. E.77.V.6)). The use of the UNCITRAL Arbitration Rules has been recommended by the United Nations General Assembly in its resolution 31/98 of 15 December 1976.

31. As to whether one or three arbitrators should be specified, the parties may wish to consider that arbitral proceedings conducted by a sole arbitrator are generally less costly and tend to be more expeditious than proceedings where the fees of three arbitrators have to be paid and where three time schedules have to be accommodated. On the other hand, three arbitrators may bring a wider range of expertise and background to the proceedings. Since the desirable expertise and background can be of different types, different methods of appointing the arbitrators may be envisaged.

### 4. Appointment of arbitrators

32. On the one hand, in an international case, each party may want to have one arbitrator of its choice who would be familiar with the economic and legal environment in which that party operates. Therefore, the parties might agree on a method by which each party appoints one arbitrator and the third arbitrator is chosen by the two thus appointed or by an appointing authority. On the other hand, in complex disputes involving legal, technical and economic issues, it may be of considerable advantage to have arbitrators with different qualifications and expertise in the relevant fields. Where parties attach particular importance to this aspect, they may wish to entrust an appointing authority with the appointment of all three arbitrators and, possibly, specify the qualifications or expertise required of the arbitrators.

### 5. Place of arbitration

33. The parties may wish to specify in the arbitration agreement the place where the proceedings are to be held and where the arbitral award is to be issued. The selection of an appropriate place of arbitration may be crucial to the functioning of the arbitral process and to the enforceability of the arbitral award. The following considerations may be relevant to the selection of the place of arbitration.

34. Firstly, the parties may consider it desirable to choose a place of arbitration such that an award issued in that place would be enforceable in the countries where the parties have their places of business or substantial assets. In many States, foreign awards are readily enforceable only by virtue of multilateral or bilateral treaties, and often only on the basis of reciprocity. In some States enforcement is available on the basis of legislation providing for the reciprocal enforcement of awards made in certain other States. The parties may thus wish to choose a place of arbitration in a State that is in such a treaty relationship, or has reciprocal legislative arrangements, with the States where enforcement might later be sought.

35. Secondly, the parties may consider it desirable to choose a place where the arbitration law provides a suitable legal framework for international cases. Some arbitration laws might be inappropriate because, for example, they unduly restrict the autonomy of the parties or fail to provide a comprehensive procedural framework to ensure efficient and fair proceedings.

36. Considerations of a more practical nature include the following: the convenience of the parties and other persons involved in the proceedings; the availability of necessary

facilities, including meeting rooms, support services and communication facilities; the availability of administrative services of an arbitral institution or chamber of commerce, if so desired by the parties; relevant costs and expenses, including expenses for travel, accommodation, meeting rooms and support services; the ability of the parties' counsel to represent the parties without the need to retain local lawyers. Another relevant consideration is that it may be advantageous for the arbitral proceedings to be held in a place which is near to the subject-matter in dispute.

37. Yet other considerations often lead parties to agree on a place other than in the States where they have their places of business. For example, the parties may select a third State because each party may have misgivings about arbitrating in the other party's country; a party in whose State the proceedings are conducted might be thought by the other party to benefit from a familiar legal and psychological environment and from other circumstances facilitating the presentation of the case.

#### **6. Language of proceedings**

38. The parties may also wish to specify the language to be used in the arbitral proceedings. The choice of the language may influence the efficiency with which the proceedings are conducted and the cost of the proceedings. Whenever possible, it is desirable to specify a single language, such as the language in which the contract is written. When more than one language is specified, the costs of translation and interpretation from one language to the other are usually considered to be part of the costs of arbitration and apportioned in the same way as the other costs of arbitration.

39. The parties may wish to specify the types of documents or communications that must be submitted in or translated into the specified language. They may, for example, require the written pleadings, oral testimony at a hearing, and any award, decision or other communication of the arbitral tribunal to be in the specified language. The tribunal may be given the discretion to decide whether and to what extent documentary evidence should be translated. Such discretion may be appropriate in view of the fact that documents submitted by the parties may be voluminous and that only a part of a document may be relevant to a dispute.

#### **E. Judicial proceedings**

40. Disputes that are not settled through negotiation or conciliation will, if the parties do not agree to arbitration, have to be settled in judicial proceedings. Courts of two or more countries may be competent to decide a given dispute between the parties, and in some cases the manner in which a dispute is decided may depend upon which court decides the dispute. For example, the validity and effect of a choice by the parties of the applicable law will depend upon the rules of private international law in the country of the court deciding the dispute (see chapter XIV, "Choice of law", paragraphs 12 and 13).

41. The uncertainties that arise when more than one court is competent to decide a dispute may be reduced by an ex-

clusive jurisdiction clause, obligating the parties to submit disputes that arise between them to a specified court in a specified place in a specified country. However, the parties should bear in mind that, under many legal systems, a clause conferring exclusive jurisdiction on a court is valid only if the selected court is competent to decide the types of disputes that are submitted to it under the clause. Therefore, in selecting a court, the parties should ascertain that the court is legally competent to decide the types of disputes that are to be submitted to it. It is advisable for the clause to specify a court in the selected country, rather than to refer simply to a competent court in that country, in order to avoid questions as to which court was to decide a given dispute. The clause may stipulate the types of disputes that are subject to it in a manner similar to the specification in an arbitration agreement (see paragraph 17 above).

42. In referring disputes to the courts of a particular State, the parties should bear in mind the extent to which judicial decision made in that State would be enforceable in the countries of the parties, or in any other country in which enforcement may be sought (see paragraph 34 above).

43. While an exclusive jurisdiction clause may reduce uncertainties with respect to matters such as the law applicable to the contract and the enforceability of a decision, and may facilitate the multi-party settlement of disputes (see paragraphs 48 and 49 below), it may also have certain disadvantages. If a court in the country of one of the parties is given exclusive jurisdiction, and the exclusive jurisdiction clause is invalid under the law of the country of the selected court, but valid under the law of the country of the other party, difficulties may arise in initiating judicial proceedings in either of the countries. Difficulties connected with initiating judicial proceedings may be magnified if the parties confer exclusive jurisdiction on a court in a third country.

#### **F. Multi-contract and multi-party dispute settlement**

44. Countertrade transactions often involve several contracts in the two directions, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court. If disputes are to be settled judicially, the parties may wish to confer exclusive jurisdiction on a particular court (see paragraphs 41 to 43 above). If the parties opt for arbitration or conciliation, they may wish to agree that the arbitral tribunal or conciliator appointed to settle the first dispute that arises will also be appointed to settle any subsequent disputes that may arise in the countertrade transaction.

45. The selection of a single body to settle disputes would be useful when the disputes to be resolved raise similar questions of fact or law. This may promote economy and efficiency in dispute settlement, facilitate consolidation of dispute settlement proceedings, and lessen the possibility of inconsistent decisions. Even if disputes that may arise under the countertrade transaction do not all raise similar questions of law or fact, the selection of a single

dispute settlement body may be advantageous because it may allow the parties to reduce the cost of legal advice and facilitate administration of the transaction.

46. There may, however, be circumstances in which the parties agree to the submission of disputes under a given supply contract to a particular dispute settlement body, but decide to submit disputes under other contracts to a different body. Such circumstances may exist, for example, when it is customary in the practice of the parties or in the trade, or it is required by mandatory rules, that a particular supply contract be submitted to a particular dispute settlement method or body, and the parties do not wish to submit the other contracts in the transaction to that same method or body.

47. The possibility of disputes under more than one contract involving similar questions of fact or law may exist in a number of situations. One such situation is when the subject-matter of the supply contracts in one direction is related to the subject-matter of the supply contracts in the other direction. This may be the case in a buy-back transaction in which, for example, a dispute as to the quality of the counter-export goods manufactured by equipment supplied under the export contract is related to a dispute as to the quality of that equipment. Similarly, in a direct offset transaction, in which the goods supplied in one direction are incorporated into the goods supplied in the other direction, a dispute as to the quality or timeliness of delivery of the goods in one direction may be related to a dispute as to the quality or timeliness of delivery of the goods in the other direction. Another situation in which related disputes may arise is when the countertrade agreement establishes a linked payment mechanism through which proceeds generated by the shipment of goods in one direction are to be used to pay for the shipment of goods in the other direction (see chapter IX, "Payment"). For example, when the importer, in accordance with the countertrade agreement, retains the proceeds of the export contract, a dispute as to the responsibility for a failure to conclude a counter-export contract may lead to a related dispute concerning the transfer of proceeds of the export contract to the exporter. When the countertrade agreement provides for the setoff of payment claims for supply contracts concluded in the two directions, a dispute as to settlement of imbalances may involve questions of fact or law pertaining to supply contracts in either direction. Yet another situation in which related disputes may arise is when the countertrade agreement provides that a problem in the conclusion or perform-

ance of supply contracts in one direction is to have an effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction (see chapter XIII, "Failure to complete countertrade transaction", paragraphs 38 to 60).

48. Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods. For example, when there is a dispute between the counter-exporter and the counter-importer as to whether liquidated damages are payable for a failure to purchase goods, a third-party purchaser engaged by the counter-importer to purchase those goods would have an interest in the dispute if a "hold-harmless" clause has been agreed upon between the third-party purchaser and the counter-importer (see chapter VIII, "Participation of third parties", paragraph 33). Similarly, the counter-importer would be interested in the outcome of a dispute between a third-party purchaser and the counter-exporter if the counter-importer remains liable for the fulfilment of the countertrade commitment despite the engagement of the third-party purchaser. A further example of a multi-party dispute would be when both the party originally committed to purchase and the third-party purchaser are liable to the supplier for the fulfilment of the countertrade commitment and the supplier decides to pursue a claim against both of them.

49. In the types of cases referred to in the preceding paragraph, it may be desirable to settle all related issues in the same dispute settlement proceedings. This could prevent inconsistent decisions, facilitate the taking of evidence, and reduce costs. However, multi-party proceedings tend to be more complicated and less manageable, and a party may find it more difficult to plan and present its case in such proceedings. Many legal systems provide a means for disputes involving several parties to be settled in the same multi-party judicial proceedings. In order to enable disputes involving several parties to be settled in multi-party judicial proceedings, it may be desirable for related contracts to contain a clause conferring exclusive jurisdiction on a court that has the power to conduct multi-party proceedings (see paragraphs 41 to 43 above). It is more difficult to structure multi-party arbitration proceedings because, under most legal systems, all the participating parties have to agree to the submission of their disputes to the same panel of arbitrators.

[A/CN.9/WG.IV/WP.51/Add.7]

## DRAFT ILLUSTRATIVE PROVISIONS

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## Introduction

1. At the twenty-third session of the Commission (1990), it was suggested that illustrative contract provisions should be included in the legal guide in order to facilitate its use (A/45/17, annex I, para. 6). The present addendum has been prepared pursuant to that suggestion.

2. The preparation of the illustrative provisions contained in the present addendum has been influenced by the following considerations. Firstly, the draft chapters of the legal guide discuss possible contractual solutions in such a way that the reader can derive from the draft chapters guidance to drafting clauses for a countertrade agreement. Secondly, illustrative provisions must of necessity be drafted in a general manner and may therefore not take into account the actual circumstances in a given countertrade transaction. These considerations reduce the number of illustrative provisions that can usefully be added to the legal guide.

3. The Working Group may wish to consider the advisability of including in the legal guide illustrative provisions such as the ones presented here.

4. If the Working Group decides that illustrative provisions should be included in the legal guide, it is suggested that they be presented in footnotes to the text of the legal guide, and that the following explanation be included in chapter I, "Introduction to Legal Guide":

### *"Illustrative provisions"*

"Some chapters of the Legal Guide contain one or more 'illustrative provisions' set forth in footnotes. They are included in order to make issues discussed in the text of a chapter easier to understand. They also serve to illustrate how certain solutions discussed in the text might be structured. Illustrative provisions have not been included where an understanding of an issue and guidance to drafting is clearly obtainable from the text of the chapter, or where a provision cannot be drafted in isolation from the particular countertrade transaction.

"It is emphasized that illustrative provisions should not necessarily be regarded as models for inclusion in particular agreements entered into by the parties. The precise content of a clause and language to be used in it is likely to vary with each countertrade transaction. In addition, there is usually more than one possible solution to an issue, even though only one of those possible solutions is presented in an illustrative provision. It is therefore important that parties who draft a provision based upon an illustrative provision carefully consider whether the provision fits harmoniously within their countertrade transaction."

## Chapter V. Type, quality and quantity of goods

### *Footnote to paragraph 13*

Assuming that "X Company" is the supplier and "Y Company" is the party committed to purchase, the clause may read as follows:

"Goods offered for purchase under the countertrade agreement must:

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

"(b) be fit for any particular purpose expressly or impliedly made known to X Company at the time of the conclusion of the countertrade agreement;

"(c) possess the qualities which X Company has held out to Y Company as a sample or model;

"(d) be contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods."

(The clause is modelled on article 35 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)).

## Chapter VI. Pricing of goods

### *Footnote to paragraph 37*

Assuming that the currency of payment is the Austrian schilling and that the reference currency is the Swiss franc, the clause may read as follows:

"If, on the date of actual payment, the exchange rate between the Austrian schilling and the Swiss franc is at variance from the exchange rate ... [specify exchange rate prevailing at a particular place] as it was on the date of conclusion of the countertrade agreement by more than ... [e.g. 5 per cent, or some other percentage specified by the parties], the price in Austrian schillings shall be increased or decreased so that that price, as converted into Swiss francs, would remain unchanged from the price as expressed in Swiss francs on the date of conclusion of the countertrade agreement."

## Chapter VIII. Participation of third parties

### *Footnote to paragraph 10*

Assuming that "Y Company" is the party committed to purchase, the clause may read as follows:

"Y Company is authorized to engage a third-party purchaser to make the purchases necessary to fulfil the countertrade commitment. In the event of such an engagement of a third party, Y Company remains liable for the fulfilment of the countertrade commitment."

*Footnote to paragraph 16*

Assuming that "Y Company" is the party committed to purchase, the clause may read as follows:

"Upon the engagement of a third-party purchaser, and upon the assumption by the third-party purchaser of the commitment to make the purchases necessary to fulfil the countertrade commitment as set forth in the countertrade agreement, Y Company will be released from liability for fulfilment of the countertrade commitment."

*Footnote to paragraph 21*

Assuming that "Z Company" is the third-party purchaser, "Y Company" is the party originally committed to purchase, and "X Company" is the supplier, the clause may read as follows:

"Z Company agrees to make the purchases necessary to fulfil the countertrade commitment set forth in the countertrade agreement between Y Company and X Company, a copy of which is attached to this contract. Z Company agrees to be bound by all the terms and conditions of that countertrade agreement, and in particular Z Company agrees to pay the liquidated damages stipulated in the countertrade agreement in the event Z Company fails to make the purchases necessary to fulfil the countertrade commitment."

The parties may wish to include the above provision in an agreement concluded by the party originally committed to purchase, by the third-party purchaser and by the supplier, in which the countertrade commitment is transferred to the third-party purchaser and the supplier consents to the transfer and to the release of the party originally committed from the countertrade commitment (see chapter VIII, paragraph 16). In such cases, the consent of the supplier to the release may be expressed in the following form:

"X Company consents to the assumption of the obligations under the countertrade agreement by Z Company and, when the assumption of those obligations becomes effective, to the release of Y Company from those obligations."

## Chapter X. Restrictions on resale of countertrade goods

*Footnote to paragraph 9*

Assuming that "Y Company" is the party purchasing goods pursuant to the countertrade agreement and that "X Company" is the supplier, the clause may read as follows:

"Y Company must inform X Company [*alternative A:*] of the resale of those goods; the information shall be given within . . . days after the conclusion of the resale contract. [*alternative B:*] of the negotiations for the resale of the countertrade goods; Y Company shall give X Company [. . . days] [sufficient time] to make any observations or

suggestions on the intended resale, and Y Company shall refrain from concluding the resale contract under negotiation before the expiry of that time period. [*Both alternatives:*] The information to be given must indicate . . . [include some or all of the following: country, region within a country, or city to which the countertrade goods are to be shipped; place of business of the person to whom the goods are being resold; resale price; whether the countertrade goods have been re-marked or repackaged prior to resale and, if so, what packaging or marking has been used.]"

## Chapter XI. Liquidated damages and penalty clauses

*Footnote to paragraph 5*

Assuming that "X Company" is the supplier, "Y Company" is the party committed to purchase, and the Austrian schilling the currency of payment, the clause may read as follows:

*[For failure to purchase goods]*

"(1) If Y Company fails to make the purchases necessary to fulfil the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, Y Company will be obligated to pay to X Company an amount in Austrian schillings equivalent to . . . per cent of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, Y Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

"(2) To the extent that the failure by Y Company results from a failure by X Company to make goods available in conformity with this countertrade agreement, paragraph (1) will not apply."

*[For failure to supply goods]*

"(1) If X Company fails to make the goods available for the fulfilment of the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, X Company will be obligated to pay to Y Company an amount in Austrian schillings equivalent to . . . per cent of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, X Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

"(2) To the extent that the failure by X Company results from a failure by Y Company to fulfil its obligations under this countertrade agreement, paragraph (1) will not apply."

*Footnote to paragraph 12 (provision that could be added to any liquidated damages or penalty clause)*

"No damages are recoverable in addition to the agreed sum for the failure for which the agreed sum is payable."

*Footnote to paragraph 22 (provision that could be added to any liquidated damages or penalty clause)*

"If payment of the agreed sum becomes due in accordance with paragraph (1), the party entitled to claim the

agreed sum has the right to deduct that sum, in whole or in part, from any payment due by that party to the party obligated to pay the agreed sum under [the following contracts only: . . .] [any contract between the parties]."

### Chapter XIII. Failure to complete countertrade transaction

#### Footnote to paragraph 6

Assuming the "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

*[For release without additional period]*

"If the X Company fails to accept a purchase order made by Y Company in accordance with this countertrade agreement [or a purchase order made by a third-party purchaser engaged by Y Company pursuant to this countertrade agreement], Y Company is entitled to declare the amount of the outstanding countertrade commitment reduced by the amount of the purchase order that was not accepted."

*[For release with additional period]*

"(1) [Same text as above]

"(2) In order to avail itself of the right in paragraph (1) to declare the outstanding countertrade commitment reduced, Y Company must give X Company written notice specifying that the failure to accept the purchase order constituted a breach of the countertrade commitment and that the outstanding countertrade commitment will be reduced by the amount of the unaccepted purchase order if X Company does not make the goods available within the additional period of [e.g., 30 days]."

#### Footnote to paragraph 22

Assuming the "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

"(1) [Y Company] [X Company] is exempt from the payment of damages, or of an agreed sum, in respect of a failure to fulfil its obligations under the countertrade agreement if that party proves that the failure was due to a physical or legal impediment beyond its control and that the party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the countertrade agreement or to have avoided or overcome it or its consequences.

"(2) The period for the fulfilment of the countertrade commitment will be extended by a period of time corresponding to the duration of the impediment. If the impediment lasts longer than [e.g., six months], [the party against which the impediment is claimed] [either party] may terminate the countertrade agreement by written notice."

#### Footnote to paragraph 24

*[General definition of exempting impediment followed by illustrative or exhaustive list]*

"(1) [Same text as in para. (1) of the illustrative provision to paragraph 22]

"(2) *[Illustrative list:]* The following are examples of events that are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1): . . . *[Exhaustive list:]* Only the following events are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1)."

#### Footnote to paragraph 43

Assuming that "Y Company" is the exporter (counter-importer) and that "X Company" is the importer (counter-exporter), the clause would read as follows:

"A failure by Y Company to purchase goods pursuant to this countertrade agreement does not entitle X Company to suspend or withhold payment due by X Company to Y Company under the contract for the supply of . . ."

#### Footnote to paragraph 49, first sentence

"If a contract for the supply of goods in one direction is terminated, neither party is entitled, irrespective of the cause for the termination, to suspend conclusion of contracts in the other direction or to suspend or withhold performance of obligations under concluded contracts in the other direction."

#### Footnote to paragraph 49, second sentence

"If a contract for the supply of goods by X Company to Y Company concluded pursuant to this countertrade agreement is terminated, neither party is entitled, irrespective of the cause for the termination, to suspend or withhold performance under the contract for the supply of goods by Y Company to X Company."

### Chapter XIV. Choice of law

#### Footnote to paragraph 20, second sentence (illustrative provision for the countertrade agreement and for a supply contract)

"The law of . . . (specify a country or a particular territorial unit) [as in force on . . . (specify date the countertrade agreement or the supply contract is entered into)] is to govern this . . . (specify countertrade agreement or supply contract). [The rules of private international law of . . . (specify the same country or territorial unit as above) do not apply.]"

#### Footnote to paragraph 20, fourth sentence (illustrative provision for the countertrade agreement and for a supply contract)

[Same as in footnote to paragraph 20, second sentence, with the addition, after the first sentence, of the following:] "The selected law governs in particular the formation of and validity of the contract and the consequences of its invalidity."

## Chapter XV. Settlement of disputes

### Footnote to paragraph 12

The following model clause is recommended in the UNCITRAL Conciliation Rules:

"Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force."

### Footnote to paragraph 28

The following clause is recommended in the UNCITRAL Arbitration Rules:

"Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force."

*Note—Parties may wish to consider adding:*

"(a) The appointing authority shall be ... (name of institution or person);

"(b) The number of arbitrators shall be ... (one or three);

"(c) The place of arbitration shall be ... (town or country);

"(d) The language(s) to be used in the arbitral proceedings shall be ..."

## C. International countertrade: draft chapters of legal guide on international countertrade transactions: report of the Secretary-General (A/CN.9/362 and Add.1-17) [Original: English]

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[A/CN.9/362]

# DRAFT CHAPTERS OF LEGAL GUIDE ON INTERNATIONAL COUNTERTRADE TRANSACTIONS: REPORT OF THE SECRETARY-GENERAL

1. The Commission considered its possible work on the topic of countertrade at its nineteenth session (1986) in the context of the discussion of a note by the Secretariat entitled "Future work in the area of the new international economic order" (A/CN.9/277). There was considerable support in the Commission for undertaking work on the topic, and the Secretariat was requested to prepare a preliminary study on the subject (A/41/17, para. 243).

2. At its twenty-first session (1988), the Commission had before it a report entitled "Preliminary study of legal issues in international countertrade" (A/CN.9/302). The Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up countertrade contracts. In order for the Commission to decide what further action might be taken, the Commission requested the Secretariat to prepare for the twenty-second session of the Commission a draft outline of such a legal guide (A/43/17, paras. 32-35).

3. At its twenty-second session (1989), the Commission considered the report entitled "Draft outline of the possible content and structure of a legal guide on drawing up international countertrade contracts" (A/CN.9/322). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare for the twenty-third session of the Commission draft chapters of the legal guide (A/44/17, paras. 245-249).

4. At its twenty-third session (1990), the Commission considered an outline of the introductory chapter to the legal guide, and draft chapter II, "Scope and terminology of legal guide" (both in A/CN.9/332/Add.1), as well as the following draft chapters: III. "Contracting approach"

(Add.2); IV. "General remarks on drafting" (Add.3); V. "Type, quality and quantity of goods" (Add.4); VI. "Pricing of goods" (Add.5); IX. "Payment" (Add.6); and XII. "Security for performance" (Add.7). The discussion in the Commission is reflected in A/45/17, annex 1. There was general agreement in the Commission with the overall approach taken in preparing the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein (A/45/17, para. 16). The Commission decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them to the Working Group on International Payments. It was also decided that the final text of the legal guide should be submitted to the twenty-fifth session of the Commission in 1992 (A/45/17, paras. 17 and 18).

5. The Working Group on International Payments, at its twenty-third session in September 1991, considered draft chapters VII. "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8); VIII. "Participation of third parties" (A/CN.9/WG.IV/WP.51/Add.1); X. "Restrictions on resale of countertrade goods" (Add.2); XI. "Liquidated damages and penalty clauses" (Add.3); XIII. "Failure to complete countertrade transaction" (Add.4); XIV. "Choice of law" (Add.5); XV. "Settlement of disputes" (Add.6); and draft illustrative provisions (Add.7). The discussion in the Working Group is reflected in document A/CN.9/357. The Working Group requested the Secretariat to revise the draft chapters and illustrative provisions in the light of the Working Group's deliberations and decisions and to present them to the twenty-fifth session of the Commission (A/CN.9/357, para. 13).

6. Addenda 1 to 17 to the present document contain the following revised draft chapters and other materials relating to the Legal Guide:

- I. "Introduction" (Add.1)
- II. "Scope and terminology of Legal Guide" (Add.2)
- III. "Contracting approach" (Add.3)

- IV. "Countertrade commitment" (Add.4) (draft chapter IV incorporates revised earlier draft chapter VII, "Fulfilment of countertrade commitment" and revised section C of earlier draft chapter III, "Contracting approach")
- V. "General remarks on drafting" (Add.5)
- VI. "Type, quality and quantity of goods" (Add.6)
- VII. "Pricing of goods" (Add.7)
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- IX. "Payment" (Add.9)
- X. "Restrictions on resale of countertrade goods" (Add.10)
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- XV. "Settlement of disputes" (Add.15)
- Draft illustrative provisions (Add.16)
- Chapter summaries (Add.17)
- Index (Add.18)<sup>a</sup>

[A/CN.9/362/Add.1]

## I. INTRODUCTION

### A. Origin and purpose of the Legal Guide

1. This Legal Guide was prepared by the United Nations Commission on International Trade Law (UNCITRAL) and by its Working Group on International Payments. In addition to representatives of member States of the Commission, representatives of many other States and of a number of international organizations participated actively in the preparatory work.

2. The Commission considered work to be undertaken in the area of countertrade in 1986, in the context of the discussion of the Commission's work in the field of the new international economic order.<sup>1</sup> In 1989 the Commission decided to prepare a legal guide on international countertrade transactions and requested the Secretariat to prepare draft chapters of such a guide.<sup>2</sup> The draft chapters were discussed at the twenty-third session of the Commission in 1990,<sup>3</sup> and at the twenty-third session of the Work-

ing Group on International Payments in 1991.<sup>4</sup> [The Commission reviewed the revised draft chapters and approved the Legal Guide at its twenty-fifth session in 1992, subject to editorial modifications left to the Secretariat.<sup>5</sup>]

3. In preparing draft materials for consideration by the Commission and the Working Group, the Secretariat consulted with practitioners and other experts in the field of international countertrade. In addition, it examined model contract forms, general contract conditions and individual contracts from various parts of the world. Such sources are too numerous to be acknowledged individually; however, recognition is hereby given to their contribution in the preparation of the Legal Guide.

4. The preparation of the Legal Guide was motivated by an awareness that parties engaging in countertrade may lack relevant legal knowledge and experience, and that as a result they may not find optimal contractual solutions to legal issues that may arise in countertrade transactions. Those issues arise in particular from the fact that countertrade transactions are composite transactions encompassing the supply of goods in two directions, that there is a contractual link between those supplies of goods and that countertrade transactions often contain commitments of parties to enter into future contracts. Contractual solutions are particularly important in this area because national legislations often do not contain provisions specific to countertrade. Legal difficulties in this area may adversely affect many parties from developing countries, as well as parties from industrially developed countries, in particular if they do not regularly engage in countertrade.

5. The Legal Guide seeks to assist parties negotiating international countertrade transactions by identifying the legal issues involved, discussing possible approaches to the solution of the issues and, where appropriate, suggesting solutions that the parties may wish to agree on. The discussion in the Guide takes into account disparities among national laws. It is hoped that one result of the Guide will be to promote the development of an international common understanding as to the identification and resolution of legal issues arising in connection with countertrade transactions.

6. The Legal Guide has been designed to be of use to persons involved at various levels in negotiating and drawing up contracts in international countertrade transactions. It is intended for use by lawyers as well as by participants in countertrade who do not have a legal background. The Guide is also intended to be of assistance to persons who have overall managerial responsibility, and who require a broad awareness of the structure of those transactions and the principal legal issues to be covered by them. It is emphasized, however, that the Legal Guide should not be regarded by the parties as a substitute for obtaining legal advice from competent advisers.

7. It should be noted that the various solutions discussed in the Legal Guide will not govern the relationship between

<sup>a</sup>Addendum 18 was not issued.

<sup>1</sup>Report 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)*, paras. 235-243.

<sup>2</sup>Report of the United Nations Commission on International Trade Law on the work of its twenty-second session, *Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17)*, para. 249.

<sup>3</sup>Report of the United Nations Commission on International Trade Law on the work of its twenty-third session, *Official Records of the General Assembly, Forty-fifth Session, Supplement No. 17 (A/45/17)*, paras. 11-18 and annex I.

<sup>4</sup>Report of the Working Group on International Payments on the work of its twenty-third session (A/CN.9/357).

<sup>5</sup>Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session, *Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17)*, paras. 83-139.

the parties unless they expressly agree upon such solutions, or unless the solutions result from provisions of the applicable law. In addition, the Legal Guide is not intended to be used for interpreting agreements or contracts in countertrade transactions.

### B. Arrangement of the Guide

8. Chapter II defines the scope of the Legal Guide by describing transactions covered by it and by explaining the focus of the discussion and the types of issues addressed. Since a prevailing terminology has not developed in countertrade practice, particular notice should be taken of chapter II, section E, which sets out certain terms specific to countertrade that are used throughout the Guide.

9. Chapter III describes possible contracting approaches to structuring a countertrade transaction. Chapter III also sets out possible types of contract clauses that parties may use, depending on the contracting approach chosen. Those types of clauses are discussed in chapters IV to XV. The discussion in the Legal Guide is restricted to those types of clauses that are specific to or of special importance for countertrade transactions.

10. Some of the clauses discussed in the Legal Guide are essential for establishing a countertrade transaction. Other clauses discussed in the Guide, while not necessarily essential, may be useful in the context of the particular commercial circumstances. In view of the great variety of circumstances in which countertrade transactions are concluded, the Legal Guide does not contain a general suggestion as to the types of clauses that parties should agree upon. It is for the parties to each transaction to judge the extent to which the issues considered in the Guide are relevant to their transaction.

### C. Recommendations in the Guide

*[The following paragraph, except for the modifications in italics, appeared in document A/CN.9/332/Add.1, under the title "1. Introduction to Legal Guide".]*

11. *Where appropriate, the Legal Guide contains suggestions as to how certain issues in a countertrade transaction*

*might be settled. Three levels of suggestion have been used. The highest level is indicated by expressions to the effect that the parties "should" take a particular course of action. Such expressions are used sparingly in the Guide and only when a particular course of action is a logical or legal necessity. An intermediate level is used when it is "advisable" or "desirable", but not logically or legally required, that the parties adopt a particular course of action. The lowest level of suggestion is expressed by formulations such as "the parties may wish to consider" or "the parties might wish to provide", or the agreement by the parties "might" contain a particular solution. The wording used for a particular suggestion may be, for drafting reasons, varied somewhat from that just indicated; however, it should be clear from the wording what level of suggestion is intended.*

### D. Illustrative provisions

*[The following two paragraphs, except for the modification in italics, have been taken from document A/CN.9/WG.IV/WP.51/Add.7, para. 4.]*

12. Some chapters of the Legal Guide contain one or more "illustrative provisions" set forth in footnotes. They are included in order to make issues discussed in the text of a chapter easier to understand. They also serve to illustrate how certain solutions discussed in the text might be structured. Illustrative provisions have not been included where an understanding of an issue and guidance to drafting is clearly obtainable from the text of the chapter, or where a provision cannot be drafted in isolation from the particular countertrade transaction.

13. It is emphasized that illustrative provisions should not necessarily be regarded as models for inclusion in particular agreements entered into by the parties. The precise content and formulation of a clause may vary with each countertrade transaction. In addition, there is usually more than one possible solution to an issue, even though only one of those possible solutions is presented in an illustrative provision. It is therefore important that parties who draft a provision based upon an illustrative provision carefully consider whether the provision fits harmoniously within their countertrade transaction.

[A/CN.9/362/Add.2]

## II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE

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[*Editorial note:* The present draft chapter II is a revision of draft chapter III bearing the same title and published in document A/CN.9/332/Add.1. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.1 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.1 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

#### A. Transactions covered

1. [1] *Countertrade transactions covered by the Legal Guide are those transactions in which one party supplies goods, services, technology or other economic value to the second party, and, in return, the first party purchases from the second party an agreed amount of goods, services, technology or other economic value.* A distinctive feature of these transactions is the existence of a link between the supplies in the two directions in that the conclusion of the supply contract or contracts in one direction is conditioned upon the conclusion of the supply contract or contracts in the other direction. When the parties enter into contracts in opposite directions without expressing such a link between them, the contracts, as regards contractual rights and obligations of the parties, cannot be distinguished from straightforward independent transactions. Therefore, the Legal Guide deals only with transactions that express in a contractual form such a link between the contracts constituting the countertrade transaction.

2. [new paragraph] For the sake of simplicity, the Legal Guide refers only to "goods" as the subject-matter of countertrade transactions. However, the discussion in the Guide on transaction, involving goods is generally applicable also to transactions involving services. The Guide can be used as a broad guidance also for transactions involving technology. In some instances the Guide makes particular reference to services or to technology.

3. [new paragraph] The Legal Guide discusses primarily countertrade transactions in which the goods are delivered across national boundaries. Countertrade transactions in domestic trade may have features that are not considered in the present Guide. Nevertheless, to the extent domestic transactions fall within the varieties of countertrade transactions described herein, the Legal Guide can be used by parties to those transactions.

4. [2] *Countertrade transactions take a variety of forms and display differing features depending upon the particular circumstances of the transaction.* The differences concern such matters as the contractual structure of the transaction (i.e., the number and sequence of the component contracts), whether goods supplied in one direction are to be used in the production of goods to be supplied in the other direction, the manner of payment, and the number of parties involved in the transaction.

[3] \*

[4] \*

5. [5] Another aspect of the variety of countertrade transactions is the degree of interest the parties may have in the different segments of a countertrade transaction. In many transactions one of the parties is interested *primarily* in the export of its own goods *rather than in acquiring goods from the other party*. In other transactions, the parties consider the supply of goods in the two directions as being in their mutual interest. There are also transactions in which, at the outset of the transaction, a party perceives a commitment to conclude future contracts as a concession to the other party, but subsequently comes to regard that commitment as a benefit. \*

6. [new paragraph] In most instances, the discussion in the Legal Guide is relevant generally to various types of countertrade. However, in some contexts the discussion indicates that it is only relevant to a particular type of countertrade.

#### B. Focus on issues specific to countertrade

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section C, paragraphs 24 to 26. Some of the substance of paragraphs 25 and 26 (A/CN.9/332/Add.1) was moved to draft chapter III, "Contracting approach" (A/CN.9/362/Add.3).]

7. [new paragraph] The Legal Guide focuses on the drawing up of contractual clauses that are specific to or of particular importance for international countertrade. Such clauses are contained in an agreement of the parties that establishes a link between the supply of goods in one direction and the supply of goods in the other direction. That agreement is, as explained below in paragraph 24, referred to in the Legal Guide as the "countertrade agreement".

8. [24] *As a rule, the Legal Guide does not deal with the content of the contracts for individual supplies of goods under a countertrade transaction since those contracts generally resemble contracts concluded as discrete and independent transactions.* In some cases, however, the content of a contract is affected by the fact that it forms part of a countertrade transaction. For example, when the proceeds of a contract in one direction are to be used to pay for the contract in the other direction, the two supply contracts may contain payment provisions particular to countertrade. *To the extent clauses specific to countertrade may be inserted in those contracts, the Legal Guide considers them.*

#### C. Governmental regulations

[*Editorial note:* in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section D, paragraphs 27 and 28.]

9. [27] In some countries countertrade is subject to governmental regulations. Such regulations, which may derive from international agreements, are closely linked with national economic policies and as a result vary from country to country and are likely to be changed more often than rules of contract law. Governmental regulations may promote or restrict countertrade in a variety of ways. For ex-

ample, it may be provided that certain types of imports must be paid for only through a countertrade arrangement, that state trading agencies are to explore the possibility of countertrade when negotiating certain types of contracts, that certain types of local products are prohibited from being offered in countertrade, or that an exporter of goods and the foreign purchaser are not free to agree that the resulting payment claim will be settled in a way other than by transferring foreign currency to the exporter's account. Other such rules may relate to exchange controls or to the authority of an administrative organ to approve a countertrade transaction. Some regulations may be specifically oriented to countertrade; others may be more general, but with an impact on countertrade (e.g., competition law, export and import regulations, foreign exchange rules). Some regulations are directed to one contracting party only and do not directly affect the content or the legal effect of the contract concluded by that party. In other instances the regulation may limit the parties' freedom of contract.

10. [28] The Legal Guide advises parties to take into account such governmental regulations. Since the regulations are disparate and are often changed, advice is given, where appropriate, in the form of a caveat rather than in any detailed discussion of the substance of the applicable regulations. *Further discussion on mandatory governmental regulations is contained in chapter XIV, "Choice of law", paragraphs — to —.*

#### D. Universal scope of Legal Guide

[Editorial note: in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section E, paragraph 29.]

11. [29] *Private law questions involved in international countertrade transactions and the motives for engaging in countertrade do not reveal regional particularities. To the extent there exist regional differences in contract practices, they concern in particular the frequency of use of certain commercial types of countertrade and the elaborateness and refinement of contractual solutions. Consequently, the Legal Guide treats the legal issues arising from countertrade at the universal level.*

#### E. Terminology

[Editorial note: in draft chapter II as it appeared in A/CN.9/332/Add.1, this section appeared as section B, paragraphs 8 to 23.]

12. [29] Terminology used in practice and in writings to describe countertrade transactions and the parties involved in them varies greatly. A prevailing terminology has not developed. The following paragraphs establish a terminology used in the Legal Guide for different varieties of countertrade transactions, parties and contracts in countertrade.

##### 1. Varieties of countertrade

13. [new paragraph] The terms used in the Legal Guide to denote different types of countertrade are explained below. Countertrade transactions are distinguished in the

Legal Guide on the basis of their commercial or technical features and their contractual structure. It should be noted that classifications other than the one explained below exist.

14. [10] *Barter.* In practice the term "barter" is used with different meanings. The term may refer, for example, to countertrade transactions in general, to an intergovernmental agreement addressing mutual trade in particular goods between identified partners, or to countertrade in which trans-border flow of currency is eliminated or reduced or where a single contract governs the mutual shipments of goods. The Legal Guide uses "barter" in a strict legal sense to refer to a contract involving a two-way exchange of specified goods in which the supply of goods in one direction replaces, entirely or partly, the monetary payment for the supply of goods in the other direction. Where there is a difference in value in the supply of goods in the two directions, the settlement of the difference may be in money or in other economic value.

15. [11] *Counter-purchase.* This term is used to refer to a transaction in which the parties, in connection with the conclusion of a purchase contract in one direction, enter into an agreement to conclude a sales contract in the other direction, i.e., a counter-purchase contract. Counter-purchase is distinguished from buy-back in that the goods supplied under the first purchase are not used in the production of the items sold in return.

16. [12] *Buy-back.* This term refers to a transaction in which one party supplies a production facility, and the parties agree that the supplier of the facility, or a person designated by the supplier, will buy products resulting from that production facility. The supplier of the facility often provides technology and training and sometimes component parts or materials to be used in the production.

17. [13] *Offset.* Transactions referred to in the Legal Guide as offsets normally involve the supply of goods of high value or technological sophistication and may include the transfer of technology and know-how, promotion of investments and facilitating access to a particular market. Two types of offset transactions may be distinguished. Under a "direct offset" the parties agree to supply to each other goods that are technologically or commercially related (e.g., component parts or products that are marketed together). A direct offset can contain features of a buy-back transaction (i.e., transfer of production equipment and technology, and purchase by the transferor of the resulting products). The difference between such a direct offset and a buy-back transaction is that in a direct offset both parties commit themselves to purchase over a period of time goods from each other, whereas under a buy-back transaction the party that has supplied the production facility commits itself to purchase goods resulting from the production facility. Such direct offsets are sometimes referred to as industrial participation or industrial cooperation. The expression "indirect offset" typically refers to a transaction where a governmental agency that procures, or approves the procurement of, goods of high value requires from the supplier that counter-purchases are made in the procuring country or that economic value is provided to the procuring country in the form of investment, technology or assistance in third

markets. The counter-export goods are not technologically related to the export goods (i.e., they are not components of the export goods, as in direct offset, and they are not resultant products of the facility provided under the export contract, as in buy-back). The governmental agency often stipulates guidelines for the offset, for example, as to the industrial sectors or regions that are to be assisted in such a way. However, within such guidelines, the party committed to counter-purchase or to providing such assistance is normally free to choose the contracting partners. A countertrade transaction may involve elements of both direct and indirect offset transactions.

## 2. Parties to countertrade transaction

18. [18] *Purchaser, supplier or party.* The Legal Guide frequently uses the term "purchaser", "supplier" or "party" to refer to parties purchasing and supplying goods in a countertrade transaction. *These terms are employed when the discussion in the Guide is relevant both to a situation in which contracts are to be concluded in a particular sequence (chapter III, "Contracting approach", paragraphs 13 to 19) and to the situation in which the parties agree to conclude contracts in the two directions without stipulating a particular sequence of conclusion (chapter III, paragraphs 20 and 21). This terminology is also used when the contracts for the supply of goods in the two directions are concluded concurrently.* \* When reference is made to a party who is committed to purchase or supply goods but has not yet done so, the Legal Guide may use the terms "party committed to purchase goods" and "party committed to supply goods" to make it clear that a contract has not been concluded yet.

19. [14] *Exporter or counter-importer.* The term "exporter" or "counter-importer" is used for the party who is—under the first contract to be concluded—the supplier, i.e., the exporter, of goods, and who has entered into a commitment with the other party to purchase, i.e., to counter-import, other goods in return. One or the other term is used depending on the context in which the party is mentioned. It should be noted that in some countertrade transactions the exporter and the counter-importer are the same party, while in others the exporter and counter-importer are different parties.

20. [15] *Importer or counter-exporter.* The term "importer" or "counter-exporter" is used for the party who is—under the first contract to be concluded—the purchaser, i.e., the importer, of goods, and who has entered into a commitment with the other party to supply, i.e., to counter-export, other goods in return. One or the other term is used depending on the context in which the party is mentioned. As in respect of the exporter and the counter-importer, in some countertrade transactions the same party is the importer and the counter-exporter. Sometimes, however, one party imports and another party counter-exports.

21. [16] In some writings on countertrade the term "exporter" is used to denote the party from an economically developed country, who often supplies goods of technological content that normally cannot be obtained in the other party's country. The term is used in those writings

irrespective of whether the "exporter" supplies first and agrees to purchase later or whether the "exporter" makes an "advance purchase" from the other party in order to enable that other party to raise funds needed for a subsequent purchase of goods from the "exporter". The term "importer" is used in those writings to denote the party from a developing country. To underline that meaning, such writings may use terms such as "primary" or "western exporter" or "developing country importer".

22. [17] A distinction based on economic or regional considerations is not used in the present Legal Guide. One reason is that the guide covers both intraregional and interregional countertrade. Thus, distinctions used in discussions of interregional countertrade, in which the issues tend to be considered primarily from the perspective of one of the parties, would not be suitable since the Legal Guide advises both parties whatever may be their relative economic strength or background. Furthermore, terms based on the time sequence of the conclusion of contracts are more suitable since, for the purpose of discussing the contractual role and interests of parties, the question of primary significance is whether the party has already sold its goods and has promised to purchase goods from the other party, or whether the party, having purchased goods, has not sold its goods yet.

## 3. Countertrade transaction and its elements [change of title]

23. [23] *Countertrade transaction.* This term is used to refer to the whole countertrade arrangement containing the related supply contracts in the two directions and any countertrade agreement. The terms "countertrade agreement" and "supply contract" are explained below.

24. [19] *Countertrade agreement.* The countertrade agreement is the term used in the Legal Guide for the basic agreement which sets forth stipulations concerning the manner in which the countertrade transaction is to be implemented. In practice, agreements setting forth such stipulations are referred to by a variety of names, such as "frame agreement", "countertrade protocol", "umbrella agreement", "memorandum of understanding", "letter of undertaking", or "counterpurchase agreement". In many countertrade transactions the main purpose of the countertrade agreement is to set out the commitment of the parties to enter into the future contracts required to fulfil the objective of the transaction ("countertrade commitment", see the following paragraph). In addition to the countertrade commitment, the countertrade agreement is likely to contain clauses dealing with the terms of the contract to be concluded and clauses designed to support the fulfilment of the countertrade commitment; such clauses may address issues such as the type, quality and quantity of the goods, price of the goods, time period of fulfilment of the countertrade commitment, payment, restriction on resale of goods, participation of third persons in the transaction, liquidated damages or penalties, security for performance, failure to complete the countertrade transaction, choice of law, and settlement of disputes. The countertrade agreement may be embodied in a discrete instrument or it may be included in a contract for the shipment of goods. When the parties agree simultaneously on the terms governing the supply of all the goods

in both directions, the countertrade agreement would contain a stipulation expressing the link between the concluded contracts and possibly other stipulations, but would not contain a countertrade commitment.

25. [20] *Countertrade commitment.* This term is used to refer to the commitment of the parties to enter into a future contract or contracts. Depending on the circumstances, those future contracts may relate only to the shipment in one direction or to the shipments in both directions. The degree to which the countertrade commitment is definite depends on the amount of detail contained in the countertrade agreement concerning the terms of the future contracts.

26. [22] *Supply contracts.* This term is used to refer generically to contracts for the supply of goods in one or in both directions. It may be used where no clear criterion exists for distinguishing between the "exporter" and "importer", where the discussion does not make it necessary to take into account a particular sequence of conclusion of contracts between the parties, or where the context requires a general reference to a contract for the supply of goods in either direction.

27. [21] *Export, import, counter-export, and counter-import contracts.* When the Legal Guide discusses transactions in which the parties can be referred to as "exporter", "importer", "counter-exporter" or "counter-importer" (see above, paragraphs 19 and 20), the supply contracts forming part of the transaction would be referred to by names consistent with the names of the parties, i.e., "export" or "import" contract for the first contract entered into, and "counter-export" or "counter-import" contract for the contract entered into subsequently. The contracts in each direction might be referred to in the singular even though there may be several such contracts on both sides of the countertrade transaction.

28. [new paragraph] *Goods.* The subject-matter of a transaction may include various types of merchandise (such as manufactured goods or raw materials), services (such as maintenance, repair, transport, construction, tourist services, consulting, training), transfer of technology, or in some cases, a combination of these elements. As mentioned above in paragraph 2, for the sake of brevity, the Legal Guide generally refers only to "goods" as the subject-matter of countertrade transactions.

[A/CN.9/362/Add.3]

### III. CONTRACTING APPROACH

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[Editorial note: The present draft chapter III is a revision of the draft chapter bearing the same title and published in document A/CN.9/332/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document

A/CN.9/332/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.2 are in *italics*. An asterisk indicates the place where text has been deleted without adding new language. The whole section C is new.]

### A. Structure of countertrade transaction (change of title)

1. [1] A preliminary question the parties have to address is the contract structure of the countertrade transaction. The parties may embody the obligations in regard to the shipments of goods in the two directions in one contract or they may embody those obligations into separate contracts. (For the discussion of the structure of the countertrade transaction and related insurance and financing considerations, see below, paragraphs 8 and 9, and section C.)

#### 1. Single contract

2. [2] Under a single-contract approach the parties conclude one contract for the supply of goods in the two directions. Such a single contract may take the form of a barter contract (below, paragraphs 3 to 8) or the form of a merged contract (below, paragraphs 9 and 10).\*

#### (a) Barter contract

3. [3] As noted in chapter II, "Scope and terminology of Legal Guide", paragraph 14, the Legal Guide uses the term barter in its strict legal sense to refer to a transaction involving an exchange of goods for goods, so that the supply of goods in one direction entirely or partly replaces the monetary payment for the supply of goods in the other direction. In a barter contract there is no need for a countertrade commitment since the parties agree at the outset of the transaction on all the contract terms for the shipments in the two directions. If the goods to be supplied in one direction are agreed to be of the same value as the goods to be supplied in the other direction, no monetary payment would be made. If the values are agreed to be different, the difference may be settled by monetary payment or by delivery of additional goods. The parties may or may not express the value of the goods in monetary terms. If they do so, the attachment of a price to the goods serves to compare the value of the deliveries. The parties may have to express the value of shipments in monetary terms due to customs or other administrative requirements.

[5] \*

4. [7] Under a barter contract the quantity of goods to be shipped in one direction is often measured by the quantity of goods to be shipped in the other direction, rather than in terms of the market price for each shipment. The absence of a price in a barter contract or the use of prices that do not reflect the market prices might cause a difficulty when non-conforming goods are delivered under a barter contract. If in such a case monetary compensation is regarded as the appropriate relief, the absence in the contract of a market price, or of any price at all, could lead to disagreement over the amount of the compensation due. The stipulation of a price other than the market price may also give rise to a difficulty in calculating customs duties when they are based on the market value of the goods.

5. [4] A factor that is often the main reason for using barter is that the use of barter eliminates or reduces the

need for currency transfers. It may be noted, however, that the avoidance of currency transfers may also be achieved through the use of other contractual forms, namely, the parties may conclude separate sales contracts in each direction and agree to set off their payment claims under the contract (such setoff of mutual claims is discussed in chapter IX, "Payment", paragraphs — to —).

6. [6] A possible difficulty in a barter contract may be a risk that the party who has shipped goods does not receive the agreed goods from the other party. Payment against the presentation of shipping documents or the opening of a documentary letter of credit, devices used with other types of contracts to address an analogous risk in other types of contracts, cannot be used in barter since neither delivery is payable in money. One way of addressing this risk may be to agree that the deliveries are to be made simultaneously, to the extent it is practical for the parties to coordinate their deliveries in this way. If simultaneous deliveries are agreed upon, the contract may clarify that, if one of the parties is not prepared to deliver on schedule, the other party would be entitled to withhold its delivery or to terminate the contract if the delay exceeds a specified period of time. The contract may also provide that the party who has breached its obligation to deliver at the agreed time must compensate the other party for loss arising from the delay or termination of the contract. The parties may address in the contract the question of which outlays or losses are to be compensated (e.g., warehousing costs, costs related to transportation, or a specified amount of overhead costs).

7. [6] The risk that the other party will not ship the agreed goods may also be overcome by providing for an independent guarantee to assure the party who has shipped of compensation in the event that the other party fails to ship (the use of guarantees for this purpose is discussed in chapter XII, "Security for performance", paragraphs — and —). If a party finds it costly or is unable to provide such a guarantee, it may be agreed that that party is to deliver goods first. Insurance might be another possible means of limiting the risk that affect the party who has shipped first and thus "prepaid" the goods to be delivered subsequently by the other party (see below, paragraph 52).

8. [new paragraph] If the right of a party to receive goods in return for its delivery is not sufficiently secured, in particular by an independent bank guarantee, that party may find it difficult to obtain financing for the transaction from a bank or from a governmental credit agency. The entity providing financing may be reluctant to provide financing to the extent the profitability of the transaction and the ability of the party seeking credit to repay the credit depends on an unsecured obligation to deliver goods of the agreed quality.

#### (b) Merged contract

9. [8] The term "merged contract" is used to describe the case in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The merged contract thus embodies all

the terms covering the obligations of the parties to ship goods to each other and to pay for the goods they have received. *The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation.* If the parties agree to set off their claims for payment under a merged contract, the difference between a merged contract and a barter contract \* would be diminished in that in either case no transfer of money takes place or only the balance of the values of the deliveries in the two directions is transferred. As in barter, there is no need in a merged contract for a countertrade commitment since the deliveries to be made in the two directions are covered by definite contract terms.

10. [9] *It appears that many legal systems are likely to give weight to a merger of the mutual obligations in determining the degree of interdependence between contract obligations for the deliveries of goods in the two directions. \* Unless the parties provide in the contract that certain obligations regarding delivery in one direction are to be performed irrespective of non-performance of an obligation regarding delivery in the other direction, the mutual obligations are likely to be considered interdependent. The consequence of such interdependence would be that non-performance of an obligation such as non-delivery, refusal to take delivery, or non-payment relating to a shipment in one direction might be invoked as a reason for suspending or refusing performance in the other direction. Furthermore, termination of an obligation in one direction, whether or not a party is responsible for the termination, may be interpreted as entitling a party to terminate an obligation in the other direction. (Such interdependence of obligations may affect the ability of a party to insure the payment claim arising from its delivery of goods and to obtain financing for the delivery, see below, paragraph 51). If the parties using a merged contract approach wish to keep the obligation to ship goods in one direction and the corresponding payment obligation independent from the obligations relating to the shipment in the other direction, they should use unambiguous language to that effect. A related discussion of possible interdependence between the export contract and the countertrade agreement is contained below in paragraphs 17 to 19. Further discussion on the question of interdependence of obligations is found in chapter XIII, "Failure to complete countertrade transaction", paragraphs — to —.*

## 2. Separate supply contracts

[change of title]

11. [10] When the parties use separate contracts for the shipments in the two directions, they would use one of the following approaches:

(a) the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently;

(b) the countertrade agreement is concluded prior to the conclusion of any definite supply contracts;

(c) the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between them are concluded simultaneously.

12. [11] The obligation to ship goods in a particular direction in a countertrade transaction may be fulfilled by two or more different contracts, which may involve different buyers and sellers. While such a situation affects the contractual structure of a given transaction, it does not affect the nature of the discussion in this chapter. Therefore, references in the singular to a supply contract, as well as to an export or counter-export contract, also cover the situation in which more than one contract is concluded for the shipment of goods in a particular direction.

### (a) Export contract and countertrade agreement concluded simultaneously

13. [12] The parties often finalize a contract for the shipment in one direction (export contract) before they are able to reach agreement on the contract for the shipment in the other direction (counter-export contract). Parties using this contracting approach may face a broad range of issues specific to countertrade. In order to ensure conclusion of the counter-export contract, the parties conclude, simultaneously with the conclusion of the export contract, a countertrade agreement containing the commitment to conclude the counter-export contract. The primary purpose of the countertrade agreement in such cases is, in addition to stating the countertrade commitment, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated below in paragraphs 29 to 33.

14. [13] The contents of the countertrade agreement would be influenced by the degree to which the parties are able to define the terms of the future contract. It is advisable that the countertrade agreement be as definite as possible concerning the terms of the future contract, in particular regarding the type, quality, quantity and price of the countertrade goods, in order to increase the likelihood that the countertrade commitment will be fulfilled. To the extent that the parties are not in a position to settle the terms of the counter-export contract in the countertrade agreement, they are advised to establish guidelines within which the terms are to be agreed upon and to lay down procedures for negotiation (for the discussion on the definiteness of the countertrade commitment see chapter IV, paragraphs 38 to 60). *In any case, it is advisable to settle in the countertrade agreement the time period within which the countertrade commitment should be fulfilled (see chapter IV, paragraphs 7 to 20).*

15. [14] The content of the countertrade agreement would also be influenced by the degree of interest the parties have in the shipments in the two directions. In many cases the exporter is primarily interested in the conclusion of the export contract, and the countertrade commitment results primarily from a desire to secure the export contract. In other cases, the importer purchases goods from the exporter in order to enable the exporter to finance the counter-import. In yet other cases, each side is particularly interested in obtaining the goods being offered by the other

side. Because the interests of the parties vary in such a manner, the content of the countertrade agreement may vary from case to case with respect to issues such as sanctions for non-fulfilment of the countertrade commitment, payment mechanisms, procedures for concluding the future contract and for monitoring fulfilment of the countertrade commitment, and interdependence of obligations.

16. [15] The simultaneous conclusion of an export contract and a countertrade agreement is an approach frequently used in counter-purchase, buy-back or offset transactions. In the case of the counter-purchase transaction, the parties may not yet know what type of goods would be counter-exported. In the case of a buy-back, the parties may not be able to agree on such terms as price or quantity because of the long time period between the conclusion of the contract for the export of the production facility and the beginning of production of resultant products. In an offset transaction, the parties may not know what type of goods will be counter-exported or the identity of the counter-exporters.

17. [16] The use of this contracting approach raises the question whether to include the terms of the countertrade agreement in the export contract or to embody those terms in a separate instrument. The choice of the parties in this regard may have an effect on the degree to which the obligations stipulated in the export contract and the obligations set forth in the countertrade agreement are considered to be interdependent. When there is such interdependence, a delay in the fulfilment or non-fulfilment of the countertrade commitment may provide the importer with a justification for suspending payment of the amounts due under the export contract or for deducting corresponding damages from the payment due under the export contract. Similarly, the exporter may regard a delay in payment for the export contract as a ground for delaying fulfilment of the countertrade commitment. Furthermore, delayed payment under the counter-export contract might prompt the importer to delay payment under the export contract. (*Such interdependence of obligations may affect the ability of the exporter to insure its payment claim under the export contract and to obtain financing; see below, paragraphs 51 and 53.*)

18. [17] If the *export contract* and the *countertrade agreement* are embodied in separate *contractual instruments*, it appears that many legal systems would consider the two sets of obligations to be independent, except to the extent specific contract provisions establish interdependence. In other legal systems the export contract and the countertrade agreement may, despite the use of separate *instruments*, be considered to be interdependent on the ground that the obligations of the parties embodied in the two *instruments* form part of a single transaction. When the parties wish to avoid interdependence of obligations between the export contract and the countertrade agreement, or when they wish to limit interdependence to particular obligations, it is advisable that they embody the export contract and the countertrade agreement in separate *instruments*. When, despite the use of separate *instruments*, it is uncertain whether the obligations under the export contract and the countertrade agreement would be considered independent, it is advisable that the independence of the two sets of obligations be clearly expressed in the countertrade agreement.

19. [18] The parties may wish to establish, by express contract clauses, an interrelationship between particular obligations arising out of the export contract and out of the countertrade agreement, while keeping other obligations independent. The parties may, for example, agree that \* the termination of the export contract permits the exporter to terminate the countertrade agreement, and that non-fulfilment of the countertrade commitment by the counter-importer entitles the counter-exporter to deduct an agreed amount as liquidated damages or penalty from payments due under the export contract. Further discussion on the question of interdependence is found in chapter XIII, "*Failure to complete countertrade transaction*", paragraphs — to —.

(b) *Countertrade agreement concluded prior to conclusion of definite supply contracts*

20. [19] The conclusion of a countertrade agreement may be the first step in the transaction prior to the conclusion of any definite supply contracts in either direction. The aim of the countertrade agreement in such a case is to express the commitment of the parties to conclude supply contracts in the two directions and to establish procedures for concluding and implementing those contracts.

21. [19] In order to achieve the envisaged level of shipments in the two directions, it is advisable that the countertrade agreement be as definite as possible concerning the terms of the contracts to be concluded in the two directions (see chapter IV, "*Countertrade commitment*", paragraphs 38 to 60). The parties may also wish to establish mechanisms for monitoring and recording the progress made in achieving the agreed upon level of trade (chapter IV, paragraphs 61 to 74) and to provide sanctions for a failure to fulfil the countertrade commitment (chapter XI, "*Liquidated damages and penalty clauses*" and chapter XII, "*Security for performance*"). The need for sanctions may be diminished if the parties agree that their countervailing claims for payment for the shipments in each direction will be set off rather than paid for individually (see chapter IX, "*Payment*", paragraphs — to —). Such a payment mechanism would provide an incentive to both parties to order goods from each other and thereby attain the level of trade envisaged in the countertrade agreement. The incentive is derived from the fact that a party who has shipped goods will be stimulated to order goods from the other party in order to be compensated for its own deliveries. Furthermore, the parties may wish to address in the countertrade agreement the question of independence of the contracts in the two directions (see chapter XIII, paragraphs —). These and other issues that the parties may wish to address in a countertrade agreement entered into prior to the conclusion of any supply contract are set out below in paragraphs 29 to 39.

(c) *Export contract, counter-export contract and countertrade agreement concluded simultaneously*

22. [20] When the parties simultaneously conclude a contract for the supply of goods in one direction and another contract for the supply of goods in the other direc-

tion, and there is no indication in the contracts that there is a relationship between them, the contracts would appear on their face to be independent of one another even if one party or both parties regarded the conclusion of one contract as a condition for the conclusion of the other contract. When, however, the parties wish to give contractual effect to an intention that the conclusion of one contract be conditioned upon the conclusion of the other, i.e., when they wish to structure the contracts in the two directions as a countertrade transaction, the parties should conclude a countertrade agreement expressing that relationship.

23. [21] This contracting approach raises a limited number of issues since it does not involve a countertrade commitment. The main issue in this contracting approach is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked by provisions in the countertrade agreement. There is no need to deal in the countertrade agreement with various issues related to the fulfilment of the countertrade commitment (in particular the type, quality, quantity or price of the countertrade goods, time schedules of fulfilment of countertrade commitment, security of performance or liquidated damages or penalties supporting the countertrade commitment). The issues that the parties may wish to address in a countertrade agreement concluded simultaneously with the definite supply contracts in the two directions are set out below in paragraphs 40 to 42.

## B. Contents of countertrade agreement

24. [new paragraph] Matters of particular importance for the structure and implementation for countertrade transactions are dealt with in the countertrade agreement. While the Legal Guide concentrates on issues to be addressed in the countertrade agreement, where necessary, reference is made in the Guide to drawing up a provision in a supply contract that is influenced by the fact that the contract is part of the countertrade transaction. The following subsections 1 and 2 provide an outline of a possible content of a countertrade agreement, depending upon whether or not the countertrade agreement includes a countertrade commitment.

25. [new paragraph] A countertrade agreement with a countertrade commitment is used when the parties envisage concluding in the future one or more counter-export contracts, or when the parties envisage concluding in the future supply contracts in the two directions (cases (a) and (b) referred to above in paragraph 11). A countertrade agreement without a countertrade commitment is used when the parties have entered, at the outset of the transaction, into the contracts for the supply of goods in the two directions and there is therefore no need for a countertrade commitment (case (c) referred to above in paragraph 11).

26. [new paragraph] The content of a countertrade agreement involving a countertrade commitment is usually more complex and gives rise to more negotiation and drafting difficulties than a countertrade agreement without a countertrade commitment. The reason for the complexity and difficulty is that usually the parties, at the time of agreeing that they will in the future conclude a supply contract, are usually not in a position to specify, with suf-

ficient definiteness, all the terms of the future contract. Lack of definiteness may make it difficult for the parties to draw up a countertrade agreement that will provide a sufficient assurance that the negotiations for the conclusion of a supply contract, containing terms acceptable to both parties, will be successful. The question of the definiteness of the countertrade commitment is discussed in chapter IV, paragraphs 38 to 60.

27. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Some of the issues listed below and discussed in the following chapters of the Legal Guide are essential in establishing a countertrade transaction that involves a countertrade commitment. For example, the parties would have to choose a contracting approach, express their commitment to engage in reciprocal trade, specify the extent of the commitment and the time frame within which the commitment should be fulfilled.

28. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Solutions to certain other issues listed below and dealt with in the Legal Guide, while not necessarily essential, would help to ensure proper implementation of the transaction. The parties will have to judge whether and to what extent various contractual issues discussed in the Legal Guide are relevant to the circumstances of the given case. Generally, it is advisable to settle in the countertrade agreement issues that the parties consider relevant since national legislations are likely not to have rules on issues specific to countertrade.

### 1. Countertrade agreement with countertrade commitment

29. [22] *Countertrade commitment.* The essential feature of a countertrade commitment is a stipulation by which the parties undertake to \* conclude one or more supply contracts in one or in the two directions. In order to add definiteness to the commitment and increase the likelihood of its fulfilment, parties often include in the countertrade agreement provisions concerning terms of the anticipated contract, sanctions for the failure to conclude the supply contract, and other provisions to ensure the proper carrying out of the countertrade transaction. Various aspects of the countertrade commitment are discussed in chapter IV.

30. [23] *Type, quality and quantity of goods.* In order for the countertrade commitment to be meaningful, it is particularly important that the countertrade agreement be as specific as possible as to the type, quality and quantity of the countertrade goods. Clauses in the countertrade agreement addressing these issues are discussed in chapter V.

31. [24] *Pricing of goods.* Since the parties are often not in a position to set the price of the countertrade goods at the time the countertrade agreement is concluded, they may establish guidelines and procedures for setting the price at a later date. Such provisions help to prevent delays in the conclusion of supply contracts and provide pricing flexibility in long-term countertrade transactions. Issues relating to pricing clauses are addressed in chapter VI.

32. [26] *Participation of third parties [change of heading].* The parties may wish to involve third parties, either as suppliers or purchasers, or both, of countertrade goods. In such cases it is advisable that the countertrade agreement contain provisions concerning participation by third parties. Those provisions could determine the manner in which a third party would be selected, whether the third party is to become bound to fulfil the countertrade commitment and the legal effect of the involvement of the third party on the obligations undertaken by the parties to the countertrade agreement. Issues to be dealt with in the countertrade agreement relating to participation of third parties are discussed in chapter VIII.

33. [27] *Payment.* When payments for the shipments in each direction are kept independent, no payment issues specific to countertrade are raised. However, when the parties wish to link the payments for the shipments in the two directions so that the proceeds of the contract in one direction are used to pay for the contract in the other direction, they would have to include in the countertrade agreement provisions on the manner in which payment is to be linked. A discussion of contractual aspects of various types of linked payment mechanisms is found in chapter IX.

34. [28] *Restrictions on resale of goods.* The freedom of a party to resell goods purchased in a countertrade transaction may sometimes be restricted by contractual agreement between the supplier and the purchaser of the goods. The purchaser may be restricted, for example, as to the territory of resale, \* resale price or packaging. Clauses in the countertrade agreement concerning such resale restrictions, as well as the question of the legality of such clauses, are discussed in chapter X.

35. [29] *Liquidated damages and penalties.* In order to limit disagreements as to the extent of damages resulting from a breach of the countertrade commitment, the countertrade agreement may stipulate a sum of money, specified as liquidated damages or a penalty, due from a party upon failure to fulfil the commitment to purchase or make available countertrade goods. The use of such clauses in a countertrade agreement is addressed in chapter XI. In paragraph — of that chapter it is pointed out that the use of a penalty, as opposed to liquidated damages, is not permitted in a number of legal systems.

36. [30] *Security for performance.* The parties may use guarantees to support fulfilment of the countertrade commitment, as well as the proper performance of individual supply contracts concluded pursuant to the countertrade commitment. The use of guarantees to support the fulfilment of the countertrade commitment, or the obligation to pay under a liquidated damages or penalty clause, raises issues to be addressed in the countertrade agreement. In transactions in which the parties limit payments in cash by exchanging goods for goods or setting off countervailing payment claims, the countertrade agreement may stipulate the use of guarantees to cover liquidation of an imbalance in the flow of trade. Issues to be addressed in the countertrade agreement when the parties wish to use guarantees to support fulfilment of the countertrade commitment and liquidation of an imbalance in trade are discussed in chapter XII.

37. [31] *Failure to complete countertrade transaction.* The parties may wish to deal in the countertrade agreement with various issues relating to the possibility of a failure to complete the transaction. These issues include possible release of a party from its obligations under the countertrade commitment, monetary compensation, exempting impediments and interrelationship of obligations. Provisions of this type are examined in chapter XIII.

38. [32] *Choice of law.* It is advisable that the parties agree upon the law to be applied to the countertrade agreement and to the supply contracts. Provisions of this nature are discussed in chapter XIV.

39. [33] *Settlement of disputes.* It is advisable that the parties address in the countertrade agreement the manner in which disputes are to be settled. Chapter XV examines issues to be considered in preparing dispute settlement clauses.

## 2. Countertrade agreement without countertrade commitment

40. [34] When the parties simultaneously conclude separate contracts for the entire supply of goods in the two directions, there is no need for a countertrade agreement containing either a countertrade commitment to conclude future contracts, or clauses on the type, quality, quantity or price of the goods, liquidated damages or penalties to be paid for failure to conclude supply contracts, or guarantees to support the countertrade commitment.

41. [35] The primary purpose of the countertrade agreement in this case would be to establish a link between the contracts in the two directions, namely, that the conclusion of a contract in one direction is conditioned upon the conclusion of a contract in the other direction. The countertrade agreement may provide that a problem in the performance of one contract would have an effect on the obligation to perform the contractual obligations in the other direction (clauses establishing a link of this type are discussed in chapter XIII). The parties may also establish a link between the contracts by structuring payment for the two contracts in such a way that the proceeds of the shipment in one direction would be used to pay for the shipment in the other direction. Linked payment mechanisms of this type are discussed in chapter IX.

42. [36] In addition, the countertrade agreement may address issues such as restrictions on the resale of countertrade goods (chapter X), participation of third persons in the countertrade transaction (chapter VIII), choice of law (chapter XIV) and settlement of disputes (chapter XV).

## C. Insurance and financing considerations

[Editorial note: the whole section C is new.]

43. Criteria and procedures relevant to obtaining export credit insurance or financing are largely the same for a contract forming part of a countertrade transaction as they are for a straightforward export transaction. Therefore, the

Legal Guide does not discuss comprehensively export credit insurance and financing. However, to the extent credit insurance and financing considerations are relevant to the structure of countertrade transactions, this subsection discusses those considerations.

44. In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. In some countries such insurance schemes are run or supported by State owned entities. In addition, many private insurance companies engage in such insurance. Insurance coverage usually starts when the exporter ships the goods. If the exporter is to manufacture goods designed specifically for the buyer, some insurers might also be prepared to cover the risk that the buyer will fail to take delivery of the goods when they are manufactured and made ready for delivery.

45. Insurable commercial risks might include the insolvency of the importer, repudiation by the importer of the contract prior to the shipment of the goods, and refusal of the importer to take delivery of the goods. Insurable non-commercial risks might include import restrictions by the State of the importer; exchange control regulations in the importer's country that prevent payment to be made or prevent use of the agreed currency; cancellation of import licence that had been properly issued; war, civil insurrection or similar conditions in the buyer's country that prevent the performance of the contract; other causes that are outside the control of the exporter and importer and that arise from events outside the exporter's country.

46. Insurance cover may be negotiated for a specific transaction or, on a broader basis, for all contracts for a certain type of merchandise concluded over a specified period of time by the exporter or by a group of exporters. The latter approach, based on turnover of goods, has the advantage of spreading the risk over a number of contracts and thereby reducing the premium.

47. Several salient principles, which are related to principles found in insurance generally, may be noted with respect to export credit insurance. One principle is that export credit insurance is a risk sharing scheme. The insurer will typically assume only a portion of the non-payment risk, while the rest of the risk must be borne by the insured exporter. The insurable portion of the risk depends on the type of risk involved and, if the insurer is a State agency, on the extent to which the State wishes to stimulate exports. Another principle is that the exporter is obligated to inform the insurer, to the best of its knowledge, of all facts that may affect the degree of the non-payment risk. A further principle is that the insured exporter must take all steps in its power to ensure that the contract for the export of goods is validly concluded and that it remains valid and enforceable.

48. Yet another principle is that, if the importer fails to pay the insured claim or if the enforceability of the claim becomes doubtful, the exporter must take all steps to minimize loss and to secure or enforce the payment claim. The insurer will typically require that it be informed of any difficulty that has arisen or is imminent regarding payment

to be made under the insured contract. In addition, the insurer will usually require that it be consulted about steps to be taken to secure or enforce the payment claim and that it be entitled to approve certain steps. The readiness of the insurer to provide insurance cover and the amount of the premium will depend on the security that the importer is ready to provide in support of its payment obligation. Such security may be, for example, an irrevocable documentary letter of credit, a bill of exchange or a promissory note, with a third party guaranteeing payment of the bill or note, or an independent bank guarantee.

49. The objective of securing the insured payment claim may be achieved in a countertrade transaction by linking the insured claim to the claim arising from the supply contract in the other direction. As discussed in chapter XIII, "Failure to complete countertrade transaction", paragraph —, in some countertrade transactions it is agreed that the exporter, if the importer fails to make payment under the export contract, is entitled to take possession and sell the goods that are to be delivered by the importer (counter-exporter) to the exporter (counter-importer). The proceeds of the sale are used to cover the exporter's outstanding claim. Since such an arrangement may reduce the risk of non-payment under the export contract, it may be easier for the exporter to obtain insurance and financing for the export contract. When a bank has provided financing to the exporter, it may be agreed, in order to provide security to the bank for the financing provided to the exporter, that the bank itself is to obtain a security interest in the counter-export goods.

50. A further principle applicable to the export credit insurance is that the insurer must be satisfied that in the normal course of events, i.e. if the exporter meets its obligations under the export contract, the importer will have no reason to refuse to pay the amount due under the export contract. Insurers wish to avoid situations where payment under the insured contract may become dependent on an event that is extraneous to the insured contract and that may be difficult for the insurer to assess.

51. The principle referred to in the previous paragraph is relevant to the case when the insured export contract forms part of a countertrade transaction. The question may arise whether the payment obligation under the export contract depends only on the performance of the export contract or whether the importer can suspend or withhold payment because of a failure of the exporter to conclude or perform a supply contract in the other direction. A source of particular concern is the possibility that payment may be suspended or withheld even if the exporter (counter-importer) claimed that the reason for the failure to conclude or perform a counter-import contract was one for which the exporter was not responsible. For example, the exporter may refuse to conclude a counter-import contract because the quality or the price of the offered countertrade goods is not acceptable in light of what was stipulated in the countertrade agreement. The possibility of such disagreement over the responsibility for non-fulfilment of the countertrade commitment is increased when the parties to the countertrade transaction have not included in the countertrade agreement definite terms of the contract to be concluded (see chapter IV, "Countertrade commitment",

paragraph 39). In a further example, the exporter may refuse to take delivery of the countertrade goods if the tendered goods do not conform to the agreed standards of quality. In order to avoid the possibility that the insured payment claim might be brought into question in such a situation, the insurer will usually require that steps be taken to make that payment claim independent from any disagreement concerning conclusion or performance of the contract in the other direction. Such independence can be established by using the separate-contract approach and by including in the countertrade agreement specific provisions indicating the independence of obligations (for a discussion on how the parties may wish to deal in the countertrade agreement with the relationship between their obligations, see chapter XIII, "Failure to complete countertrade transaction", paragraphs — to —).

52. In the case of a barter contract, the party who is to deliver goods first is subject to the risk that the other party will fail to deliver its goods in return (see above, paragraphs 6 and 7). Some private insurers and, in some cases, governmental insurance agencies may be prepared to insure that risk. The case covered by such insurance would usually be limited to the bankruptcy of the party who failed to deliver and to certain political risks such as governmental restrictions or prohibitions that prevent the fulfilment of the contract. Insurance cover may be easier to obtain if the other party provides sufficient security for its obligation to deliver goods. Such security may be provided in the form of an independent bank guarantee. Another possible security may be an agreement giving the party who has delivered goods a right to take possession of the goods to be delivered in the other direction (see above, paragraph 49).

53. Parties often require financing in order to be able to carry out the transaction. The ability of a party to insure its credit risk is an important factor in the consideration by the financial institution whether to grant the requested financing. Financing may be in the form of a supplier credit or a buyer credit.

54. In the case of a supplier credit, the exporter delivers goods to the importer under a deferred payment arrangement and, in order to enable the exporter to enter into such an arrangement, a bank in the exporter's country provides fi-

nancing to the exporter. Such financing may be, for example, in the form of a loan to the exporter or in the form of an undertaking by the bank that the bank will purchase the bills of exchange or promissory notes signed by the buyer in favour of the exporter. By purchasing the bills or notes, the bank, as the endorsee, would become the creditor of the foreign buyer. If no discounting of bills or notes takes place, the bank may require the exporter to assign the payment claim under the export contract to the bank. In addition, the bank may require the exporter to assign to it the benefits of the credit insurance policy. Such an assignment is often combined with an undertaking by the insurer to the effect that, if the buyer fails to pay under the export contract, and the failure falls within the risks covered by the insurance policy, the insurer will reimburse the bank. By becoming the beneficiary of the insurance policy, the bank is exposed to the risk that the exporter would breach the export contract and as a result the buyer would justifiably fail to pay under the export contract. In such a case the bank would have recourse only to the exporter. The bank is also exposed to the risk that the reason for the buyer's failure constitutes a risk that is not covered by the insurance policy. In order to ameliorate the position of the bank, and in order to make it easier for exporters to obtain financing, some export credit insurers might be prepared, against a fee payable by the exporter, to issue to the bank providing financing to the exporter an unconditional guarantee supporting the bank's repayment claim against the exporter.

55. Under a buyer credit, the exporter arranges for a bank in the exporter's country to provide financing to the importer for the purchase of goods from the exporter. The bank in the exporter's country typically provides financing to a bank in the importer's country, which in turn extends financing to the importer. The bank in the exporter's country receives from the export credit insurer an undertaking whereby the insurer agrees to reimburse the bank if the buyer or its bank fail to repay the credit. Such an undertaking is issued on the application of the exporter and against payment by the exporter of an agreed premium. In case of failure by the buyer or its bank to repay the credit, the insurer who has reimbursed the bank that gave the credit has recourse to the exporter only if the exporter has failed to perform the obligations under the contract for the export of goods.

[A/CN.9/362/Add.4]

#### IV. COUNTERTRADE COMMITMENT

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[*Editorial note:* The present draft chapter IV incorporates revised draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8, revised paragraphs 26 and 27 from draft chapter V, "Type, quality and quantity of goods" as it appeared in A/CN.9/332/Add.4, and revised section C of draft chapter III, "Contracting approach", as it appeared in A/CN.9/332/Add.2. The revisions of paragraphs are in italics. The note in square brackets at the beginning of some paragraphs indicates that those paragraphs are new. An asterisk indicates the place where text has been deleted without adding new language.]

#### A. General remarks

1. [*new paragraph*] A countertrade commitment, a commitment to conclude a future contract, is an essential feature present in two types of countertrade transactions. The first type is when the parties at the outset of the transaction finalize a contract in one direction (export contract) and then commit themselves to conclude a counter-export contract (see chapter III, paragraphs 13 to 19); the second type is when the parties commit themselves at the outset of the transaction to conclude a series of supply contracts in the two directions (see chapter III, paragraphs 20 and 21). The term countertrade commitment is explained in chapter II, paragraph 25.

2. [*new paragraph*] The degree to which parties may commit themselves to enter into a future contract may range from a "firm" commitment to enter into a supply contract to a more limited "serious intention" type of commitment (referred to also as "best efforts" or "good faith" commitments). Under a firm countertrade commitment, the parties undertake to conclude a contract in accordance with the terms set out in the countertrade agreement, without retaining a discretionary right to refuse to conclude a contract. Under a serious-intention type of commitment, the undertaking is limited to an obligation to negotiate in good faith, with a party retaining the right to refuse to enter into

a contract if none of the contract offers is acceptable to it. Under the latter commitment, any sanctions for failing to comply with the commitment can apply only in the limited cases when the party fails to participate in negotiations or does not negotiate in good faith. The Legal Guide focuses on firm countertrade commitments. It does not deal with serious-intention type of commitments since such commitments do not provide sufficient assurance to the parties that the objectives of the countertrade transaction will be achieved.

#### B. Extent of countertrade commitment

3. [*new paragraph*] The extent of a countertrade commitment is frequently expressed in a monetary value. In counter-purchase, buy-back or indirect offset transactions, in which the parties conclude first a supply contract in one direction (export contract) (see chapter III, paragraphs —), the extent of the countertrade commitment is often expressed as a percentage of the value of the goods delivered under the export contract. In countertrade transactions in which the parties conclude the countertrade agreement prior to concluding an unspecified number of contracts in the two directions (see chapter III, paragraphs 20 and 21), the extent of the purchases to be made in the two directions is often defined by an absolute monetary amount. Sometimes, however, the countertrade commitment is quantified by reference to a specific quantity of a given type of goods. It should be noted that the extent of the countertrade commitment may be subject to governmental regulations.

4. [*new paragraph*] In countertrade transactions with successive deliveries (e.g., buy-back transactions), in long-term transactions, or in transactions where the counter-exporter's financing costs are uncertain at the time of the conclusion of the countertrade agreement (e.g., because of a floating-rate credit arrangement), clauses are sometimes found providing for an increase or a decrease of the countertrade commitment depending upon movement in prices of the goods in question or in financing costs. In the

case of capital goods, it may be agreed that the commitment will be increased in proportion to expenses for spare parts or technical assistance.

5. [from A/CN.9/332/Add.4, para. 26] When the purchaser has made prior purchases from the supplier of a given type of goods, the provisions in the countertrade agreement regarding quantity may contain a concept often referred to as "additionality". According to this concept, only those purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment. The parties would normally be able to establish the threshold of additionality by agreeing on the quantity that is to be regarded as the usual or traditional purchase. When the parties do not identify the type of goods in the countertrade agreement, they may include a general stipulation that if the goods ultimately selected are of a type that the purchaser is already buying, only those purchases above existing levels would be counted towards fulfilment of the countertrade commitment.

6. [from A/CN.9/332/Add.4, para. 27] Where the arrangement allows the purchaser to choose from a number of eligible suppliers other than the party to whom the countertrade commitment is owed (e.g., in an indirect offset transaction), the additionality threshold would not be based on previous trade volume between the parties to the countertrade agreement, but on the trade volume with the suppliers selected or on the volume of previous purchases by the committed party in the suppliers' country. *In defining the additionality threshold, the parties may, for example, agree on an amount of purchases that is to be considered as the usual or traditional amount of purchases, which would not be counted towards fulfilment of the countertrade commitment. The parties may also stipulate that purchases from specified types of suppliers or from certain specified suppliers, or purchases from those suppliers that do not exceed an agreed amount, are to be regarded as the usual or traditional purchases. In some cases, the parties may wish to apply an additionality threshold only to certain types of goods. The parties may provide in the countertrade agreement that the party committed to purchase can count its purchases towards the fulfilment of the countertrade commitment after it has been established in an agreed manner that purchases agreed to be regarded as usual or traditional have been made.*

### C. Time period for fulfilment of countertrade commitment

*[The present section C incorporates, with modifications in italics, paragraphs 17 to 30 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in document A/CN.9/332/Add.8.]*

#### 1. Length of fulfilment period

7. The parties should specify in the countertrade agreement the length of time to be allowed for fulfilment of the countertrade commitment (hereinafter referred to as the "fulfilment period"). The countertrade agreement may determine the length of the fulfilment period by stipulating

that the fulfilment period is to commence upon a fixed date and to expire on a fixed date.

8. Another method is to make the commencement of the fulfilment period contingent upon an event specified in the countertrade agreement and to set the length of the fulfilment period. Such an approach may be desirable in a variety of circumstances. For example, when the conclusion of the countertrade agreement precedes the entry into force of the export contract, the parties may agree that the fulfilment period will not begin until the export contract has entered into force. When there is uncertainty at the time of the conclusion of the countertrade agreement about the availability of countertrade goods or about the ability of the purchaser to utilize or market them, the parties may agree that the fulfilment period will commence upon the completion of certain preparatory activities (e.g., identification of goods, inspection by purchaser, certification of the technical capability of the factory producing the goods, agreement with a third-party purchaser or completion of joint marketing research). Where the exporter wishes to ensure that performance of the export contract is at an advanced stage or completed before performance of the countertrade commitment commences, the parties may stipulate in the countertrade agreement that commencement of the fulfilment period is to be triggered by an event in the performance of the export contract such as the opening of the letter of credit, delivery of a specified portion of the goods or payment. In a buy-back transaction, an appropriate moment might be the beginning of production of buy-back products by the facility supplied under the export contract. In order to avoid uncertainty as to whether the conditions for commencement of the fulfilment period have been met, it is advisable that the countertrade agreement state those conditions and the related obligations of the parties as precisely as possible.

9. In determining the length of the fulfilment period the parties should consider a number of factors. One factor is the size and type of the transaction being contemplated. For example, where the countertrade commitment is large and involves a series of shipments, more time would normally be needed for fulfilment of the countertrade commitment than if the transaction were relatively small. Where the countertrade agreement defines the countertrade goods in broad terms, it may be that a longer fulfilment period would be needed in order to allow time for identifying suitable countertrade goods. The quality of the countertrade goods may affect the length of the fulfilment period. The better the quality, the more likely it will be that the purchaser will either be able to market or use them in-house, thus allowing a shorter fulfilment period.

10. In some cases, the length of the fulfilment period is set so that it extends beyond the date when payment is due under the export contract. Such an approach would allow the exporter time to fulfil the countertrade commitment after payment under the export contract is due. In such a case it is in the interest of the importer to include in the countertrade agreement effective sanctions for breach of the countertrade commitment.

11. The parties may agree that the fulfilment period for the shipment in one direction is to be of the same length as the fulfilment period for the shipment in the other direc-

tion. Such an approach may be appropriate when no particular importance is attached to the order of the shipments in the two directions (e.g., countertrade carried out within the framework of a setoff account (chapter IX, "Payment", paragraphs —) or an evidence account (paragraphs 68 to 74 below)). Such an approach may also be appropriate in a counter-purchase transaction in which the counter-importer is prepared to begin fulfilling the countertrade commitment without waiting to be paid under the export contract.

12. The fulfilment period should be of a sufficient length to take into account difficulties the supplier may encounter in making the countertrade goods available. If the goods are not made available in time, the purchaser could object to the exercise by the supplier of remedies for non-fulfilment of the countertrade commitment by claiming that non-fulfilment was due to unavailability of the goods. If the purchaser is entitled to select the goods from a list of eligible countertrade goods, the length of time needed to make available each of the different goods listed should be taken into account calculating the length of the fulfilment period.

## 2. Extension of fulfilment period

13. The parties may require more time to fulfil the countertrade commitment than provided by the countertrade agreement. For example, a purchaser may encounter unanticipated difficulties in utilizing or reselling the goods to be purchased. A supplier may have difficulties in making agreed upon goods available on schedule.

14. The law applicable to the countertrade agreement may provide for an extension of the time allowed for the performance of a party's contractual obligations in the event that the possibility of performance is affected by circumstances beyond the control of that party. The parties may wish to include in the countertrade agreement clauses addressing such situations (see chapter XIII, paragraphs —, for a discussion of exemption \* clauses).

15. The countertrade agreement may provide that the parties will negotiate an extension if the party seeking an extension has made reasonable efforts to fulfil the commitment. Alternatively, the parties might agree that, if the party made reasonable efforts to fulfil the commitment, that party would be entitled to an appropriate extension of the fulfilment period. It may be left to the parties to agree on the new fulfilment period. The countertrade agreement might indicate how the purchaser could demonstrate reasonable efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show that it had made reasonable offers to potential suppliers to purchase goods, or that it had contacted a reasonable number of potential suppliers in search of suitable countertrade goods, or that potential suppliers had indicated that they would be willing to enter into supply contracts some time after the expiry of the fulfilment period. Evidence of such reasonable, but unsuccessful, efforts are sometimes in practice referred to as "negative files". The countertrade agreement may also provide that a supplier who was unable to make goods available due to circumstances specified in

the countertrade agreement would be entitled to an extension. Such circumstances may include, for example, lateness of the purchaser's order or changes in the purchaser's specifications. The parties may agree that a party could request an extension of the fulfilment period only if that party had fulfilled a portion of the countertrade commitment.

16. If the fulfilment of the countertrade commitment is supported by a guarantee, it is advisable that the parties provide that the period of the guarantee should be extended to cover an extension of the fulfilment period (see chapter XII, "Security for performance", paragraphs —).

## 3. Subperiods within fulfilment period

17. Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods. For example, a five-year fulfilment period could be divided into five annual subperiods, with a specified portion of the total commitment to be fulfilled during each subperiod. Such an approach assists the parties in planning delivery and marketing of the countertrade goods, and helps to ensure that fulfilment does not fall so far behind that the parties would be unable at the latter stages of the fulfilment period to fulfil the outstanding countertrade commitment.

18. The countertrade agreement may allow flexibility in dealing with shortfalls in the fulfilment of the commitment assigned to individual subperiods by permitting the carry-over of all or a portion of a shortfall to the next subperiod. In such a case, the purchaser would have, in the following subperiod, to fulfil the portion of the commitment allocated to that subperiod, as well as to fulfil the portion of the commitment carried over from the preceding period. The portion not carried over would be subject to sanctions for failure to fulfil the countertrade commitment (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance"). Such flexibility would allow the purchaser to adjust the quantity to be purchased in a given subperiod in response to circumstances such as short term market fluctuations. However, a high degree of flexibility might adversely affect the interests of the supplier if the proceeds of sales in each subperiod are to be used for payments under the supply contract in the other direction.

19. To address the possibility that the fulfilment achieved in a given subperiod exceeds the required level, the parties may agree that some or all of the extra purchases would be credited to the commitment due in the following subperiod. Alternatively, the parties may agree that the excess fulfilment in one subperiod would not affect the level of the commitment due in the following subperiod.

20. The parties may wish to set deadlines within the fulfilment period for completion of different actions that precede fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, selecting goods from a list of possible countertrade goods, placing orders, shipping goods or opening letters of credit.

## D. Defining eligible supply contracts

*[The present section D incorporates, with the addition of two new paragraphs, paragraphs 2 to 9 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]*

21. The parties normally define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts") by indicating in the countertrade agreement the type of goods to be purchased under those future supply contracts. In some cases, the parties include in the countertrade agreement additional criteria relating to the geographical origin of the goods, the identity of the supplier, or the identity of the purchaser. When the parties are not in a position to indicate the type of goods in the countertrade agreement, some of these criteria may be included for the purpose of defining eligible supply contracts.

### 1. By type of goods

22. When the parties define the contracts eligible to be counted towards fulfilment by indicating the type of goods to be purchased, it is advisable that they do so with as much precision as possible. Precision is particularly advisable when the goods to be purchased exist in different varieties. (For a discussion of clauses in the countertrade agreement concerning the type of goods, see chapter VI, "Type, quality and quantity of goods", paragraphs 3 to 23.)

23. Sometimes the parties provide in the countertrade agreement that, in addition to the purchase of the countertrade goods, other related items are to be counted towards fulfilment of the countertrade commitment. Such ancillary items may be, for example, purchase of samples and prototypes in the course of selecting the countertrade goods, local contracting of labour, local purchase of goods and services essential for carrying out a supply contract, unbilled activities by the purchaser in the supplier's country (e.g., recruitment of personnel, training programmes, secondment of staff and other forms of technical assistance), purchase from the supplier of transportation services, or performance by the purchaser of after-sales service on the countertrade goods. The countertrade agreement may provide that only a limited portion of the countertrade commitment may be fulfilled through such items.

24. When the purchaser has made prior purchases from the supplier, the countertrade agreement may provide that supply contracts must meet an "additionality" requirement in order to be counted towards fulfilment (see above, paragraphs 5 and 6).

25. *[new paragraph]* It should be noted that stipulations on eligibility of supply contracts based on the geographical origin of goods might conflict with mandatory rules of competition law and rules adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

### 2. By geographical origin

26. Eligibility of supply contracts may be defined by a stipulation that countertrade goods must be produced in a

particular geographical area. Stipulations of this type are sometimes found in indirect offset transactions where the importer wishes to channel the counter-purchases to a particular region. Furthermore, the countertrade agreement may stipulate a required minimum level of local content. Such stipulations may provide that particular components of the goods must be locally produced or that the value of local components must constitute a certain percentage of the total value. Local content requirements are sometimes found in governmental regulations.

27. *[new paragraph]* As in the case referred to above in paragraph 25, stipulations requiring a party to purchase goods from identified suppliers might conflict with mandatory rules of competition law and provisions adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

### 3. By identity of supplier

28. The parties may agree that the exporter is to fulfil the countertrade commitment by purchasing goods from persons other than the importer. This is typically the case in indirect offset (see chapter II, paragraph 17). In such cases, it is advisable that eligible supply contracts be defined by identifying the suppliers from whom the goods are to be purchased. The countertrade agreement may list eligible suppliers or may stipulate criteria to be observed by the purchaser in selecting a supplier. It may be provided, for example, that a selected supplier must be from a particular economic sector, be of a certain size, have a particular production programme, be located in a particular region, or be locally owned. Where several eligible suppliers are identified, the purchaser may be left free to distribute purchases among various suppliers or a particular structure of purchases from the identified suppliers may be stipulated. The identification of eligible suppliers does not necessarily mean that those suppliers have made a commitment to make countertrade goods available. In some cases the importer may provide an assurance that the eligible suppliers are prepared to negotiate the conclusion of a supply contract or *the importer may promise* to assist the purchaser in identifying a supplier who is willing to conclude a supply contract. (For a discussion of the participation of third persons as suppliers, see chapter VIII, paragraph \_\_\_\_.) The countertrade agreement may indicate the effect on the countertrade commitment if none of the eligible suppliers are prepared to conclude a supply contract.

### 4. By identity of purchaser

29. A restrictive element sometimes found in the definition of eligible supply contracts concerns the identity of the purchaser. For example, the countertrade agreement may provide that only purchases made by the party committed to purchase goods or by specified third persons (e.g., third persons from a particular country or geographical region) are to be counted towards fulfilment. For a discussion of restrictions on the participation of third persons as purchasers, see chapter VIII, paragraph \_\_\_\_.

### 5. Non-conforming purchases

30. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement would nevertheless be counted towards fulfilment of the countertrade commitment. For example, non-conforming purchases could be counted if the good faith efforts of the purchaser to locate suitable goods from the eligible suppliers or in the geographical regions or economic sectors identified in the countertrade agreement were unsuccessful. A provision of that type could call upon the purchaser to provide evidence of efforts to make purchases of the type required by the countertrade agreement (for a discussion of the analogous case of a party requesting an extension of the fulfilment period, see above, paragraphs 13 to 16). It could be agreed that the specific prior consent of the party to whom the commitment is owed would be necessary for the purchases not meeting the eligibility requirements to be counted towards fulfilment. In order to foster efforts to comply with origin requirements, the countertrade agreement could limit the availability of an exception to the later stages of the fulfilment period. Furthermore, the parties may agree that purchases counted towards fulfilment that fall outside the eligibility provisions are to be counted at less than the full value of the purchases (see paragraphs 32 and 33 below).

#### E. Rate of fulfilment credit [change of title]

*[The present section E incorporates, with modifications in italics, paragraphs 13 to 16 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]*

31. In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the amount deducted from the outstanding countertrade commitment is hereinafter referred to as "fulfilment credit"). Sometimes the parties agree that the fulfilment credit granted for a supply contract is to be an amount different from the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain outlays not included in the cost of the goods themselves (e.g., transportation and insurance) or to exclude from the fulfilment credit certain costs included in the purchase price. The supplier may agree to the crediting of such cost elements if, for example, they involve the purchase in the supplier's country of services related to the performance of the supply contract. *The rate of fulfilment credit might also be prescribed by mandatory provisions of law (chapter XIV, "Choice of law", paragraphs —).*

32. The countertrade agreement may provide that purchases are to be credited towards fulfilment of the countertrade commitment at different rates depending upon the type of goods purchased. For example, fulfilment credit could be granted at the rate of 50 percent of the purchase value for one type of goods and 150 per cent for another, or that investments or technology transfer will be credited at more than the capital contribution of the investment or the monetary value of the technology transfer (e.g., 150 per cent). Such a variable rate of fulfilment credit may be used

*in particular in indirect offset transactions, in which the exporter concludes contracts with third parties, and the importer wishes to promote the purchase of certain types of goods.\* In direct offset, as well as in buy-back, the countertrade agreement may provide that a certain amount of fulfilment credit will be granted for export sales, other than those to the counter-importer, generated by the production facility supplied by the exporter. Credit may also be granted for a percentage of the value of sales to buyers in the counter-exporter's country. A variable rate of fulfilment credit might also be used in transactions in which the supply contracts are to be entered into between the parties to the countertrade agreement, in particular if the purchaser has a choice between several types of goods; in such a case the variable rate may serve as a stimulus to purchase a certain type of goods.*

33. The countertrade agreement may also provide for different rates of fulfilment credit depending upon the identity of the supplier, the geographical origin of the goods or the identity of the purchaser. The rationale behind such a provision is to steer the activities of the purchaser towards particular suppliers or regions, or to introduce the goods in certain markets.

34. The rate of fulfilment credit may also be made to vary according to the point of time when a purchase is made. Under a scheme of this type, the purchaser could fulfil the countertrade commitment by the purchase of a smaller quantity of goods if a supply contract was concluded at an early stage of the period for the fulfilment of the countertrade commitment. This approach is designed to give the purchaser an incentive for fulfilling the commitment earlier rather than later in the fulfilment period. In such a case it is particularly important that the countertrade agreement specify the point when fulfilment credit is to be given (e.g., when an order is placed or when payment is made).

#### F. Stage when commitment fulfilled

*[The present section F incorporates, with modifications in italics, paragraphs 10 to 12 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]*

35. It is advisable that the countertrade agreement indicate the specific action that must be taken in order for the countertrade commitment to be fulfilled. The parties may choose between two basic approaches. Under one approach, the countertrade commitment is deemed to be fulfilled once a supply contract is concluded. In such cases, a breach of an obligation under the supply contract would be subject to remedies available under the supply contract. The parties may agree that, if the supply contract is not performed due to a reason imputable to one party, the amount of the unperformed contract could, at the option of the other party, be reinstated in the countertrade commitment.

36. Under the second approach, the commitment is deemed to be fulfilled at an agreed stage in the performance of the supply contract. For example, it may be agreed

that the commitment of the purchaser is fulfilled when the letter of credit is opened or when the funds have been transferred to the supplier and that the corresponding commitment of the supplier is fulfilled when the goods are delivered or placed at the disposal of the purchaser in the agreed manner. In such cases, in the event of a breach of the supply contract, the aggrieved party might be able to invoke remedies not only for breach of the supply contract, but also for breach of the countertrade agreement if the countertrade commitment remained unfulfilled. *A disadvantage of this second approach is that it is more complicated and uncertain than the first approach, under which fulfilment is deemed achieved simply upon the conclusion of a supply contract. The second approach might result in uncertainty when exempting impediments affect the ability of a party to take the steps necessary in the performance of a supply contract to achieve fulfilment of the countertrade commitment. In order to avoid this uncertainty, additional provisions would be required in the countertrade agreement on the effect of such impediments.*

37. The parties may wish to address the effect on the countertrade commitment of a failure to conclude or perform a supply contract. It may be agreed, for example, that when the reason for such a failure is imputable to one of the parties, the outstanding countertrade commitment of the other party may, at the option of that other party, be deemed fulfilled in the amount of the unaccepted contract offer or unperformed contract (see chapter XIII, "Failure to complete countertrade transaction", paragraph \_\_\_\_).

## G. Defining terms of future supply contracts

[The present section G is a restructured section C, paragraphs 37 to 61, of draft chapter III, "Contracting approach" as it appeared in A/CN.9/332/Add.2. Paragraphs 39 to 42 of the earlier section C, A/CN.9/332/Add.2, entitled "Negotiation procedures", have been included at the end of the present subsection 6.]

### 1. Terms of future supply contracts

38. [paragraph 43 in A/CN.9/332/Add.2] Commitments to enter into supply contracts often do not stipulate in a definite manner all the terms of the contracts to be concluded. Sometimes the parties have not decided yet on the type of goods that will be the subject of the future supply contracts or what the terms of delivery will be. Even if the parties are able to set out in the countertrade agreement terms of the future supply contract, they sometimes forego doing so because they expect each party to live up to the commitment to conclude a future contract, though the terms of that contract may not be defined in great detail in the countertrade agreement.

39. [new paragraph] A lack of definiteness of the countertrade commitment may result in delays or uncertainties in negotiating a supply contract in view of the potentially broad scope of the negotiations. It is therefore advisable that the parties, to the extent feasible, include in the countertrade agreement the terms of the future contract or provide for means for subsequent determination of those

terms (see paragraphs 44 to 56 below). In addition, the parties may wish to address in the countertrade agreement procedures to be followed in their negotiations (see paragraphs 57 to 60 below). This will facilitate negotiations, increase the likelihood that a supply contract will be concluded and increase the possibility that the party interested in the conclusion of the contract would be able to hold the other party responsible for refusing to conclude the contract. If, for example, the countertrade agreement specifies the goods that a party is committed to purchase, or at least contains a list of goods as a basis of negotiations, the counter-exporter may be able to show that the refusal of the counter-importer to purchase any goods constitutes a breach of the countertrade commitment. If the goods are specified, it is also advisable to provide a mechanism for determining the price; this is particularly important when the countertrade goods are not of a standard type and it may be open to disagreement what is a fair market price.

40. [paragraph 46 in A/CN.9/332/Add.2] As the countertrade agreement becomes more definite in specifying the terms essential for the existence of an enforceable contract, the agreement approaches the point at which the parties have settled all the terms of the supply contract and postponed only the act of concluding the contract. When the countertrade agreement embodies the essential terms of the future contract for the purchase of goods, in some legal systems the possibility exists that such a countertrade agreement could be relied upon as an enforceable sales contract. In order to avoid disagreements, it is advisable that the parties, when concluding a countertrade agreement that contains the essential terms of the contract to be concluded, stipulate clearly whether a separate contract is to be executed pursuant to the countertrade agreement.

41. [paragraph 47 in A/CN.9/332/Add.2] Many legal systems contain rules to which the parties may resort in order to provide definiteness to a contract clause. For example, numerous legal systems provide a solution when the parties have not settled the price of the goods; the solution may be, for instance, that the price should be the one "generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned" (article 55 of the United Nations Convention on Contracts for the International Sale of Goods). Another example may be the rule on the quality of the goods to be delivered under the contract when the contract has not settled that issue; the rule in article 35(2)(a) of the above-mentioned Convention is that the goods should be "fit for the purposes for which goods of the same description would ordinarily be used". In some legal systems the parties may, within certain limits, resort to a court for the purpose of determining such a contract element. In other legal systems, however, the courts are not competent to intervene in this manner in a contractual relationship.

42. [paragraph 48 in A/CN.9/332/Add.2] Although such means for contract supplementation exist in many legal systems, they normally do not provide a solution in all cases of indefiniteness. The contract elements left indefinite in the countertrade agreement may not lend themselves to being made definite by reference to the applicable law. For example, if the parties have not agreed on the type of goods to be counter-exported, it would probably be impos-

sible to determine the type on the basis of the applicable law. Where the type of goods has been settled, the criteria provided in the applicable law concerning the price of the goods may not lead to a clear solution. Furthermore, such contract supplementation is subject to uncertainty arising out of divergencies among legal systems as to the techniques of supplementation, the role of the courts or *arbitral tribunals in determining the missing term*, the role of the parties, or as to the judicial control over the result of the supplementation. \* As a result, the parties may wish to consider the contractual means discussed below for providing definiteness to a contract term left open in the countertrade agreement.

43. [paragraph 49 in A/CN.9/332/Add.2] The terms that are often left indefinite in the countertrade agreement and with respect to which contractual means for completing indefinite terms may be particularly useful are the type, quality, price and quantity of the countertrade goods. The contractual means that the parties may consider for completing any one or more of those terms are discussed in a general manner in subsections (a) through (c) below. In other parts of the Legal Guide, these contractual means will be referred to in specific contexts.

(a) *Standards or guidelines*

44. [paragraph 50 in A/CN.9/332/Add.2] The parties may wish to provide standards or guidelines to be used in determining particular contract terms. The use of a standard would allow the parties to determine a contract term by computation or by some other objective method not dependent upon the discretion of the parties. Examples of such standards include a formula, tariff, quotation, rate, index, statistic, or some other criterion not influenced by the will of either party. For example, the price of the countertrade goods may be determined by reference to the price at which goods of the same type are sold in a particular market or exchange, or the quality of the countertrade goods may be defined by reference to a particular national or international quality standard. Many legal systems recognize as valid a provision that the price or other contract term should be determined by reference to a standard.

45. [paragraphs 50 and 45 in A/CN.9/332/Add.2] Guidelines, on the other hand, set parameters within which a contract term is to be determined and involve a degree of latitude in arriving at a contract term. For example, the countertrade agreement may set a range within which the parties are to negotiate the price or it may be agreed that the price must be "reasonable" (*such price clauses are further discussed in chapter VII, "Pricing of goods", paragraphs —*). [The following text in italics has been taken from paragraph 45 of A/CN.9/332/Add.2:] *Sometimes the parties are not in a position to be more definite about the terms of the anticipated supply contract than to provide that the contract terms should be fair or in accordance with the prevailing market conditions. Such provisions may be helpful when countertrade goods of a standard quality are agreed upon, thereby enabling a fair price to be ascertained. If, however, the type of countertrade goods is not settled or if the countertrade goods are products that do*

*not have a standard price, such a "fair terms" commitment may not substantially enhance the position of the party interested in the conclusion of the contract. In such cases opinions may differ as to what contract terms are fair, thereby protracting the negotiations and making uncertain the success of a claim against the party refusing to conclude the contract.* If the type of goods has not been determined, the parties may agree on a list of goods on which the negotiations should focus or to which it should be limited (such lists are discussed in chapter VI, "Type, quality and quantity of goods"). As to other terms of the future contract, such as delivery, the parties may agree that the supply contract should be negotiated on the basis of prevailing market conditions. Where reference is made to market conditions, it is advisable that the parties refer to a specific market.

46. [paragraph 52 in A/CN.9/332/Add.2] Because of the discretion left to the parties, the inclusion of a guideline in the countertrade agreement for a particular term in the future contract does not ensure the finalization of that term. Nevertheless, a narrow range within which agreement should have been achieved, or clear guidelines limiting the latitude available to the negotiators, will not only make it more likely that a contract will be concluded but will also make it easier to show that a party refusing a given contract offer is in breach of the countertrade commitment.

(b) *Determination of contract term by third person*

47. [paragraph 53 in A/CN.9/332/Add.2] Sometimes the parties agree that a particular contract term will be determined by a third person. While such an approach provides a high degree of certainty that the term will be made definite, its infrequent use may be attributable to a reluctance by parties to relinquish their control over a contract term. When such a method is used, it is usually to determine the price of goods (see chapter VII, paragraphs — and —). The parties might be willing to agree on such a method of determining a contract term if clear, and preferably narrow, guidelines are established within which the third person is to decide or if the third-person intervention is the last resort after other agreed mechanisms (e.g., negotiation, application of an agreed standard) have failed. If the parties do not wish to entrust the decision on a contract term to a third person, but still want the benefit of the opinion of a third person, it may be agreed that the determination by the third person will only be a recommendation.

48. [paragraph 54 in A/CN.9/332/Add.2] A number of legal systems recognize the right of the parties to entrust a third person with determining a contract term. In particular, reference by the parties to a third person for the determination of the price is a question frequently addressed in legal systems. There are, however, variations among the systems. For example, while some legal systems recognize that an arbitral tribunal or even a court may be entrusted with the determination of a contract term, others permit such a determination only if it is not performed as part of arbitral or judicial proceedings. Legal systems also differ as to the consequences of a failure by the parties to agree on the third person or of a failure by the third person to

act. Under some legal systems, the parties would have no recourse to a procedure for designating or replacing the person, and would have to accept the consequences of the contract term being left undetermined. In other systems, if the third person was to determine the price, the case may be treated as if the parties had agreed on a reasonable price. There are also differing approaches to the availability and extent of judicial review of a decision by a third person.

49. [paragraph 55 in A/CN.9/332/Add.2] The issues that the parties may wish to address in a stipulation empowering a third person to determine a contract term are discussed in the following paragraphs.

50. [paragraph 56 in A/CN.9/332/Add.2] *Person to request determination of term.* The parties may wish to address the question whether, at the time when the parties fail to agree on the term, either party would be entitled to request the third person to determine the term or whether the third person may act only upon the request of both parties.

51. [paragraph 57 in A/CN.9/332/Add.2] *The identity of the third person or the appointment procedure.* The parties may wish to name in the countertrade agreement the person who is to determine the contract term. In this case, the parties may also wish to provide an appointment procedure to be used in the event that the named person fails to act or is unable to act. If the parties do not wish to name the person who is to determine the contract term, it may be advisable for the parties to agree that they will appoint the third person at such time as they are unable themselves to reach agreement on the contract term. In such a case the parties may wish to agree on an appointment procedure, which is to become operative if the parties cannot reach agreement on the appointment of the third person.

52. [paragraph 58 in A/CN.9/332/Add.2] *Guidelines or standards to be observed by third person.* The parties are advised to delimit the mandate of the third person by providing guidelines or standards to be observed in determining the contract term. Such guidelines and standards are discussed generally above, paragraphs 50 to 52, and, as to price, in chapter VII, "Pricing of goods", paragraphs — to —.

53. [paragraph 59 in A/CN.9/332/Add.2] *Nature of decision of third person.* The parties may agree that the decision by the third person would be binding as a contractual stipulation of the parties. Another approach may be to provide that the determination of the third person would be treated as a recommendation to be considered by the parties in good faith.

54. [paragraph 60 in A/CN.9/332/Add.2] *Procedure for challenging decision by the third person.* In some situations, for example, where the binding determination by the third person involves a question of particular economic significance, the parties might wish to provide an opportunity for the decision to be challenged by resort to another person, a panel of persons, or an institution. As to the nature of the decision on the challenge, it may be provided that the decision would bind the parties or only be a recom-

mendation. The parties may wish to stipulate the mandate that would be given to the person deciding on the challenge (i.e., to uphold or reject the challenge, or to modify the challenged decision). The parties may wish to indicate how, in the event the challenged decision is set aside, the decision on the contract term is to be made (e.g., by the parties themselves or by the same or a different third person).

#### (c) *Determination of contract term by contract party*

55. [paragraph 61 in A/CN.9/332/Add.2] Sometimes the countertrade agreement leaves the determination of a contract term to one of the parties to the countertrade agreement. Utmost caution is advisable in agreeing on such a solution, which leaves the determination of the contract term to a person who has an interest in the outcome of the determination.

56. [paragraph 61 in A/CN.9/332/Add.2] *The parties should be aware that a clause empowering a contract party to determine a contract term is in many legal systems not enforceable. Where such a clause is recognized, it is subject to strict conditions.* If the subject of the determination is the price, a number of systems would recognize such a right given to a party if its exercise is limited by such standards as reasonableness, good faith or fairness. Some of these systems would construe an agreement not expressly referring to such a standard as implicitly referring to it. Other legal systems require the freedom to determine the price to be limited by a more definite standard such as objectively ascertainable market prices, price averages or absolute limits stipulated by the parties. Analogous restrictions apply to the determination of terms such as the quantity of goods to be delivered under a contract or the time of contract performance.

## 2. *Negotiation procedures*

57. [paragraph 39 in A/CN.9/332/Add.2] Countertrade agreements may set forth with varying degrees of procedural detail the manner in which negotiations are to be carried out. Specifying the negotiation procedures increases the probability that the negotiations will lead to a successful outcome. This would be particularly true where the nature of the negotiations is likely to be complicated, either because of the subject-matter of the eventual contracts or because of the number of persons who might be involved in those negotiations.

58. [new paragraph] Care should be taken to make negotiating procedures a part of a firm undertaking to conclude a supply contract. If the undertaking is limited to a mere obligation to negotiate, the parties, as noted above in paragraph 2, will have little assurance that the objectives of the transaction will be achieved. Even if negotiating procedures are combined with a firm countertrade commitment, such procedures alone do not ensure that negotiations will be successful. The most effective way to increase the likelihood of succeeding in the negotiations would be either to stipulate in the countertrade agreement the terms of the future contract or, if this is not possible, to agree on means

for providing definiteness to the countertrade commitment. Such means are discussed above, in particular in paragraphs 44 to 56.

59. [paragraph 40 in A/CN.9/332/Add.2] At a minimum, the countertrade agreement might provide that a party would be obligated to respond to contract proposals by the other party. More specific procedures would address issues such as: the party who is to submit a contract offer; questions to be covered by a contract offer; time periods for submitting it; the form, means or frequency of communication; the time period for reply; the time within which an agreement must be reached, and beyond which negotiations will be deemed to have failed. Furthermore, the parties may provide that in certain circumstances a party would be relieved of the duty to negotiate (e.g., when that party has made an offer meeting the agreed conditions and it has not been accepted, or, if the other party was to make the offer, when no such offer has been made).

60. [paragraph 41 in A/CN.9/332/Add.2] The stipulation of negotiation procedures such as those mentioned in the previous paragraph may \* increase the possibility that a party who has not negotiated in good faith could be held responsible for the failure to conclude a contract. Such procedures could enable an aggrieved party to demonstrate, for example, that the other party refused to negotiate, imposed conditions to negotiate that the party could not properly impose, used unfair dilatory tactics, reopened discussion on issues already agreed upon, negotiated with other parties when it was improper to do so, or prematurely broke off negotiations.

## H. Monitoring and recording fulfilment of countertrade commitment

*[The present section H incorporates, with some modifications in italics, paragraphs 31 to 44 of draft chapter VII, "Fulfilment of countertrade commitment", as it appeared in A/CN.9/332/Add.8.]*

61. The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment. Such arrangements may be particularly useful in long term countertrade transactions with multiple shipments in one or both directions.

### 1. Exchange of information

62. The parties may wish to establish procedures for exchange of information on progress in the fulfilment of the countertrade commitment. Such procedures may be useful, in particular, in "indirect offset" transactions (chapter II, paragraph 17), since the countertrade commitment is owed to a person who does not act as the supplier of the countertrade goods and the potential suppliers are, therefore, not parties to the countertrade agreement. A system of exchange of information may also be useful when the parties are engaged in a large volume of mutual trade, especially when only a part of that trade stems from the countertrade agreement.

63. The parties may include in the countertrade agreement guidelines concerning the contents, frequency and timing of the information to be exchanged. The required information could cover, for example, contracts that have been concluded *and* are eligible to be counted towards fulfilment (especially when concluded with a third person), shipments that have been made, payments effected in accordance with agreed upon procedures and purchases planned for an upcoming subperiod of the fulfilment period. Furthermore, the parties to the countertrade agreement sometimes find it useful to meet periodically to assess the progress that is being made towards fulfilment. Such meetings could be used to review the status of concluded contracts and those under negotiation and to consider possible modifications of the countertrade agreement. The countertrade agreement could address questions such as the frequency and location of meetings and the representation of the two sides.

64. In particularly complex transactions that require ongoing monitoring and coordination, the parties may wish to establish in the countertrade agreement a joint coordination committee. It is advisable that the parties address issues such as the frequency and location of meetings, representation of the two sides, the manner in which the results of the meetings will be reported and the mandate of the committee. The mandate of such a committee would typically be to assess progress in the implementation of the transaction, analyse difficulties and consider possible solutions, establish working groups for specific problems, and consider proposals to amend the countertrade agreement.

### 2. Confirmation of fulfilment of countertrade commitment

65. The parties may agree that the purchaser has a right to obtain from the party to whom the countertrade commitment is owed a written confirmation of the fulfilment of the countertrade commitment. Such a confirmation may take the form of a statement from the supplier (sometimes referred to as a "letter of release"). The parties may agree that the letter of release is a condition for payment under the supply contract concluded in fulfilment of the countertrade commitment (e.g., the letter of credit terms may specify that the letter of release is to be among the documents presented to the bank in order to obtain payment). Fulfilment of the countertrade commitment may also be evidenced by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

66. Written confirmation of fulfilment is intended to avoid disagreements, which may occur after a particular supply contract has been performed, as to whether the contract counts towards fulfilment of the countertrade commitment. Written confirmation may also be helpful to a party who wishes to demonstrate (e.g., in negotiating other countertrade agreements) a record of fulfilling countertrade commitments.

67. Where written confirmations are envisaged in a multiparty transaction (see chapter VIII, "Participation of

third parties", paragraphs — to —), it is advisable that the countertrade agreement indicate whether the fulfilment of the commitment is to be confirmed by the supplier of the goods or by the party to whom the commitment is owed. Absent such an indication, a disagreement may arise between the purchaser and the party to whom the commitment is owed as to the significance of a statement by a third-party supplier that a supply contract fulfils the countertrade commitment, or of a clause in a supply contract with a third-party supplier to that effect.

### 3. Evidence accounts

68. The parties may agree that the *supply contracts in the two directions* are to be recorded in a ledger kept by themselves, by a bank or by a controlling authority. Such a ledger is referred to herein as an "evidence account", a term frequently used in practice. Other terms used in practice include "record account" and "trade account". An evidence account is not a payment mechanism. Rather, it is used only for recording the conclusion, performance and value of supply contracts, with financing and payment being arranged independently. With an evidence account, the parties undertake a countertrade commitment of a given value and then conclude supply contracts in the two directions without having to negotiate a countertrade commitment for each individual supply contract. Evidence accounts may accommodate multiple parties on one or both sides. An evidence account may be particularly useful in a long-term countertrade transaction to monitor the cumulative value of the purchases in the two directions and thereby to assist the parties in dealing with imbalances that may develop.

69. The use of an evidence account may be subject to governmental regulations. Such regulations may determine the manner in which an evidence account is to operate and require administration of the account by a controlling authority such as the central bank or foreign trade bank. An evidence account administered by a controlling authority may provide the purchaser access to a wider variety of countertrade goods and trading partners than might be available without an evidence account administered by the controlling authority. Government regulations may also require authorization of evidence accounts. It may be provided that such authorization would be given only for countertrade transactions exceeding a minimum turnover and to parties with an established presence in a given country. In some cases, an evidence account is authorized with the restriction that purchases by third parties will not be counted towards fulfilment of the countertrade commitment; such a restriction may be imposed when the motive for permitting an evidence account is to establish a long term trading relationship with a particular party. The countertrade goods may be limited to those agreed upon by the parties or those that the controlling authority has an interest in promoting.

70. When the parties are free to establish an evidence account, they may decide to administer the account themselves or to engage a bank or banks to do so. A variety of structures are possible depending on whether the account is

administered by one or both of the parties or by one or two banks engaged by the parties. For example, parallel accounts could be established by a party or a bank on each side of the transaction in which supplies are credited and purchases are debited. Each parallel account could in turn consist of two ledgers, one listing contracts concluded in each direction and the other recording payments. If banks are to administer the evidence account, the parties may wish to use the banks that handle payment for the supply contracts.

71. The countertrade agreement should specify the documentation required for triggering entries in the evidence account (e.g., copies of contracts, evidence of letters of credit, or shipping documents). Such documentary requirements should be in line with the provisions in the countertrade agreement concerning the stage when the countertrade commitment is deemed fulfilled (see above, paragraphs 35 to 37). In order to minimize administrative burden, the parties may wish to align to the degree possible the documentary requirements for the evidence account with those of any governmental authority monitoring the countertrade transaction.

72. It is advisable that the parties address in the countertrade agreement deviations from the agreed upon ratio between the values of the shipments to be made in the two directions. *It may be agreed that, while the agreed upon ratio must be achieved upon the conclusion of the fulfilment period or at specified points in the fulfilment period, the values of the shipments may deviate from the agreed ratio during the fulfilment period or between the specified points in the fulfilment period.* The parties may further agree that deviations during the fulfilment period must remain within a specified range. For example, during the fulfilment period the value of the shipments in one direction should be not less than 60 and not more than 120 per cent of the value of the shipments in the other direction. *It may be agreed that, if a party fails to conclude the supply contracts necessary to achieve the agreed upon ratio, the other party is entitled to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction until the ratio is achieved (see also chapter XIII, "Failure to complete countertrade transaction", paragraph —). A failure to achieve the agreed ratio may also be made subject to sanctions (see chapters XI, "Liquidated damages and penalty clauses", and XII, "Security for performance").* It is advisable to define in the countertrade agreement small deviations from the ratio that would be tolerated.

73. In order to minimize errors or discrepancies in the evidence account, *it is advisable for the parties to agree to verify at fixed points of time the information entered in the account.*

74. Where two banks are involved in administering the evidence account, the technical details of the account may be the subject of an interbank agreement. The countertrade parties have an interest in the contents of the interbank agreement, though they are not normally parties to it. It is therefore advisable that the parties consult with the banks to ensure that the evidence account established by the banks is acceptable to the parties.

[A/CN.9/362/Add.5]

## V. GENERAL REMARKS ON DRAFTING

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[*Editorial note:* The present draft chapter V is a revision of draft chapter IV bearing the same title and published as document A/CN.9/332/Add.3. Where the numbering of a paragraph has changed, the earlier paragraph number appears in square brackets at the beginning of the paragraph. The revisions of paragraphs that appeared in A/CN.9/332/Add.3 are in italics.]

## A. General remarks

1. A countertrade transaction is usually the result of extensive written and oral communications between the parties. Each party may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts). Such a checklist could reduce the possibility of omissions or errors occurring in the steps taken prior to entering into the contracts. A party may also wish to consider seeking legal or technical advice in drawing up the contracts. While countertrade transactions can be expected to become routine for parties experienced in countertrade, even simple countertrade transactions may pose difficulties for newcomers to countertrade calling for legal or technical advice. For complex transactions, even experienced parties may require advice.

2. The process of establishing a countertrade transaction could be facilitated if the parties agree that, before a first draft of the countertrade agreement and any supply contract is prepared, negotiations on the main technical and commercial issues are to take place. Thereafter, one of the parties could be asked to submit a first draft reflecting the agreement reached during the negotiations. A first draft may then be discussed and elaborated, resulting in a preliminary set of contract documents, which, after review and finalization, will govern the relationship between the parties.

3. The legal rules applicable to the countertrade agreement may require that a countertrade agreement be in written form. Even when written form is not required, it is recommended that the parties express their agreement in writing to avoid later disputes as to what terms were actually agreed upon. If the parties decide that modifications of

the countertrade agreement are to be in writing, it is advisable that this be stated in the countertrade agreement. *However, even if such a provision has been included in the countertrade agreement, there may be situations in which a modification can be made otherwise than in writing. A number of legal systems have rules, comparable to article 29(2) of the United Nations Sales Convention, according to which a party may be precluded by its conduct from asserting a contract provision that any modification or termination of the contract must be in writing to the extent that the other party has relied on that conduct.*

4. *It is desirable that the parties clarify the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents which came about during the negotiations, on the other. The parties may wish to provide that those communications and draft documents are not part of the contract. They may further provide that those communications and draft documents cannot be used to interpret the contract, or, alternatively, that they may be used for this purpose to the extent permitted by the applicable law. Under the law applicable to the contract, oral exchanges, statements and conduct of a party and correspondence may be relevant to the interpretation of the contract even if they occur after the contract is entered into.*

5. The parties should ensure that the contract terms as expressed in writing are unambiguous and will not give rise to disputes, and that the relationship between the various documents comprising the transaction is clearly established. Such precision may be of particular importance in countertrade transactions that are carried out over a long period and may have to be administered by persons who have not participated in the negotiations at the outset of the transaction (e.g. buy-back or offset transactions). Each party may find it useful to designate one person to be primarily responsible for supervising the preparation of the contract documents. It is advisable for that person to be a skilled draftsman familiar with international countertrade transactions. To the extent possible, it is advisable for that person to be present during important negotiations. Each party may find it useful to have the final contract documents scrutinized by a team having expertise in the subject-matter reflected in the documents in order to ensure accuracy and consistency of style and content.

6. The applicable legal rules may also contain rules on the interpretation of contracts and presumptions as to the meaning of certain expressions such as "reasonable price" (chapter VII, "Pricing of goods", paragraph 24), "trust" and "*compte fiduciaire*" (chapter IX, "Payment", paragraph 16), and "penalty" (chapter XI, "Liquidated damages and penalty clauses", paragraph —). The parties are advised to select contract wording in light of the applicable law in order to ensure that the expressions used reflect the intended meaning. One approach is for the applicable law to be determined at a very early stage of the relationship between the parties (e.g., at the commencement of negotiations). The countertrade transaction may then be negotiated and drawn up taking that law into account. Another approach is for the parties to determine the applicable law only after negotiations have taken place on the main technical and commercial issues and have resulted in a measure of accord between the parties. They may thereafter review the first drafts relating to the transaction, which reflect that accord, in the light of the applicable law to ensure that the terms of the draft take account of that law. *The advisability of stipulating the law applicable to the countertrade agreement and the related supply contracts is discussed in chapter XIV.*

7. The parties should take into account the mandatory legal rules of an administrative, fiscal or other public nature in the country of each party that are relevant to the countertrade transaction. They should also take into account such mandatory legal rules in other countries when those rules are relevant to the transaction. Certain rules may concern the technical aspects of the countertrade agreement (e.g., safety standards for the countertrade goods or rules relating to environmental protection), and the terms of the countertrade agreement should not conflict with those rules. Other rules may concern export, import and foreign exchange restrictions (e.g., it may be provided that certain rights and obligations are not to arise until export or import licences, approvals for payments or for the use of particular payment mechanisms have been granted). Legal rules relating to taxation may be a factor, and the parties may wish to include in the countertrade agreement provisions dealing with liability for tax. *Mandatory provisions are also considered in chapter XIV, "Choice of law", paragraphs — to —.*

8. The parties may wish to consider whether the countertrade agreement is to contain introductory recitals. The recitals may set forth representations made by one or both parties which induced the parties to enter into the agreement. The recitals may also set out commercial objectives to be achieved through the transaction or describe the context in which the countertrade agreement was entered into. The extent to which recitals are used in the interpretation of the terms of the agreement introduced by the recitals varies under different legal systems, and their impact on the interpretation may be uncertain. Accordingly, if the contents of recitals are intended to be significant in the interpretation or implementation of the countertrade agreement, it may be preferable to include those contents in the operative provisions of the countertrade agreement.

9. The parties may find it useful to examine standard forms of countertrade agreements, general conditions,

standard clauses, or previously concluded countertrade agreements to facilitate the preparation of contract documents. Such an examination may clarify for the parties the issues that should be addressed in their negotiations. However, it is inadvisable to adopt provisions appearing in those documents without critical examination. Those provisions may, as a whole, reflect an undesirable balance of interests, or those provisions may not accurately reflect the terms agreed to by the parties. The parties may find it advisable to compare the approaches adopted in the forms, conditions or countertrade agreements examined by them with the approaches recommended in the present Legal Guide.

## B. Language

10. The contracts constituting the countertrade transaction (i.e., the countertrade agreement and the individual supply contracts) may all be drawn up in only one language version (which may, but need not be, the language of either of the parties), or in the two languages of the parties where those languages differ, or the countertrade agreement may be drawn up in one language and the supply contracts in another language. Where the conclusion of the countertrade agreement precedes the conclusion of the supply contracts in the two directions (chapter III, "Contracting approach", paragraph 19), or where it precedes the conclusion of the counter-export contract (chapter III, paragraphs 12 to 18), it is advisable that the countertrade agreement specify the language of the contracts. The specification of the language before the commencement of negotiations on a supply contract may facilitate preparations of the parties for the negotiations and avoid a disagreement.

11. Drawing up a contract in only one language version will reduce conflicts of interpretation in regard to its provisions. Drawing up all the contracts constituting the countertrade transaction in the same language will reduce conflicts between two contracts of related content. On the other hand, each party may understand its rights and obligations more easily if one version of the contract is in its language. In addition, where extensive or complex working instructions to personnel of one or both parties are derived directly from the contract, it may be of particular importance that the contract is in the language in which the instructions are to be given. *The parties may decide that certain annexes to the countertrade agreement or a supply contract (e.g., those setting out technical specifications) will be drawn up in or translated into a particular language. If translations are envisaged, it is advisable to settle the question of who should bear the translation costs. If only one language is to be used, the parties may wish to take the following factors into account in choosing that language: that it is advisable for the language chosen to be understood by the senior personnel of each party who will be implementing the contract; that it might be advisable for the contract to be in a language commonly used in international commerce; that the settlement of disputes is likely to be facilitated if the language chosen is the language in which proceedings would be conducted or if the language chosen is the language or one of the languages of the country of the applicable law.*

12. If the parties do not draw up the contracts in a single language version, it is advisable to specify in the contracts which language version is to prevail in the event of a conflict between the two versions. For example, if the negotiations were conducted in one of the languages, the parties may wish to provide that the version in the language of the negotiations is to prevail. A provision that one of the language versions is to prevail might induce both parties to clarify as far as possible the prevailing language version. The parties may wish one language version to prevail in respect of certain segments of the transaction or in respect of certain contract documents (e.g. countertrade agreement or technical documents related to the countertrade agreement or a supply contract) and another language version in respect of the remainder of the contracts or documents. Where the parties provide that both language versions are to have equal status, the parties should attempt to provide guidelines for the settlement of a conflict between the two language versions. The parties may provide, for example, that the agreement is to be interpreted according to practices that the parties have established between themselves and usages regularly observed in international trade with respect to the agreement in question. The parties may also wish to provide that where a term of the contract in one language version is unclear, the corresponding term in the other language version may be used to clarify that term.

### C. Parties to transaction

13. Where a contract involved in the transaction (the countertrade agreement or a supply contract) consists of several documents, the parties may wish to identify and describe themselves in a principal document designed to come first in logical sequence among the documents that incorporate that contract. The document should set forth, in a legally accurate form, the names of the parties, indicate their addresses, record the fact that the parties have entered into a contract, briefly describe the subject-matter of the contract, and be signed by the parties. It should also set forth the date on which, and the place where, the contract was signed, and the time when it is to enter into force. Subsequent reference in the contract to the parties may be facilitated if the principal document would specify that in the subsequent text and in the subordinate documents the parties would be referred to by agreed abbreviations or by expressions such as exporter, importer, counter-exporter, counter-importer, trading house. A party may have several addresses (e.g., the address of its head office, the address of a branch through which the contract was negotiated) and it may be preferable to specify in the document the address to which notifications directed to a party should be sent.

14. Parties to countertrade transactions are usually legal persons. In such cases the source of their legal status (e.g. incorporation under the laws of a particular country) may be set out in the contract. There may be limitations on the capacity of legal persons to enter into contracts. Therefore, unless satisfied of the other party's capacity to enter into the contract, each party may wish to require from the other some proof of that capacity. If a party to the contract is a legal person, the other party may wish to satisfy itself that the official of the legal person signing the contract has the authority to bind the legal person. When a governmental

agency is a party to the countertrade transaction, special authorization may be necessary for the conclusion of the countertrade agreement or the supply contract. Special authorization may also be required for a governmental agency to enter into an arbitration agreement and to include in that agreement a clause by which the agency agrees to carry out the award made by the arbitral tribunal.

15. [paragraph 14, last sentence] If the contract is entered into by an agent on behalf of a principal, the name, address and status of the agent and of the principal may be identified, and evidence of authority from the principal enabling the agent to enter into the contract on its behalf may be annexed.

### D. Notifications

16. [15] In a countertrade transaction a party frequently has to notify the other party of certain events or situations. Such notifications may be required, for example, to initiate negotiations for the conclusion of a supply contract, to facilitate cooperation in the performance of the contract, to enable the party to whom notification is given to take action, as the prerequisite to the exercise of a right, or as the means of exercising a right. The parties may wish to address and resolve in their contract certain issues which arise in connection with such notifications.

17. [16] In the interests of certainty, it is desirable to require that all notifications referred to in the countertrade transaction be given in writing, although in certain cases requiring immediate action the parties may wish to provide that notification can be given orally in person or by telephone, to be followed by confirmation in writing. The parties may wish to define "writing" (see paragraph 21 below) and to specify the acceptable means of conveying written notifications (e.g., surface mail, airmail, telex, telegraph, facsimile, electronic data interchange (EDI)). However, care should be taken not to so limit the means of notification that, if the means specified is not available, no valid notification could be given. The parties may also wish to specify the language in which notifications are to be given (e.g., the language of the contract).

18. [17] With regard to the time when a notification is to be effective, two approaches may be considered. One approach is to provide that a notification is effective upon its dispatch by the party giving the notification, or after the lapse of a fixed period of time after the dispatch. Alternatively, the parties may provide that a notice is effective only upon delivery of the notification to the party to whom it is given (see paragraph 21 below). Under the former approach, the risk of a failure to transmit or an error by the transmitting agency in transmission of the notification rests on the party to whom the notification is sent, while under the latter approach it rests on the party dispatching the notification. The parties may find it advantageous to select a means of transmitting the notification which provides proof of the dispatch or delivery, and of the time of dispatch or delivery. Another approach may be to require the party to whom the notification is given to acknowledge receiving the notification. It may be convenient for the

contract to contain a general provision to the effect that, unless otherwise specified, one or the other approach with respect to when a notification becomes effective (on dispatch or delivery) is to apply to notifications referred to in the contract. Exceptions to the general approach adopted may be appropriate for certain notifications.

19. [new paragraph] The parties may wish to specify the addresses of company departments or of representatives of the parties to which notifications should be sent. Different addressees might be specified for different kinds of notifications.

20. [18] The parties may wish to specify the legal consequences of a failure to notify. The parties may also wish to specify the consequences of a failure to respond to a notification that requires a response. For example, when the parties envisage a series of shipments *in one or in the two directions*, they may provide that if the supplier notifies the purchaser of a proposed shipment of a given quantity of the goods on a particular date, the purchaser is deemed to have agreed unless an objection is made.

### E. Definitions

21. [19] *It is advisable* to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contract. Definitions are particularly useful in contracts between parties from different countries, even if they use the same language, because of the increased possibility that certain expressions or concepts may be used differently in the two countries. Definitions are also useful when the contracts are in two languages since they tend to reduce the likelihood of errors in translation. A definition ensures that the expression or concept defined is understood in the same sense whenever it is used in the agreement or the contract, and dispenses with the need to clarify the intended meaning of the expression or concept on each occasion that it is used. A definition is advisable if an expression which needs to be used is ambiguous. Such definitions are sometimes made subject to the qualification that the expressions defined bear the meanings assigned to them, "unless the context otherwise requires". Such a qualification takes into account the pos-

sibility that an expression which has been defined has inadvertently been used in a context in which it does not bear the meaning assigned to it in the definition. The preferable course is for the parties to scrutinize the contract carefully to ensure that the expressions defined bear the meanings assigned to them *wherever they occur*.

22. [20] Since a definition is usually intended to apply throughout an agreement or contract, a list of definitions may be included in the controlling document. Where, however, an expression that needs to be defined is used only in a particular provision or a particular section of the agreement or contract, it may be more convenient to include a definition in the provision or section in question.

23. [21] *Examples of expressions that parties may wish to define include* "countertrade agreement", "writing", "dispatch of notification", and "delivery of notification". The parties may wish to consider the following examples:

*Countertrade agreement.* "Countertrade agreement" consists of the following documents, and has that meaning in all the said documents: (a) the present document; (b) list of possible countertrade goods; (c) . . . .

*Writing.* "Writing" includes statements contained in a telex, telefax, telegram or other means of telecommunication which provides a record of the content of such statements.

*Dispatch of a notification.* "Dispatch of a notification" by a party occurs when it is properly addressed and conveyed to the appropriate entity for transmission by a mode authorized under the contract.

*Delivery of a notification.* "Delivery of a notification" to a party occurs when it is handed over to that party, or when it is left at an address of that party at which, under the contract, the notification may be left, irrespective of whether the notification is brought to the attention of the individual responsible to act on the notification.

24. [22] The parties may find it useful, when formulating their own definitions, to consider the descriptions contained in the present Guide of the various concepts commonly used in countertrade transactions. Those descriptions can be located by the use of the index to this Guide.

[A/CN.9/362/Add.6]

## VI. TYPE, QUALITY AND QUANTITY OF GOODS

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[*Editorial note:* The present draft chapter VI is a revision of draft chapter V, "Type, quality and quantity of goods", published as document A/CN.9/332/Add.4. The note in square brackets at the beginning of each paragraph indicates either that the paragraph is new or it refers to the number under which the paragraph appeared in document A/CN.9/332/Add.4. The revisions of paragraphs that appeared in A/CN.9/332/Add.4 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

## A. General remarks

1. [*new paragraph*] As noted in chapter II, paragraph 2, the discussion concerning "goods" in the Legal Guide is broadly applicable to services and technology. Where necessary, the present chapter makes reference to certain special issues concerning services and technology.

2. [1] The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. The more precise the countertrade agreement is with respect to the type of goods, the greater the possibility is of stipulating in the countertrade agreement the quantity and quality of the goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known.\*

## B. Type of goods

### 1. General remarks

3. [2] Various considerations may enter into the selection of the type of goods. The supplier would prefer that the goods be those that could easily be made available or those that the supplier wishes to introduce in a new market, while the purchaser would like to purchase goods that are needed or could be resold easily. The freedom of the parties to agree on the type of goods to be supplied in one or both directions may be affected by government regulations dealing specifically with the types of goods that may be involved in countertrade transactions. For example, in some countries government regulations exclude certain

types of goods from being offered for purchase in a countertrade transaction if the price of the goods is not paid in foreign currency to the the exporter's account.\* Government regulations may also provide that the import of certain types of goods is permitted only if the exporter agrees to purchase goods in return.

4. [3] The choice of the parties as to the type of goods may also be restricted by government regulations requiring that the countertrade goods must originate in the country, or in a particular region of the country, or must be purchased from a particular economic sector or group of suppliers. Such restrictions on origin and source are particularly likely to be encountered when the party requiring a countertrade commitment is a governmental entity.\* Clauses in the countertrade agreement concerning origin and source restrictions are discussed in chapter IV, "Countertrade commitment", paragraphs 26 to 28, and chapter VIII, "Participation of third parties", paragraphs — to —. *In addition to regulations specific to countertrade referred to in the previous two paragraphs, there may exist restrictions generally applicable to the export or the import of goods which could affect the freedom of the parties to select the types of goods to be traded under the countertrade transaction.*

5. [*new paragraph*] Parties may wish to be assured, prior to entering into the countertrade transaction, that, if the prescribed conditions are met, there are in principle no obstacles to obtaining the required export and import licences. Such an assurance, which may be given by a party to the transaction or by a third person, may be appropriate, for example, in countertrade transactions that require committing large portions of production capacity or disclosure of technological information. In such transactions the denial of a licence could pose greater difficulties than a similar denial in a simple sales transaction.

6. [*new paragraph*] If a governmental restriction on the export or import of goods is imposed after the parties have agreed on the type of goods, the parties would be impeded in the carrying out of the countertrade commitment or of a supply contract. Such impediments are discussed in chapter XIII, "Failure to complete countertrade transaction", paragraphs —.

### 2. List of possible goods

7. [4] When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of possible

countertrade goods, the purchase of which would count towards fulfilment of the countertrade commitment. Where the countertrade agreement is concluded prior to the supply contracts pertaining to deliveries in both directions (chapter III, "Contracting approach", paragraphs 20 and 21), there may be two lists, one for each direction in which goods will be shipped. The product list may be attached to the countertrade agreement at the time of signature or may be agreed upon later.

8. [5] The countertrade agreement should be clear as to the nature and extent of the undertaking of the parties with respect to a list of possible countertrade goods. The supplier may undertake to make available all the types of goods on the list. In such a case the purchaser would be free to choose from among different types of goods appearing on the list, unless the countertrade agreement restricts the purchaser's choice. For example, there may be a limit on the number of different types of goods that may be purchased or there may be minimum or maximum levels set for the purchase of certain types of goods.

9. [6] The undertaking of the supplier as to availability may be limited to certain specified types of goods on the list. In such a case, the purchaser would be free to choose from among the goods that are identified in the countertrade agreement as being available. The possibility of purchasing any of the other types of goods, whose availability is not assured, would be left to subsequent negotiation.

10. [7] It may be agreed that the purchaser's commitment is to be reduced to the extent the supplier fails to make available those types of goods that are identified in the countertrade agreement as being available (see chapter XIII, "Failure to complete countertrade transaction", paragraphs —). In addition, the supplier's commitment to make available goods appearing on a list may be supported by a liquidated damages or penalty clause (see chapter XI, "Liquidated damages and penalty clauses") or a guarantee (chapter XII, "Security for performance").

11. [8] When the supplier does not make an undertaking as to the availability of any particular type of goods appearing on the list, the determination of the types of goods actually available will occur in the course of the subsequent negotiations. If the supplier fails to make available any of the goods on the list, the purchaser would not be liable for the failure to fulfil the countertrade commitment (see chapter XIII, "Failure to complete countertrade transaction", paragraphs —).

12. [9] The parties may wish to state in the countertrade agreement that the purchaser is obligated to supply within a specified time period the specifications necessary to establish accurately the purchaser's requirements with respect to the goods to be purchased and to enable the supplier to make a corresponding offer. The countertrade agreement may indicate that specifications will be provided by a third party (e.g., a trading house engaged to purchase the goods, or an end-user).

13. [10] Because countertrade agreements are often entered into for the purpose of developing new exports or

new markets for existing exports, selection of the countertrade goods could be conditioned on a requirement that the goods be a non-traditional export of the supplier or, if they are a traditional export, that they be resold in a new market. Where the purchaser has made prior purchases from the supplier or has a prior commitment to purchase goods from the supplier, the countertrade agreement may stipulate that the purchase is to be of a new type of goods and must result in a level of sales higher than established levels in order to be counted towards fulfilment (see also chapter IV, paragraphs 5 and 6, concerning "additionality" as a factor in setting the *extent of the countertrade commitment*). It is advisable that the countertrade agreement define the requirements as to new products or markets, either by identifying products and markets considered new or identifying those not considered new.

14. [11] Establishing a procedure in the countertrade agreement for making decisions on the type of countertrade goods may be helpful, particularly in a long term countertrade transaction or one involving multiple parties. For example, the parties may wish to form a joint committee that would meet at regular intervals to identify countertrade goods and to monitor fulfilment of the countertrade commitment. Procedures established for identifying countertrade goods should be coordinated with deadlines in the fulfilment schedule. (See chapter IV, "Countertrade commitment", paragraphs 17 to 20; for a general discussion of negotiation, see chapter IV, paragraphs 56 to 60). Such a joint committee might also be utilized to settle the price of the goods (see chapter VII, "Pricing of goods", paragraph —).

### 3. Services

15. [new paragraph] When services are to be a subject-matter of a supply contract, it is advisable that the countertrade agreement be as specific as possible in describing them. Even if certain aspects of the envisaged service cannot be agreed upon at the time of entering into the countertrade agreement, the parties may facilitate subsequent negotiations and increase the likelihood of concluding the intended contract if they describe in the countertrade agreement those aspects of the service that they are in a position to agree on. The descriptions will depend on the type of the service envisaged. For example, if transport is the subject-matter of the future contract, the issues that the parties might be able to address in the countertrade agreement include the following: the routes, type of vehicles or vessels to be used, any special equipment that the carrier must have available, types of goods to be transported, special considerations concerning dangerous goods, any permits that may be necessary to effect the transport and the party responsible to obtain the permits. If maintenance of industrial equipment is the service in question, the countertrade agreement might, for example, outline certain of the elements of a maintenance programme, including the level of efficiency at which the equipment is to be maintained. Such elements could include, for example, periodic inspection of the equipment; maintenance manual and procedures; cleaning; adjustment and lubrication; replacement of defective or worn-out parts; the period

of time during which maintenance is to be provided; maintenance schedules; maintenance records; obligations of the parties with respect to unforeseen breakdowns and repairs; manner of calculating the price of the service.

#### 4. Technology

16. [new paragraph] Countertrade transactions may involve the transfer of technological processes necessary for the manufacture of products or the transfer of knowledge and skills necessary to use particular industrial equipment. The communication of these processes, knowledge and skills is often referred to as the transfer of technology. When the transfer of technology is involved in a countertrade transaction, it is usually part of the export contract, i.e., the contract that is entered into at the outset of the countertrade transaction together with the countertrade agreement stipulating the conclusion of a counter-export contract. For example, export contracts in buy-back and indirect offset transactions include the transfer of technology. In some countertrade transactions, however, the countertrade agreement envisages technology to be transferred in connection with a supply contract to be concluded.

17. [new paragraph] The transfer of technology may occur in different ways. It may occur through the grant of licences to use industrial products or processes that are the subject of different forms of industrial property. Most legal systems provide for the registration, subject to certain conditions, of inventions of industrial products or processes which are thereby recognized and protected under the law relating to industrial property in force within the territory of the country in which the registration takes place. The owner of the industrial property obtains the exclusive right to exploit the products or processes that are the subject of the industrial property. A common form of industrial property protection consists of patents. Once a patent is granted, for a limited period determined by law, the invention that is the subject-matter of the patent can be exploited in the country that granted the patent only with the consent of the patent holder. A person can apply in more than one country for the grant of a patent. There exist international treaties according to which the registration of an invention with the designated international office provides national patent protection in the States members of the treaty; such treaties are, for example, the European Patent Convention of 1973 and the treaty establishing the African Intellectual Property Organization of 1962 and 1977. Most legal systems also recognize other forms of industrial property. For example, a distinctive sign used to identify goods and indicate their origin (e.g., as coming from a particular manufacturer) may be protected through registration as a trade mark. A protected trade mark cannot be used without the consent of the registered owner of the trade mark. The transfer of technology may occur in conjunction with a licence for the use of a trade mark. A patent holder or the owner of a trade mark may license the use of the patent or trade mark (i.e., permit, subject to the conditions of the licence, to use the subject-matter of the patent, or the trade mark, in return for remuneration). Some legal systems recognize additional forms of industrial property, such as utility models and industrial designs.

18. [new paragraph] When the purchaser requires a particular technology, it is advisable that the countertrade agreement contain as precise as possible a description of that technology. In some cases, however, the purchaser may prefer the obligations of the supplier of the technology to be defined primarily in terms of certain performance parameters to be achieved by the use of the technology (e.g., production of goods of a quantity and quality stipulated in the contract). In such cases, a general description of the technology may be sufficient for the countertrade agreement, and the supplier may be required to provide the detailed description upon the conclusion of the supply contract.

19. [new paragraph] Certain industrial processes may be known only to one or a few enterprises. These enterprises might not wish, or may have been unable, to protect the industrial processes through registration in accordance with the law relating to industrial property. They may, instead, keep this knowledge confidential. In such cases, the transfer of technology may occur through the supply of this knowledge (generally called "know-how"). Such transfer of know-how may be subject to conditions as to the maintenance of confidentiality by the party to whom the know-how has been transferred. The information and skills necessary for the operation and maintenance of a plant may be communicated through the training of personnel or through documentation. A given transaction may involve the transfer of technology through one or more of the methods described in this and the previous paragraph.

20. [new paragraph] The supplier of know-how will usually require the know-how to be kept confidential. Confidentiality may be required at two stages. Firstly, the supplier may provide some information relating to the know-how during negotiations for the conclusion of the countertrade agreement in order to enable the purchaser to decide whether it wishes to enter into a countertrade agreement, and to make proposals as to contract terms. The supplier will wish the purchaser to keep this know-how confidential. Secondly, when a supply contract is entered into pursuant to the countertrade agreement, the supplier will require the additional know-how supplied thereafter to be kept confidential. To achieve these results, it may be necessary under some legal systems for the parties, prior to the commencement of negotiations, to conclude an agreement under which the purchaser undertakes to maintain confidentiality with regard to know-how supplied during negotiations, and thereafter to include provisions on confidentiality in the countertrade agreement and in the supply contract. Under other legal systems, however, the obligation of the purchaser to maintain confidentiality results from the obligation of the parties to observe good faith during negotiations. The supplier may wish to consider whether it is necessary to supplement by an express stipulation any obligation to maintain confidentiality imposed by law.

21. [new paragraph] The extent to which contractual provisions may impose obligations as to confidentiality on the purchaser may be regulated by mandatory legal rules. Issues to be addressed by such contractual provisions may include clear identification of the know-how to be kept confidential, the duration of the confidentiality and the extent of permissible disclosure (e.g., disclosure being per-

missible in specified circumstances, or to specified persons). The parties might seek to provide that once the know-how to be kept confidential becomes available to the public, the obligation of confidentiality terminates, as does the obligation to pay royalties. The parties may also wish to provide, for example, that a person engaged by the purchaser to advise the purchaser in connection with the supply contract is to be allowed access to such of the know-how as is necessary for the exercise of the advisory functions. They may further wish to provide that if the countertrade agreement or the supply contract is terminated because of a failure on the part of the supplier, and the purchaser wishes to achieve the objective of the supply contract by engaging another supplier, the purchaser may disclose to the other supplier such part of the know-how as is necessary for achieving that objective. The purchaser may, however, be obligated to obtain from its adviser or the other supplier prior to the disclosure of the know-how an undertaking that the adviser or the other supplier will not disclose the know-how to others.

22. [new paragraph] An obligation of confidentiality may need to be imposed on the supplier of the technology, for example, when the purchaser is to have exclusive use of the technology, or when the supplier of the technology is to receive improvements to the technology made by the purchaser. In formulating a contractual provision for this purpose, the discussion in the previous two paragraphs may be useful.

23. [new paragraph] This Legal Guide does not deal comprehensively with contract negotiation relating to the licensing of industrial property, or the supply of know-how, since this subject is not specific to countertrade and has been dealt with in detail in publications issued by United Nations bodies.<sup>1</sup>

### C. Quality of goods

24. [12] The question of quality of countertrade goods raises two main issues that the parties may wish to address in the countertrade agreement. The first involves specifying the level of quality that the goods must meet; the second involves establishing procedures to ascertain, before the conclusion of a supply contract, that goods being offered meet the specified level of quality (pre-contractual inspection). Agreement on both aspects of quality may help the parties to avoid disagreements over such questions as

whether the party committed to purchase countertrade goods is obligated to purchase particular goods offered by the supplier or whether the goods are worth the price at which they are offered.

#### 1. Specifying quality

25. [13] If the type of goods is not identified in the countertrade agreement, or is identified only by broad categories, precise statements of quality cannot be made. In such cases, the parties may only be able to state quality requirements in general terms such as "export", "prime" or "marketable" quality. When the type of goods is identified, it is advisable to be as precise as possible with respect to quality. *If the goods are commodities or semi-manufactured goods with standardized levels of quality (e.g., wire, steel sheets or petro-chemical products), it may be sufficient to use general statements of quality or descriptors of a particular grade of quality. In the case of manufactured goods, it is advisable to define the quality in a more specific way, for example, by referring to a quality standard, the purpose for which the goods must be fit, packaging, or safety and environmental requirements.*

26. [new paragraph] It should be noted that the quality of goods may be subject to standards of various kinds. There may be mandatory regulations prescribing certain measurable standards that goods must meet. In addition, the level of quality to be expected from goods may be a matter of trade usage in a particular market or industrial sector. Furthermore, quality standards may be enunciated in court decisions, for example, when a producer of a product is held liable for damage caused to the user of the product because in view of the court the design of the product was not safe. Moreover, there may exist non-mandatory quality standards or recommendations adopted by bodies such as trade associations, chambers of commerce or associations of users or consumers. Non-mandatory standards may also be established by governmental agencies entrusted with formulating and updating standards for commercial goods and services. Quality standards emanating from the foregoing sources may differ among countries or markets. Major differences may exist in particular with regard to consumer goods or services. In order to avoid disagreements, it is advisable that the countertrade agreement specify the standards that the countertrade goods must meet and, if the understanding of a quality standard may vary, it is advisable to link it to a particular country or market.

27. [new paragraph] When a particular type of service will be a subject-matter of a future supply contract, it is desirable that the countertrade agreement specify the quality standards to be observed in performing the service. If norms established by professional bodies are available, the quality of the service may be described by reference to those norms. Where such norms are not available, the countertrade agreement may stipulate that the service is to be effected in accordance with the standards that would be observed by a professional providing that kind of service. If professional standards differ, it is advisable that the parties specify the country whose professional standards should apply.

<sup>1</sup>The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in World Property Organization, *Licensing Guide for Developing Countries* (WIPO publication No. 624(e), 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in *Guidelines for Evaluation of Transfer of Technology Agreements*, United Nations Industrial Development Organization, Development and Transfer of Technology Series, No. 12 (ID/233, 1979), and in the *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry* (United Nations publication, Sales No. E.70.ILE.15). Other relevant publications are the *Handbook on the Acquisition of Technology by Developing Countries* (UNCTAD/TT/AS/5, 1978) and *Guide to Guarantee and Warranty Provisions in Transfer-of-Technology Transactions*, United Nations Industrial Development Organization (prepared jointly by the secretariats of the United Nations Industrial Development Organization and the International Center for Public Enterprises in Developing Countries) (ID/355, 1989). A manual on technology transfer is currently under preparation by the United Nations Industrial Development Organization.

28. [14] The parties may wish to address in the countertrade agreement, i.e., prior to the conclusion of a supply contract, the remedies of the purchaser in the event that goods delivered under supply contracts concluded subsequently do not meet quality standards stipulated in the countertrade agreement or in the individual supply contract. By including such provisions in the countertrade agreement, the parties could avoid negotiating the question of the purchaser's remedies each time a supply contract is concluded.

## 2. Pre-contractual quality control

29. [15] This section deals with pre-contractual quality control, i.e., quality control carried out before the conclusion of a supply contract by the party committed to purchase in order to establish whether the goods offered conform to the quality standards set in the countertrade agreement. *If several shipments of goods are intended, the parties may agree that pre-contractual quality control will be carried out on all goods intended to be the subject-matter of future supply contracts or only on some portions of those goods. Pre-contractual quality control is likely to reduce the possibility that, after a supply contract is concluded, the goods are discovered not to meet the agreed quality standards. It may be noted that a supply contract itself may provide for a quality inspection before the goods are shipped by the supplier ("pre-shipment inspection"). Such pre-shipment inspection, which relates to the performance of a concluded supply contract, is not specific to countertrade and is therefore not discussed in the Legal Guide.*

### (a) Identity of inspector

30. [16] The pre-contractual quality control may be conducted by an inspector designated either by the party committed to purchase or by the parties jointly. When the inspector is to be designated jointly, the parties may wish to stipulate in the countertrade agreement criteria for the selection of the inspector. When the type of goods has been identified, the parties are in a better position to name the inspector since the subject-matter in which the inspector would need expertise is known to the parties.

### (b) Inspection procedures

31. [17] *It is advisable that the parties agree on various aspects of the inspection procedure such as: the location and time of inspection; the time-frame for inspection; the manner of notifying the parties of the inspection results; the mandate of an inspector to be designated jointly; whether, in the case of an inspector designated by the purchaser, the supplier will be informed of the inspector's mandate; the inspector's duty of confidentiality; deadlines for submission of the inspector's report; a requirement that reasons be stated for a finding that the goods are non-conforming; whether sampling and testing procedures customarily used in a particular trade suffice or whether ad hoc procedures need to be established; additional inspections or tests when the result of an inspection is contested (e.g., it may be agreed that a party could request a further*

*inspection to be conducted by a second inspector, that in the interest of finding a quick solution the second inspection should be carried out within short time-limits, that an experienced and independent quality arbitrator be engaged for this purpose, and that the second inspection would be controlling); and cost of inspection.*

### (c) Effect of inspector's finding

32. [18] It may be agreed that the inspector's finding would be regarded as a statement of opinion on the basis of which the parties would consider what steps to take. Alternatively, it may be agreed that a finding by the inspector as to the quality of the goods would directly affect the contractual relationship of the parties. For example, it may be agreed that in the event that the inspector finds that the goods conform to the quality standard stipulated in the countertrade agreement, and if the parties have agreed on the essential terms of a supply contract, the parties are deemed to have concluded the supply contract. In the event of a negative finding, the supplier's offer to conclude a supply contract would be deemed not accepted and the rejection of the goods in question would not constitute a breach of the countertrade commitment. *The parties might agree that a negative finding and the rejection of the goods do not affect the extent of the countertrade commitment. Alternatively, it might be agreed that in the case of a negative finding, or in the case that two consecutive offers of the same type of goods are rejected as a result of a negative finding, the party committed to purchase would be released from the countertrade commitment up to the value of the goods refused (see also chapter XIII, "Failure to complete countertrade transaction", paragraph [6]). Where the countertrade agreement envisages various levels of quality, it may be agreed that the inspector's finding as to quality would be used in a formula for determining the price of the goods.*

## D. Quantity of goods

33. [19] When the countertrade commitment refers to goods of one specified type, the quantity of goods to be purchased may be stipulated in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts \*. When the parties express the countertrade commitment as a monetary amount, rather than as a quantity of goods to be purchased, they may wish to postpone determining the quantity until the conclusion of the supply contract. Such a postponement would allow fluctuations in the unit price of the goods to be taken into account. An increase in the unit price would mean a reduction in the quantity of goods to be purchased, while a drop in the unit price would mean an increase in the quantity to be purchased. When the countertrade commitment is expressed in terms of the number of units to be purchased, the parties may wish to stipulate a minimum monetary amount so that, in the event of a drop in the unit price, additional units would have to be purchased.

34. [20] When the countertrade agreement provides for several possible types of goods, the quantity of each type of goods that will be purchased may be left to be deter-

mined at the time of the conclusion of the supply contracts. The overall value of the purchases would have to be in conformity with the extent of the commitment set in the countertrade agreement. The countertrade agreement may specify the minimum and maximum percentages of the countertrade commitment that may be fulfilled by purchase of each type of goods.

35. [21] Where the parties are not in a position to determine quantity in the countertrade agreement, it may be useful for the countertrade agreement to set a deadline for agreement on quantity. The parties may refer to a specific date (e.g., 30 days before the close of a subperiod of the fulfilment period) or to an event in the contract in the other direction (e.g., in a buy-back transaction it may be agreed that quantity is to be determined upon the start-up of the plant delivered under the export contract).

36. [22] It may also be agreed that, at specified points in the period for the fulfilment of the countertrade commitment, a party committed to purchase would be obligated to provide an estimate of the quantities of goods expected to be purchased in the upcoming period of time. Similarly, a party committed to supply goods may agree to periodically provide an estimate of the quantity of goods expected to be made available. The parties may wish to agree on a permitted deviation between the estimated quantities and the quantities actually purchased or made available.

37. [23] When the proceeds of the export contract are to be used to pay for the counter-export contract, it is advisable that the parties ensure that the quantity purchased under the export contract is such that the proceeds of the export contract would cover payment for the counter-export contract. Payment mechanisms used in such cases are discussed in chapter IX.

38. [24] If the parties foresee the possibility of purchases of quantities beyond those stipulated in the countertrade agreement, they may wish to consider whether the purchaser's additional orders will be granted any preference over other potential buyers. A related issue is whether the additional quantities would be supplied on the same terms as the original quantities envisaged in the countertrade agreement.

39. [25] The parties may leave the quantity of goods to be determined on the basis of the purchaser's requirements. In such cases, the parties may wish to consider whether the

supplier is to be the purchaser's single source for the goods and whether the purchases are to fall within a range specified in the countertrade agreement. The quantity of the goods may also be determined on the basis of the supplier's output of a given product. This approach may be used, for example, in a buy-back transaction. In this case too, the parties may wish to stipulate that the purchases are to fall within a range set in the countertrade agreement.

*[Two paragraphs on "additionality", which appeared in the earlier draft chapter entitled "Type, quality and quantity of goods" (A/CN.9/332/Add.4, paragraphs 26 and 27), were moved to chapter IV, "Countertrade commitment" (A/CN.9/362/Add.4) paragraphs 5 and 6.]*

### E. Modification of provisions on type, quality and quantity

40. [28] A need for a review of provisions on type, quality or quantity of goods may arise due to the unavailability of goods specified in the countertrade agreement, the desire to place additional products on a list, a change in the commercial conditions underlying the transaction, a shift in the commercial objectives of the parties or a governmental regulation affecting the choice of countertrade goods. It could be agreed, particularly in long term transactions, that the parties would review the provisions on type, quality and quantity of goods either at regular intervals or in response to changes in circumstances stipulated in the countertrade agreement (e.g., a change beyond a certain threshold in the price of the goods). The review could be carried out within the framework of a mechanism for monitoring and coordinating fulfilment of the countertrade commitment (see chapter IV, "Countertrade commitment", paragraphs 61 to 74).

41. [29] In order to avoid a modification procedure, the parties may wish to provide that under certain conditions fulfilment credit would be earned by the purchase of goods other than those agreed upon in the countertrade agreement or appearing on a list of possible countertrade goods. For example, it might be required that the purchases in question meet an additionality test (chapter IV, "Countertrade commitment", paragraphs 5 and 6), or it may be stipulated that they would earn fulfilment credit at a reduced rate (for further discussion of clauses allowing non-conforming purchases to be counted toward fulfilment of the countertrade commitment, see chapter IV, paragraph 30).

[A/CN.9/362/Add.7]

## VII. PRICING OF GOODS

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[*Editorial note:* The present draft chapter VII is a revision of draft chapter VI, "Pricing of goods", published as document A/CN.9/332/Add.5. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.5 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.5 are in italics.]

#### A. General remarks

1. [1] It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future *supply contract*. When the parties are not able to set the price in the countertrade agreement, it is advisable to provide a method *according to which the price will be determined at the time the supply contract is to be concluded. When contracts are to be concluded in both directions, methods for price determination may be agreed for contracts in each of the two directions.* This chapter deals with methods for determining the price after the countertrade agreement has been concluded. *It also deals with certain questions encountered in the specific contexts of supplying services and the transfer of technology.* In addition, the chapter discusses the currency in which the price is expressed and revision of price.

2. [2] The parties may need to defer setting the price, for example, because the *specific* type of goods has not been identified at the time of the conclusion of the countertrade agreement or because there is to be a long interval between the conclusion of the countertrade agreement and the conclusion of a given supply contract. Such an interval may prompt the parties to defer setting the price because of the possibility of price fluctuation or of a change in the underlying economic conditions during the interval. In some cases, the parties may set the price of an initial shipment, but leave the determination of the price of subsequent shipments for a later time. Providing a method for determining the price may help the parties avoid differ-

ences over what the appropriate price should be, which may delay or prevent the conclusion of supply contracts. *Such differences may be compounded when a party expects a supply contract in one direction not to be profitable and wishes to offset the expected loss in setting the price for the contract in the other direction.*

3. [3] In a barter transaction, it may not be necessary to include a provision on price because the goods shipped in one direction constitute payment for the goods shipped in the other direction. Nevertheless, pricing issues may arise in a barter transaction if the parties decide to measure the relative value of their shipments in monetary terms, rather than merely in terms of volume and quality, or if the shipments are of different values and the imbalance is to be settled in money. Pricing would also be necessary when customs regulations require that goods entering a country indicate a monetary value.

4. [4] In setting the price of the countertrade goods, it is advisable that the parties specify whether or not the price includes costs ancillary to the costs of the goods themselves, such as transportation or insurance, testing, or customs duties and taxes. Some of the elements of the price may be indicated by using an appropriate trade term such as those defined in *INCOTERMS 1990* of the International Chamber of Commerce.

5. [5] The parties may wish to stipulate the point of time when the price is to be calculated, particularly in the case of goods whose price may fluctuate. When the countertrade transaction involves a single shipment or a number of shipments within a relatively short period of time, and the price is to be determined only once, a specified date may be agreed upon. In some cases, the price setting mechanism may be set in motion by an event such as the start-up of a plant under a buy-back transaction or the placing of an order. When multiple shipments are spread out over a longer period of time, several dates for determination of price may be agreed upon or the countertrade agreement may provide a mechanism for revision of the initial price.

6. [6] The parties should bear in mind that there may be mandatory rules that affect the level at which the price may be set. For example, if the price is set at a low level in relation to the market price, the goods may be subject to anti-dumping import duty.

### B. Currency of price

7. [7] The currency in which the price is to be paid may involve certain risks arising from the fluctuation in exchange rates between that currency and other currencies. If the price is to be paid in the currency of the supplier's country, the purchaser bears the consequences of a change in the exchange rate between that currency and the currency of the purchaser's country. The supplier, however, will bear the consequences of a change in the exchange rate between the currency of the supplier's country and the currency of another country in which the supplier has to pay for equipment, materials or services needed in the production of the goods. If the price is to be paid in the currency of the purchaser's country, the supplier bears the consequences of a change in the exchange rate between this currency and the currency of the supplier's country. If the price is to be paid in the currency of a third country, each party bears the consequences of a change in the exchange rate between this currency and the currency of its respective country. Where a financing institution has granted the purchaser a loan for the purchase of the goods, the purchaser may prefer the price to be paid in the currency in which the loan is granted.

8. [8] In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties in force in the countries of the supplier and the purchaser, which may mandatorily govern this question. The parties should also take into account that under some legal systems the price in an international contract must be paid in the currency in which it is denominated, while other legal systems may permit, or even require, payments in the currency of the place of payment, even if the price is denominated in a convertible currency.

9. [9] The countertrade agreement may denominate the price in a currency that the parties consider to be stable or in a unit of account that is not a national currency, but provide that it is to be paid in another currency. The effects of such an approach are similar to those achieved by a currency clause (see paragraphs 48 to 50 below), and restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. If this approach is used, it is advisable to agree in the countertrade agreement that the exchange rate is to be the one prevailing at a specified place on a specified date.

10. [10] It is not advisable for the contract to denominate the entire price in two or more currencies, and allow either the debtor or the creditor to decide in which currency the price is to be paid. Under such a clause, only the party having the choice is protected, and the choice may bring the party having the choice unjustified gains.

### C. Determining price after conclusion of countertrade agreement

#### 1. Standards

11. [11] The countertrade agreement may provide for a determination of the price through the use of a standard (see chapter IV, "Countertrade commitment", paragraph 44). Such a method provides a price at the time of the conclusion of the supply contract in an objective manner not influenced by the will of the parties.

12. [12] The parties may wish to include a procedure to apply in the event a standard they select proves to be unworkable (e.g., because a market price is not available as expected). For example, the parties may provide that the price is to be determined through the use of an alternate standard or that the price is to be determined by a third person.

#### (a) Market prices for goods or services of standard quality [title modified]

13. [13] When goods identified in the countertrade agreement are commodities or semi-finished products (e.g., grains, oil, metals, wool) for which prices are regularly reported, the parties may agree to link the price of the countertrade goods to the reported price. Such a linkage to a standard price can also be used for determining the price of services if the service is standard and if there exists a reported price for the service. Such standard services may be, for example, transport; harvesting, cleaning, sorting or packing certain types of goods; or painting of standard surfaces such as ships. Where the price of goods or services is quoted in several markets, the parties are advised to specify a particular market or exchange to which reference will be made. In order to protect against price fluctuations, the standard may call for an average of the prices reported at several agreed points of time (e.g., the prices reported on the first business day of the month for the six months preceding the date of the determination of the price).

#### (b) Production cost

14. [14] The parties may agree that the price is to be based on the supplier's cost of producing the goods, plus an amount to cover the supplier's overhead and profit. Such an approach may be selected when the exact cost of various inputs cannot be anticipated at the time the countertrade agreement is concluded. In order to limit the purchaser's risk of having to pay an excessive price, it is advisable that, where possible, the parties stipulate in the countertrade agreement the quantity of inputs (e.g., raw materials, energy and labour) that will be required for the production of one unit of the goods. The parties may also wish to stipulate that the supplier should maintain records reflecting production costs in accordance with forms and procedures required by the purchaser, and that the purchaser shall have access to those records. This approach might be used when the contract to be concluded involves

*a technological solution that has not been fully developed yet and the exact cost of its development cannot be foreseen.*

(c) *Competitor's price*

15. [15] The price may be determined on the basis of the price charged by an identified competitor producing the same type of goods as those that will be delivered under the supply contract. If the countertrade agreement does not identify the competitor, it may establish criteria for the selection of a competitor (e.g., geographical criteria or criteria related to the volume of production of the same type of goods). Because the competitor may sell a product at different prices in different geographical regions and markets, it is advisable that the countertrade agreement identify the market to which reference will be made. The price clause could also indicate how the price information will be obtained and the date as of which the competitor's price is to be determined. Furthermore, the parties may agree to exclude specially discounted prices charged to certain customers (preferential prices). For example, the standard may exclude prices charged for the goods when they are purchased by disaster relief organizations or by employees of the supplier.

16. [16] A competitor's price may not be relevant, without adjustments, if it is based on a significantly larger or smaller quantity than the quantity intended to be purchased under the countertrade agreement. A competitor's price may also not be appropriate if the competitor's goods are of a different quality, if the competitor's price is based on payment conditions (e.g., deferred payment) not being offered by the supplier of the countertrade goods, or if the amount of transportation costs or insurance and public charges contained in the competitor's price differs from what is to be included in the price of the countertrade goods. It is therefore advisable to stipulate that the standard should take into account only prices for shipments that are comparable in quantity, quality, delivery and payment conditions to the future supply contract, or that amounts should be added to or subtracted from the competitor's price in order to compensate for differences.

17. [17] The parties may agree that the price is to be determined on the basis of several competitors' prices. Such a clause may identify the competitors or it may provide that each of the parties is to obtain quotations from a specified number of competitors. If the competitors are not identified, it is advisable that a clause of this type specify the countries or regions from which the parties are to obtain the quotations. It is also advisable that the countertrade agreement indicate the manner in which the price is to be calculated (e.g., whether by calculating a mean or a median price). The parties may wish to specify the period of time during which the quotations are to be obtained. In doing so, the parties should take into account the length of time necessary to obtain the quotations as well as the need to base the calculation on current prices.

18. [18] When the party committed to purchase goods manufactures the same type of goods, the parties may agree that the price will be determined on the basis of the price

charged by the purchaser or on the basis of the purchaser's own cost of manufacture. Such an approach might be used, for example, in a buy-back transaction in which a producer of a certain type of goods sells a facility that produces that type of goods and agrees to buy back the resultant products.

(d) *Most-favoured-customer clause*

19. [19] It may be agreed that the price of the countertrade goods will be based on the lowest price at which goods of the same type are supplied by the supplier to other customers. In some cases, the parties may restrict the clause to a limited category of customers (e.g., customers in a particular country or customers identified in the countertrade agreement). The parties may wish to indicate the means to be used to identify the most-favoured customer. For example, the supplier could be required to provide specified types of information indicating the prices charged by the supplier to other customers. It is also advisable to ensure that the most-favoured-customer price is relevant to the shipments to be made pursuant to the countertrade agreement (see above, paragraph 16). The parties may also wish to specify the date as of which the most-favoured-customer price is to be determined. The parties may wish to specify any specially discounted prices (preferential prices) offered by the supplier to certain customers that should not be taken into account (see above, paragraph 15). The scope of the most-favoured-customer clause may be broadened by agreeing that the price will be determined on the basis of the lowest price charged by the supplier or by other specified suppliers of the same type of goods.

(e) *Use of more than one standard*

20. [20] The countertrade agreement may provide that the price is to be determined by a formula involving two or more standards. For example, the price may be determined by averaging the prices derived from the selected standards. Another possibility is for the price derived from a particular standard to be compared with prices derived from one or more other standards. If the difference between the price derived from the selected standard and the prices from the comparator standards does not reach a specified threshold, the price derived from the selected standard would apply. If the difference exceeds a specified threshold, the final price would be, for example, the average of the price derived from the standards. Such techniques may be useful when it is desired to avoid the possibility that the price derived through the use of a single standard might not reflect the market value of a given product at the time the purchase is to be made.

## 2. *Negotiation*

21. [21] The parties may stipulate in the countertrade agreement that the price to be paid under the future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement. It is advisable that, to the degree possible, the parties agree on guidelines for the determination of the price. (For a discussion on procedures for the negotiations, and on guidelines for the

determination of the price, see chapter IV, "Countertrade commitment", paragraphs 44 to 46, and 57 to 60).

22. [22] Guidelines for the determination of the price may establish minimum and maximum limits within which the price is to be negotiated. In establishing such limits, the parties may use price standards of the type described above in paragraphs 11 to 20. For example, it may be agreed that the price should not be more than 5 per cent higher or more than 5 per cent lower than the price charged by a competitor.

23. [23] Alternatively, guidelines may merely provide a reference price to be taken into account in negotiations. In formulating a guideline of this type, the parties may use price standards such as those described above in paragraphs 11 to 20. For example, it may be agreed that the price will be negotiated taking into account the price of a particular competitor.

24. [24] A negotiation guideline may also take the form of a statement that the price of goods is to be "competitive", "reasonable", or at a "world market" level. Such a clause might be acceptable when the goods are of a standard quality. A guideline of this type may be made more precise by specifying, for example, whether the price should be based only on prices paid to the supplier by other buyers or should also be based on prices charged by other suppliers, the period of time the parties should refer to in determining what is a "competitive", "reasonable" or "world market" price, and, if there are variations in prices in different markets, which markets, types of buyers or geographical territories are referred to.

### 3. Determination of price by third person

25. [25] Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question). For a discussion of determination of contract terms by third persons, see chapter IV, "Countertrade commitment", paragraphs 47 to 54. Such an approach may be used in combination with a clause on price setting by negotiation so that the determination of the price would be entrusted to a third person in the event that the parties failed to negotiate a price.

26. [26] The countertrade agreement should delimit the mandate of the third person by providing guidelines of the type discussed with respect to negotiation (above, paragraphs 21 to 24). The parties may wish to establish deadlines for referral of the matter to a third person, so that the price could be set in time to allow conclusion of contracts as planned.

### 4. Determination of price by one party

27. [27] Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement. Utmost caution is advisable in agreeing on such a solution, since it leaves the determination of the price to a person who is interested in the outcome of the determination. In many legal systems an agreement of this type is not

enforceable. (For further discussion, see chapter IV, "Countertrade commitment", paragraphs 55 and 56.)

### D. Pricing of services

28. [new paragraph] When the parties determine in the countertrade agreement a service as the subject-matter of the future supply contract (e.g., maintenance, repair, transport, construction services), it is advisable for the parties to settle in the countertrade agreement, to the extent possible, certain questions relating to the price of the services. By doing so, the parties may facilitate negotiations for the conclusion of the envisaged supply contract.

29. [new paragraph] Various approaches may be used in setting the price for services. One approach is to agree on unit rates for units of work processes involved. The units may be, for example, a quantity unit of the result (e.g., a square metre of paint work, kilometre of transport of goods, cubic metre of excavated material, hour of labour). This approach may be appropriate when the services in question are of a routine character or when the quantity of the services needed cannot be envisaged accurately at the time of entering into the countertrade agreement. If there is no provision for a revision of the unit price in the event of changes in unit costs, the risk of increases in costs and benefits arising out of decreases in costs are divided between the parties. The supplier bears the risk of an increase of the costs of materials and labour for each unit or receives the benefit of a decrease in those costs.

30. [new paragraph] Another approach is for the price to be expressed as a lump sum payable for the specified service. Under this method, the purchaser knows the total price of the service, and the supplier bears the risk of increases in the cost of the service and benefits if the cost turns out to be lower than anticipated. Since the lump-sum price may include an amount to compensate the supplier for bearing the risk of cost increases, the price may be higher in some cases than if the cost-reimbursable pricing method were used for the same service (see the following paragraph). In addition, the lump-sum pricing method requires a precise specification in the contract of the scope of the service. It might be advisable for the purchaser to address in the countertrade agreement the manner of monitoring the performance by the supplier to ensure that the contractor does not reduce its costs by using substandard materials or working methods.

31. [new paragraph] Yet another approach may be to stipulate that the supplier of the service is to be paid a fee to cover its overhead and profit, and that the supplier is to be compensated for its expenses on a cost-reimbursable basis. It is desirable for the countertrade agreement to specify clearly which costs are reimbursable and which are to be borne by the supplier out of its fees. Reimbursable expenses might be, for example, wages of personnel directly involved in the performance of the contract, routine items of materials or equipment used in performing the service, or costs incurred in employing specified types of subcontractors. Usually, the solution providing each party a better opportunity to foresee its costs is to enumerate the costs to be reimbursed and to provide that all other costs

are to be borne by the supplier; sometimes, however, the parties decide to enumerate the costs that are not reimbursable and provide that all other reasonable costs are to be reimbursed.

### E. Pricing of technology transfer

32. [new paragraph] Sometimes the countertrade agreement envisages the future conclusion of a supply contract that includes the transfer of technology (see chapter VI, "Type, quality and quantity of goods", paragraphs 16 to 23). In such cases, it is advisable for the parties, to the degree possible, to address in the countertrade agreement a variety of questions particular to the pricing of technology. Settling such questions in the countertrade agreement may facilitate finalization of the supply contract involving the transfer of technology. Those questions, discussed in the following paragraphs, are analysed in publications dealing with transfer of technology generally.<sup>1</sup>

33. [new paragraph] The two principal forms of pricing of technology transfers are the lump-sum payment or payment of royalties. In the lump-sum method, the total price is determined at the outset. Among the key questions raised by this method are the time of payment and whether it is to be paid in one payment or in instalments. Under the law of some countries, the use of the lump-sum method may be subject to certain conditions. These conditions may, for example, restrict the types of transfers (e.g., purchase of patent rights or specified types of technical services and assistance) or sectors in which the lump-sum method may be used; they may also prescribe the basis on which the lump sum is to be calculated and require a special governmental authorization.

34. [new paragraph] If the royalty method is used, the price payable (i.e., the royalty) is fixed by reference to some economic result of the use of the transferred technology. The law of some countries mandates the use of the royalty method of payment in certain types of industrial property licenses or technology transfer agreements). The royalty is typically linked to the production, sales, or profits arising from the use of the technology. Where the volume of production is used as the reference factor, the royalty may be determined, for instance, as a fixed amount per unit or quantity (e.g., per ton or per litre) produced. The law of some countries restricts the freedom of parties to agree on royalties based on production. For example, it may be required that for certain types of licences or technology transfers royalties should be linked to sales volume.

35. [new paragraph] The linkage of royalties to sales has the advantage of not imposing on the transferee of the technology liability for payment of royalties for goods that have been produced but not sold. Parties wishing to use this approach must decide whether the royalty is to be based on the gross or on the net selling price. The latter

method provides the possibility of excluding from the calculation of the royalty a number of items that are included in the sales price but which are unrelated to the technology or already have been a source of profit for the transferor. These might include, for example, packing expenses, taxes, transport and insurance costs, cost of raw materials, and the percentage of the price covering the royalties. The law of some countries may define the permissible range of elements that may be included in the net selling price. Furthermore, the parties may wish to stipulate that the royalty is to be based on the fair market price of the product. Such an approach may be used to guard against a diminution in the level of the economic return achieved by the transferor that would result were the transferee to sell the products in question at a low price to a party with whom the transferee had a special relationship. Various methods exist in turn for defining the fair market price. Other questions raised by the linking of royalties to sales include the point of time when the product is deemed sold and the time when the remittance of the royalty becomes due.

36. [new paragraph] Another basis for the calculation of royalties is to link royalties to profits obtained by the transferee from the exploitation of the technology transferred. Other approaches to the calculation of royalties include minimum royalty arrangements, in which a minimum payment is due irrespective of whether a given level of production, sales or profits has been achieved, decreasing royalty arrangements, in which the amount of the royalty decreases as production or sales increase, and maximum limits on the amount of royalties due. The use of certain of these arrangements may, in some cases, be mandated, and, in other cases, restricted, under the law of some countries. For example, in some countries, minimum royalty arrangements may not be permitted when royalties are linked to production, sales or profit, decreasing royalties might be mandated, and maximum royalty limits imposed for certain types of technology transfers. The attention of the parties should also be directed to the question of which of the parties is to be liable for payment of taxes on the royalties. It should be noted that the laws of some countries regulate this question (e.g., the parties may be required to stipulate in the contract for the transfer of technology who is to pay taxes).

37. [new paragraph] When considering whether to use the lump-sum or the royalty method, the parties should bear in mind, in addition to provisions of the applicable law, that each method of price calculation may have certain advantages and disadvantages in the light of the type of transaction and the economic circumstances involved. If, for example, royalties are payable over a long time, economic circumstances may change during this period affecting the volume of sales, and consequently the royalties payable; in a joint venture in which the transferor is a partner, it might be considered that a royalty linked to sales would be preferable to a lump-sum arrangement because of the added motivation provided to the transferor to develop sales. In some cases, it may be desirable to combine the two methods (e.g., an initial lump-sum payment followed by payment of royalties). The particular manner in which a royalty arrangement is structured would likewise have to reflect the economic circumstances and contractual obliga-

<sup>1</sup>The different methods of determining the price payable for technology are considered in detail in the *Licensing Guide for Developing Countries* (WIPO) and in *Guidelines for Evaluation of Transfer of Technology* (UNIDO); see footnote 1 in chap. VI, "Type, quality and quantity of goods".

tions involved. For example, if the licensor or technology transferor is to assist in sales of the products resulting from the transfer of the technology, caution might be advisable in applying a decreasing royalties arrangement since such an arrangement might have the unintended effect of discouraging the transferor from expending fully its efforts in the direction of increasing sales. Where royalties are to be paid, the parties would typically agree on a method of reporting the variable data (e.g., volume of production, sales or profits) which serve as the basis for calculating the royalty. Provision is usually made for the transferee to keep certain records and for the transferor to be given an opportunity to review those records.

38. [new paragraph] In negotiating the technology pricing clause, the question might arise whether any separate fees should be payable for specific technical services and assistance to be provided by the transferor of technology. Such services and assistance may include, for example, training programmes for the personnel of a patent or trademark licensee, technical experts furnished by the licensor or transferor, various technical services relating to the purchase of capital goods, and management, planning, research and development services. Some countries have provisions relating to that question.

#### F. Revision of price

39. [28] When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. It may be agreed that a revision would occur at specified points of time. Those points of time should be coordinated with the schedule for the fulfilment of the countertrade commitment (e.g., the revision is to take place four weeks prior to the commencement of a subperiod).

40. [29] Under another approach, it may be agreed that a revision would take place in response to specified changes in underlying economic conditions (e.g., an exchange rate fluctuation beyond a certain percentage from a reference rate in effect on the date the countertrade agreement was concluded or changes beyond an agreed threshold in specified components of production cost such as raw materials or labour). Contractual provisions concerning price revision due to a change in the value of the currency in which the price is to be paid are mandatorily regulated under some legal systems. The parties should, therefore, examine whether a clause which they intend to include in the countertrade agreement is permitted under the law of the country of each party.

41. [30] Yet another approach is to provide for a price revision at regular intervals (e.g., every six months), as well as for unscheduled revisions in response to specified changes in underlying economic conditions. In order to limit the frequency of price revision, it could be agreed that an unscheduled review could not take place within a specified period of time following a review, or within a specified period of time preceding a scheduled review. Yet another approach would be to set the price revision procedure in motion upon the delivery of a specified portion of the total quantity of goods to be purchased.

42. [31] The countertrade agreement might provide for the price revision clause to apply only in cases where its application would result in a revision exceeding a certain percentage of the price.

43. [32] When the countertrade agreement contains a price revision clause, the parties may wish to specify the shipments to which the revised price is to apply. It may be agreed, for example, that the applicable price for a given shipment is the price in effect on the date the goods are ordered or on the date the letter of credit is issued.

#### 1. Reapplication of price clause

44. [33] The parties may stipulate in the countertrade agreement that the price is to be revised through the use of the same method as was employed to determine the initial price (standards (paragraphs 11 to 20), negotiation (paragraphs 21 and 24), determination of price by a third person (paragraphs 25 and 26) or determination of price by one party (paragraph 27)).

#### 2. Index clause

45. [34] The purpose of index clauses is to revise the price of the countertrade goods by linking the price to the levels of the prices of certain goods or services prevailing on a certain date. *Usually the linkage is to the price of raw materials or services used in the production of the countertrade goods.* A change in the agreed indices automatically effects a change in the price. In formulating an index clause, it is advisable to use an algebraic formula to determine how changes in the specified indices are to be reflected in the price. Several indices, with different weightings given to each index, may be used in combination in the formula in order to reflect the proportion of different cost elements (e.g., materials or services) to the total cost of the goods. Different indices may be contained in a single formula to reflect the costs of different types of materials and services. When the sources of the same cost element (e.g., labour or energy) are in different countries, different indices may be found in a single formula for that cost element.

46. [35] Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g., they should be published at regular intervals). They should be reliable. Indices published by recognized bodies (such as chambers of commerce, or governmental or intergovernmental agencies), may be selected. The parties should exercise caution in using indices based on different currencies in a formula, as changes in the relationships between the currencies may affect the operation of the formula in unintended ways.

47. [36] In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a particular element of costs, the parties may wish to use an available index in respect of another element. It is advisable to choose an element whose price is likely to fluctuate in approximately the same proportions and at the same

times as the actual element to be used. For example, in cases where it is desired to provide an index for labour costs, a consumer price index or cost-of-living index is sometimes used if there is no wage index available.

### 3. *Change in exchange rate of currency in which price is payable*

#### (a) *Currency clause*

48. [37] Under a currency clause, the price to be paid is linked to an exchange rate between the currency in which the price is to be paid and a certain other currency (referred to as the "reference currency") determined at the time of entering into the countertrade agreement. If this rate of exchange has changed at the time of payment, the price to be paid is increased or decreased in such a way that the amount of the price in terms of the reference currency remains unchanged. For purposes of determining the applicable exchange rate, it may be desirable to adopt the time of actual payment, rather than the time when the payment falls due. If the latter time is adopted, the supplier may suffer a loss if the purchaser delays payment. Alternatively, the supplier may be given a choice between the exchange rate prevailing at the time when payment falls due or that prevailing at the time of actual payment. It is advisable to specify an exchange rate prevailing at a particular place.

49. [new paragraph] The intention of a currency clause is typically to stabilize the international purchasing power of the amount to be paid pursuant to the contract. Therefore, a currency clause may not operate as intended if the exchange rate between the currency in which the price is to be paid and the reference currency is set by administrative decisions independent of events taking place in the currency market.

50. [38] The reference currency should be stable. The insecurity arising from the potential instability of a single

reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the currency in which the price is payable and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

#### (b) *Unit-of-account clause*

51. [39] If a unit-of-account clause is used, the price is denominated in a monetary unit of account composed of cumulative proportions of a number of selected currencies. In contrast to a clause in which several currencies are used (above, paragraph 50), the weighting given to each selected currency of which such a monetary unit of account is composed is usually not the same, and greater weight is given to currencies generally used in international trade. The unit of account may be one that is established by an intergovernmental institution or by agreement between two or more States and that specifies the selected currencies making up the unit and the relative weighting given to each currency (e.g., Special Drawing Right (SDR), European Currency Unit (ECU), or Unit of Account of the Preferential Trade Area for Eastern and Southern African States (UAPTA)). In choosing a unit of account, the parties should consider whether the relation between the currency in which the price is payable and the unit of account can be easily determined at the relevant times, i.e., at the time of entering into the supply contract and at the time of actual payment.

52. [40] The value of a unit of account composed of a basket of currencies is relatively stable, since the weakness of one currency of which the unit of account is composed is usually balanced by the strength of another currency. The use of such a unit of account will therefore give substantial protection against changes in exchange rates of the currency in which the price is payable in relation to other currencies.

[A/CN.9/362/Add.8]

## VIII. PARTICIPATION OF THIRD PARTIES

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[Editorial note: The present draft chapter VIII is a revision of draft chapter VIII, "Participation of third parties", published as document A/CN.9/WG.IV/WP.51/Add.1. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.1 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.1 are in italics. An asterisk indicates the place where text has been deleted without adding new language.

### A. General remarks

1. [1] This chapter deals with cases in which a party, instead of itself purchasing or supplying goods in a particular direction, engages a third party to do so. Section B discusses the case in which a party originally committed to purchase goods engages a third party to make those purchases. Section C discusses the case in which a third party is designated to supply goods.

2. [1] This chapter also discusses cases in which a supplier of goods in one direction does not assume a commitment to purchase goods in the other direction, but instead a third-party purchaser assumes such a commitment from the outset of the transaction; such cases are dealt with in section D. Section D also discusses cases in which a purchaser of goods in one direction does not assume a commitment to supply goods in the other direction, but instead a third-party supplier assumes such a commitment from the outset.

[Some of the substance of paragraph 2 as it appeared in A/CN.9/WG.IV/WP.51/Add.1 was moved to paragraph 3.]

3. [3] Cases in which the party committed to purchase goods makes those purchases itself and then resells the goods are not within the subject-matter of this chapter, since those cases are not specific to countertrade. Various restrictions that may be placed on the resale of countertrade goods are discussed in chapter X.

### B. Purchase of countertrade goods

4. [4] A party committed to purchase goods frequently cannot use the goods to be purchased, or lacks the marketing capacity or knowledge necessary to resell them. In these cases the party committed to purchase may wish to engage one or more third parties to make the purchases necessary to fulfil the commitment. The third party may be, for example, an end-user of the goods or a trading company specializing in the purchase and resale of certain types of goods.

5. [new paragraph] This section discusses only cases where the third party is to enter into a purchase contract with the supplier. Not discussed are cases in which the party committed to purchase engages a third person to perform the service of locating persons to whom the goods could be resold or the service of representing the committed party in the resale of the goods. Such services per-

formed by a third person, which are not specific to countertrade, do not affect the rights and obligations of the parties under the countertrade agreement and are therefore not a matter to be addressed in that agreement.

6. [5] A third-party purchaser who agrees to become involved in the countertrade transaction makes a commitment to the party originally committed (i.e., only to the party who engages the third party) to purchase goods from the supplier within an agreed period of time. In some cases, the third party also makes a commitment to the supplier to enter into future contracts. Since the third party's commitment relates to the conclusion of future contracts, that commitment would address issues such as the type, quality, quantity and price of the goods to be the subject of the future contracts, period for fulfilment of the commitment, restrictions on resale of the goods, security for performance, liquidated damages or a penalty, and settlement of disputes. *While the third party's agreement to enter into a future contract with the supplier may address the same type of issues as are addressed in the countertrade agreement between the supplier and the party originally committed, the content of the solutions in the two agreements would not necessarily be the same. Different solutions might be adopted, for example, as to security for performance, liquidated damages or a penalty, the applicable law or the settlement of disputes. (Implications of the commitment by the third party are discussed below in paragraphs 17 and 18; the terms of the third party's commitment are discussed below in paragraph 22.)*

7. [6] When a third-party purchaser is to be engaged, it is often the case that payment obligations under the supply contracts in each direction are to be settled independently. Such cases do not raise payment issues specific to countertrade. It may be agreed, however, to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 68 and 76.

8. [7] Sometimes the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser may have to assume in the future. Alternatively, a purchaser accumulating such excess fulfilment credit may be permitted to transfer the excess fulfilment credit to a third party (for a discussion of fulfilment credit, see chapter IV, "Countertrade commitment", paragraphs 31 to 34). The transfer of the fulfilment credit to a third party would entitle that third party to sell goods to the party who originally granted the fulfilment credit and to reduce any countertrade commitment by the amount of the transferred fulfilment credit. Such a transfer may involve the payment of a fee by the third party to the transferor of the fulfilment credit. In some countries, special regulations exist on the right of transfer of countertrade credit (e.g., restricting the types of exports that can generate transferable credits, the types of parties to whom countertrade credit may be transferred, or the types of imports against which transferred credits may be applied).

### 1. Countertrade agreement

9. [8] When the parties at the outset of the transaction foresee the possibility that the party committed to purchase will wish to engage a third-party purchaser, it is advisable to address that possibility in the countertrade agreement. *Provisions concerning a third-party purchaser are particularly advisable when, as described in the next paragraph, the parties might have differing expectations as to whether the purchaser is free to engage a third-party purchaser.*

10. [new paragraph] If the countertrade agreement does not address the participation of a third-party purchaser in the fulfilment of the countertrade commitment, the issue may arise between the parties as to whether the party originally committed to purchase is free to engage a third party to make the purchases. The solution to the issue would in many national laws be found in general principles of contract law, according to which a contract party is entitled to involve a third party in the performance of a contractual obligation without having to obtain the consent of the party entitled to the performance. Consent, however, would be required under those general principles if, in the circumstances of the case, the party entitled to the performance had a legitimate reason to insist that the obligation should be performed by the party originally committed. Such a legitimate reason might exist when, because of special properties or capabilities of the obligated party, the performance of the obligation by a third party would in some way diminish the value of the performance. For example, the supplier of countertrade goods might consider that, because of the reputation and existing resale network of the party committed to purchase, the resale of the goods by that party was essential for establishing a long-term place for the goods in the market or for maintaining the market image of the goods.

11. [9] The participation of third parties in the fulfilment of countertrade commitments may be subject to mandatory rules. Such rules may make the participation of third parties subject to consent by the supplier, impose guidelines as to the acceptability of third parties or require governmental authorization of third-party participation. A frequent reason for such restrictions is the desire to ensure proper implementation of the countertrade transaction or to prevent the marketing of the goods in traditional export markets of the State in question.

#### (a) Selection of third party

12. [10] Clauses in the countertrade agreement permitting the engagement of third parties may be formulated in such a way that the party originally committed to purchase goods is free to select the third party. In such clauses it is advisable to provide that notice of the engagement of a third party must be given to the supplier in advance of the purchases by the third party.

13. [11] Sometimes the countertrade agreement limits the freedom of the party originally committed to purchase goods to select the third party. Various types of limitations may be used. For example, the countertrade agreement may name the third party, list acceptable third parties, or stipu-

late the criteria to be followed in selecting the third party. Where the countertrade agreement names the third party or contains a short list of potential third parties, the countertrade agreement may provide for the selection of another party if the identified third parties are not in a position to purchase the goods.

14. [12] Another way of limiting the freedom to select a third party is to provide that the party originally committed to purchase goods is not permitted to engage a third party without the consent of the supplier. To expedite the designation of the third party, it may be agreed that the supplier will be deemed to have consented to the designation unless an objection is raised within a specified period of time. *The countertrade agreement may indicate the type of information about a proposed third party that the party originally committed to purchase is obligated to furnish to the supplier (e.g., financial standing of the proposed third party and type and quantity of goods to be purchased).* In order to limit the discretion of the supplier, the countertrade agreement may identify the types of objections that would be acceptable. Such acceptable objections might be, for example, that the proposed third party is already the supplier's trading partner, that the third party is selling goods produced by competitors of the supplier, or that the third party previously has failed to meet an obligation owed to the supplier or has been involved in a dispute with the supplier.

15. [13] The supplier may have various reasons for wishing to limit the freedom of the party originally committed to purchase in the selection of a third party. One category of reasons is aimed at preventing the selection of certain third parties. For example, restrictions may be designed to prevent sales to existing customers from being counted towards fulfilment of the countertrade commitment, to prevent the engagement of persons active in a particular market (e.g., because of existing distributorship agreements in the market or because of rules applicable to trade with that country), or to ensure that goods requiring special precautions in their use are not purchased by parties not trained to handle them. The other category of reasons is aimed at bringing about the selection of certain third parties. For example, a restriction may be designed to obtain the selection of a third party from a particular country or market or of a third party with experience in particular products or markets (e.g., because the supplier wishes to introduce the goods in a market).

16. [14] The parties should bear in mind, however, that a limitation on the purchaser's freedom to select a third party may have disadvantages. For example, the party originally committed to purchase goods might have to factor into the costs of the transaction the risk that the fee charged by the third party in connection with the purchase of the countertrade goods (see below, paragraphs 30 to 36) might be higher than fees charged by other third parties or the risk that the third party will fail to make the purchases. The parties may agree that some of these risks will be assumed by the supplier who insists on the selection of a particular third party. For example, it may be agreed that the liability of the party originally committed under the liquidated damages or penalty clause would be reduced to the amount that that party could recover from the third party.

(b) *Liability for fulfilment of countertrade commitment*

17. [15] It is advisable for the parties to the countertrade agreement to address in the countertrade agreement the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment. The answer to that question depends on whether the third party has made a commitment to purchase goods only to the party engaging the third party or whether the third party has also made a commitment to the party who is to supply the goods (see above, paragraph 6).

18. [16] When the third party's commitment is made only to the party originally committed, the party originally committed remains liable to the supplier for its countertrade commitment even though the third party has been engaged. When, however, the third party makes the commitment both to the party originally committed and to the supplier, two approaches with respect to the commitment of the party originally committed may be considered. One approach is to stipulate in the countertrade agreement that the commitment of the party originally committed to purchase is to be maintained; in such a case, both the party originally committed and the third party will be liable to the supplier for the fulfilment of the commitment, and, ultimately, the party originally committed and the third party would settle the question of responsibility between themselves pursuant to their contract. Such an approach might be appropriate where the third party's commitment to the supplier to conclude future purchase contracts is not supported by the same guarantees as is the countertrade commitment of the party originally committed, or where the supplier has had no experience or has had unsatisfactory experience in dealing with the third party. The other approach is to stipulate that, upon the assumption of the commitment by the third party, the party originally committed will be released from the countertrade commitment, leaving only the third party liable to the supplier for the conclusion of future contracts. In order to implement such a substitution of the party liable to the supplier, the parties may agree on a transfer of the countertrade commitment from the party originally committed to the third party. The general contract law of most countries contains rules on transfers of contractual obligations that would be relevant to a transfer of a countertrade commitment. An alternative method of substituting the party liable to the supplier would be for the party originally committed and the supplier to agree to terminate their countertrade commitment at the moment the third party assumes a commitment to conclude future contracts with the supplier. To ensure that the original countertrade commitment is not terminated before the third party's commitment becomes effective, it is advisable to stipulate in the countertrade agreement that the termination would not take effect until the third party's commitment had become effective.

19. [17] As noted below in paragraph 22, third parties sometimes limit their commitment to a promise to exercise "best efforts" to make the purchases. *Where it is agreed that the countertrade commitment of the party originally committed is to be terminated when the third party commits itself to enter into a future contract with the supplier, it would be in the interest of the supplier to agree to such a*

*replacement of the party committed to purchase only if the commitment of the third party is a commitment to actually purchase goods rather than a "best efforts" type of commitment. If the third party were to make only a "best efforts" commitment, the supplier would have limited assurance that the conclusion of the supply contract would take place.*

20. [18] Guarantees issued to support fulfilment of countertrade commitments are normally formulated in such a way that they cover only the obligation of the party originally committed. Therefore, if the supplier wishes to have the third party's commitment secured, it is advisable that the countertrade agreement require that the guarantee be modified or that a new guarantee be issued. It is also advisable that there be an indication of the consequences if the guarantee cannot be modified or an appropriate new guarantee cannot be procured.

2. *Contractual relationship between party originally committed and third party*

(a) *Third party's commitment to purchase goods*

21. [19] When the party originally committed to purchase intends to engage a third party to make the purchases, those two parties should reach an understanding as to the type of commitment to be made by the third party.

22. [20] Two types of commitment by third parties to parties originally committed are used in practice. One type is a promise that, subject to the terms of the engagement of the third party, the countertrade goods will actually be purchased. The other type of commitment is a promise by the third party that an effort will be made to purchase goods without an assurance that the effort will be successful. The third party may not be willing to make a full commitment because of uncertainty as to whether an end-user for the goods could be found or whether the purchase price of the goods would be competitive. Such a promise only to make an effort may be described by terms such as "serious intention", "best endeavours", "best efforts", or "good-faith efforts" or by a clause to the effect that the third party will purchase the goods if an end-user for the goods can be found. If the third party fails to purchase the goods, it can exonerate itself from the consequences of the failure merely by showing a good faith effort to carry out its mandate. The party originally committed to purchase the goods may find the participation of the third party on a "best efforts" basis acceptable if there is reason to expect that the third party will fulfil the mandate (e.g., because of the third party's record or because the anticipated purchase and resale prices are likely to make the purchase commercially attractive).

23. [21] Sometimes the terms of the contract engaging the third party require the third party to make a commitment directly to the supplier to conclude future contracts (see above, paragraphs 6 and 17).

24. [22] The terms under which the third party is engaged should be coordinated with the terms of the countertrade agreement. The need for coordination exists in particular with respect to the type, quality, quantity and

price of the countertrade goods. A problem may arise, for example, if the third party commits itself to purchase goods of a standard quality at a world market price, while the countertrade agreement specifies a different level of quality or price. In such a case, it may occur that the supplier makes available goods that conform to the countertrade agreement but that the third party is justified in refusing to purchase because the goods do not conform to the terms of the contract between the party originally committed and the third party. That would leave the party originally committed to purchase liable to the supplier for non-fulfilment of the countertrade commitment without the possibility of indemnification from the third party.

25. [23] Furthermore, a problem may arise when the countertrade agreement does not contain an assurance as to the availability of the goods but the third party, relying on its contract with the party originally committed, expects the goods to be made available. When such inconsistency exists, the party engaging the third party may be liable to the third party for a failure on the part of the supplier to make the goods available.

26. [24] When the countertrade agreement and the terms of the engagement of the third party both contain an assurance as to the availability of goods, the party originally committed may be liable to the third party for a failure by the supplier to make the goods available. In such a case, *the party originally committed would be interested in making the assurance of the availability of the goods subject to a liquidated damages or penalty clause or secured by a guarantee.*

27. [25] It is advisable for the contract by which the third party is engaged to reflect any restriction on the resale of goods set out in the countertrade agreement. Otherwise, the party originally committed to purchase may be liable for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement without the benefit of indemnification from the third party.

28. [26] In some cases, the party originally committed may wish to have an opportunity to make alternative arrangements to fulfil the countertrade commitment in the event that the third party fails to make the necessary purchases. This could be achieved by setting a deadline for purchases to be made by the third party that precedes the deadline for the fulfilment of the countertrade commitment that is binding upon the party originally committed. If the party originally committed wishes to have such an opportunity, it would be advisable, in negotiating the countertrade agreement, to ensure that the fulfilment period is of a sufficient length so as to allow the third party adequate time to make the purchases, *as well as to allow time for alternative arrangements to be made should the third party fail to make those purchases.*

29. [27] It is advisable to make it clear in the contract for the engagement of the third party whether it is up to the third party to carry out all aspects of the negotiation with the supplier relating to the conclusion of the future contract, or whether the party originally committed to purchase the goods should participate in some way in the conclusion or performance of the contract. It may be provided, for

example, that the party originally committed to purchase must approve or at least be informed of a particular aspect of the purchase of the goods (e.g., the price or the destination of the goods).

#### (b) *Third party's fee*

30. [28] In return for the third party's commitment to purchase goods, the party originally committed may have to pay a fee to the third party. A fee, *to be agreed upon in the contract between the party originally committed and the third party*, is normally required when the price of goods to be purchased by the third party is not competitive and the resale of the goods would therefore not be profitable to the third party without the payment of a fee. Such a fee is referred to in practice by expressions such as "commission", "disagio", "subsidy", "discount", "premium", or "compensation". The amount of the fee would depend in particular on the *demand for the type of goods in question and on the expected difference between the purchase price and the resale price of the goods*. The amount of the fee may also be affected by the cost of any guarantee that the third party would have to procure to cover its liability either to the party originally committed or to the supplier, or to both, for a failure to make the necessary purchases.

31. [*new paragraph*] When a governmental agency is engaging a third party to purchase goods or when a governmental agency is being engaged to purchase goods, in some jurisdictions *mandatory restrictions apply to the payment of a fee by or to the governmental agency.*

32. [29] The fee may be calculated as a percentage of the price of the purchases to be effected by the third party or as an absolute amount per unit or quantity of goods. Sometimes a combination of the two methods is used. If the fee is calculated as a percentage of the price of the goods, it is advisable for the parties to be clear as to the amount on the basis of which the fee is to be calculated (e.g., whether any transport or insurance costs form part of that price).

33. [30] At the time the third party is engaged to conclude the future supply contracts, it may be difficult, due to price fluctuations, to predict the resale price. The parties may therefore provide for a variable fee, to be determined on the basis of the actual difference between the prices, increased by an agreed percentage or amount to cover the third party's costs. Depending upon the underlying commercial circumstances, the parties may wish to consider the possibility that the resale price might rise to a level at which the resale of the goods is profitable for the third party. If this possibility is taken into account, the third party would have to pay an amount to the party originally committed to purchase the goods corresponding to the extent to which the actual resale price increased above the anticipated resale price. Such an amount due from the third party is sometimes referred to as a "negative disagio".

34. [31] It is advisable to specify the point of time when the fee becomes due. It may be provided, for example, that the fee becomes due when the third party is engaged, upon the conclusion of the supply contract between the supplier and the third party, upon the opening of a letter of credit on

the instructions of the third party in favour of the supplier, or at the time of payment by the third party to the supplier. Sometimes it is agreed that specified percentages of the fee are payable at different points of time. For example, it may be agreed that a certain percentage of the fee is payable upon the engagement of the third party, a certain percentage upon the conclusion of the contract between the third party and the supplier, and the remainder upon payment by the third party for the goods. When the fee is to be paid subsequent to the conclusion of the contract between the party originally committed and the third party, the third party may request a bank guarantee to secure the obligation to pay the fee.

35. [32] It is advisable for the contract engaging the third party to stipulate whether the contractual relationship between the third party and the party originally committed would be affected by a termination or reduction of the countertrade commitment of the party originally committed. A termination or reduction of the countertrade commitment may result, for example, from the termination of the export contract (see chapter XIII, "*Failure to complete countertrade transaction*", paragraph \_\_\_\_). The third party may be interested in completing the purchase and earning the fee irrespective of the fate of the countertrade commitment of the party originally committed, particularly when expenses have been incurred in locating an end-user, when an end-user has been promised the goods or when the goods have actually been purchased and resold. The party engaging the third party, on the other hand, may be interested in being able to terminate the engagement of the third party in the event that the countertrade commitment is terminated.

36. [new paragraph] Sometimes it is agreed that the payment of the fee is to be shared by the party committed to purchase and the supplier. In such a case, the details concerning the sharing, including any limit to the costs to be borne by the supplier, should be dealt with in the countertrade agreement.

#### (c) "*Hold-harmless*" clause

37. [33] The party originally committed to purchase goods may be liable to the party to whom that commitment is owed when the third party fails to make the anticipated purchases (see above, paragraphs 17 and 18). A party originally committed to purchase goods engaging a third party may therefore wish to include in its contract with the third party a "*hold-harmless*" clause. According to such a clause, the third party would have to indemnify the party originally committed to purchase for any liability to the supplier resulting from non-fulfilment of the countertrade commitment for reasons imputable to the third party. The parties may also stipulate that the "*hold-harmless*" clause would protect the party originally committed to purchase goods in the event of a violation by the third party of a restriction on the resale of the goods set out in the countertrade agreement and reflected in the contract engaging the third party. It may be agreed that the party originally committed to purchase the goods is to give the third party notice when a claim is raised that may result in the third party's liability under the "*hold-harmless*" clause.

#### (d) *Exclusivity of third party's mandate*

38. [34] It is advisable for the party originally committed and the third party to indicate in their contract whether the third party is to be the only party engaged or whether the party originally committed reserves the right to engage an additional third party for the purpose of fulfilling the same countertrade commitment. A third party could be given an exclusive mandate with respect to all the purchases to be made in fulfilment of the countertrade commitment or exclusivity could be given only with respect to a particular type of goods, a particular supplier, or a particular territory where the goods are to be purchased or resold.

39. [35] When the third party is given an exclusive mandate, the party originally committed may wish to reserve the right to declare the mandate as non-exclusive if by a specified time before the end of the fulfilment period the third party has not purchased an agreed quantity of goods.

40. [36] When the quantity of goods to be purchased is particularly large, it might be agreed that during a specified period of time the third party is *not permitted* to purchase the same type of goods from other sources. A rationale for such a restriction may be the desire to avoid a temporary oversupply in the market in which the third party plans to resell the goods, or a desire to compel the third party to concentrate its efforts on the fulfilment of the commitment in question.

#### C. Supply of countertrade goods

41. [37] Sometimes, a party who purchases goods in one direction does not supply goods in the other direction. Instead, one or more third parties are designated to supply the goods. There are two types of transactions in which such an approach may be used. One type is a transaction in which the party purchasing goods in one direction assumes a commitment for the supply of goods in the other direction, but because of difficulties in making the agreed goods available designates a third party to supply the agreed goods. The other type is an indirect offset transaction as described in chapter II, "*Scope and terminology of Legal Guide*", paragraph 17. In indirect offset transactions it is foreseen at the time of the conclusion of the export contract and of the countertrade agreement that the importer (often a governmental agency) will not counter-export goods and that the party committed to counter-import will have to locate third parties willing to supply goods. Those third parties are normally not bound by any commitment to conclude supply contracts with the counter-importer.

42. [38] In a transaction involving a third-party supplier, payment obligations under the supply contracts in the two directions are often settled independently. Payment in such a manner does not raise issues specific to countertrade. However, issues specific to countertrade do arise when the parties decide to link payment in the two directions so that the proceeds of the supply contract in one direction are used to pay for the supply contract in the other

direction. For a discussion of such linked payment mechanisms, see chapter IX, "Payment", paragraphs 68, 75 and 76.

43. [39] When the possibility exists that a third party may be involved in the supply of goods, it is advisable for the countertrade agreement to address the means by which the third party supplier is to be selected and the consequences of a failure by the third party to make the agreed goods available.

44. [40] Different approaches may be used for the selection of the third party supplier. One approach is for the countertrade agreement to name the third party. Another approach is for the countertrade agreement to stipulate that the third party supplier is to be agreed upon at a later date. Yet another approach is to leave the selection of the third party to one of the parties to the countertrade agreement.

#### *1. Selection of third party by party committed to purchase*

45. [41] It often occurs in offset transactions that the selection of the third party supplier is left to the party committed to purchase. That selection may be restricted by guidelines established in the countertrade agreement requiring the selection of suppliers from particular geographical regions or industrial sectors, or of suppliers of specific types of products or services. Such guidelines are referred to in chapter IV, "Countertrade commitment," paragraph 28.

46. [42] When the party committed to purchase is to select the third-party supplier, it is advisable to clarify in the countertrade agreement the effect of a failure by a potential third-party supplier to conclude a supply contract. When the selection is to be made from a large number of potential suppliers, it may be stipulated that the refusal by a potential third-party supplier would not result in a release from the commitment to purchase. When the third-party supplier is to be selected from a list of identified suppliers, it may be agreed that a refusal by all the suppliers on the list to conclude a supply contract in conformity with the terms of the countertrade agreement would release the party committed to purchase from its commitment. (For a further discussion of release from the countertrade commitment, see chapter XIII, "Failure to complete countertrade transaction", section B.)

#### *2. Selection of third party by party committed to supply*

47. [43] In some cases, the selection of third-party suppliers is left to the party who has a right under the countertrade agreement to supply goods. This may be the case when the party purchasing goods in one direction does not engage in the sale of goods that are to be supplied in the other direction (e.g., when a government agency purchases goods in an offset transaction), does not have goods of interest to the party committed to purchase, or is uncertain as to whether it will have suitable goods at the time the supply contract is to be concluded and therefore wishes to have the option of designating a third-party supplier.

48. [new paragraph] The party committed to supply may be left free to designate the third-party supplier. This may be the case, for example, if the countertrade goods are of a standard quality and readily available. Alternatively, the countertrade agreement may provide guidelines within which the party committed to supply goods may designate the third-party supplier or the countertrade agreement may list the potential third-party suppliers. The party committed to purchase may wish to include in the countertrade agreement a clause providing that purchasing from a third party should not cause additional costs to the party committed to purchase.

49. [44] When the selection of the third-party supplier is left to the party originally committed to supply goods, the parties may provide in the countertrade agreement that the third party must be in a position to make available goods that conform to the terms of the countertrade agreement. It is advisable for the countertrade agreement to be clear as to the consequences of a failure by the third party to make the agreed goods available. It may be agreed that such a failure would release the party committed to purchase from the countertrade commitment to the extent that the third party failed to make goods available, or it may be agreed that a new supplier would be selected. When the obligation of the party originally committed to supply is supported by a liquidated damages or penalty clause, or by a guarantee, it may be clarified that a failure by the third party to make the goods available would entitle the party committed to purchase to payment under the liquidated damages or penalty clause or under the guarantee. \*

50. [new paragraph] It is advisable that the obligations assumed by the third party are coordinated with the obligations under the countertrade agreement of the party originally committed to supply. This is particularly important with respect to the obligations as to the quality, quantity or price of goods to be delivered, a guarantee of availability of goods, or liquidated damages or a penalty for a failure to make the goods available. The purpose of the coordination is to ensure that the goods offered by the third party to the party committed to purchase would be in accordance with the countertrade agreement. If, for example, the third party does not make available goods that meet the level of quality stipulated in the countertrade agreement and a supply contract is therefore not entered into, the party originally committed to supply would be liable under the countertrade agreement and the party committed to purchase may be released from the countertrade commitment.

51. [new paragraph] The contract between the party originally committed to supply and the third party may include a "hold-harmless" clause, whereby the third party agrees to indemnify the party originally committed to supply for the liquidated damages or a penalty that might have to be paid under the countertrade agreement as a result of a failure of the third party to make the agreed goods available.

52. [new paragraph] In some transactions, the party originally committed to supply and the third-party supplier agree that a commission will be paid by the third-party supplier to the party originally committed for the opportunity to market goods.

### D. Multi-party countertrade

53. [45] There are three types of countertrade transactions that involve more than two parties but are distinct from the transactions covered in sections B and C of this chapter.

54. [46] One type is a tripartite transaction in which a party who supplies goods in one direction does not, at any point in the transaction, make a commitment to purchase goods in the other direction; instead, that commitment to purchase is assumed from the outset by a third party. By contrast, section B covers cases in which a party, after having assumed a commitment to purchase goods, engages a third party to make those purchases. A tripartite structure of this first type may be used, for example, in a buy-back transaction in which the exporter of the production facility does not wish to become involved in the purchase of the resultant products and there is a need, in order to secure financing, to have, at the outset, a third party committed to purchase those products. A tripartite transaction of this type may be initiated through the conclusion by the three parties of an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract for the supply of goods in one direction, while at the same time the third-party purchaser (counter-importer) and the counter-exporter enter into a commitment to conclude a future contract for the supply of goods in the other direction.

55. [47] A second type of multi-party transaction is a tripartite arrangement in which a party who purchases goods in one direction does not, at any point in the transaction, assume a commitment to supply goods in the other direction; instead, a third-party supplier assumes, at the outset, a commitment to supply goods. This type of tripartite transaction is distinct from the two types of transactions covered in section C: transactions in which a party, after having assumed a commitment to supply goods, designates a third party to supply those goods, and indirect offset transactions, in which the counter-importer makes a commitment to the importer to negotiate supply contracts with potential suppliers who have not made a commitment to conclude supply contracts with the counter-importer. One contractual approach for this type of tripartite transactions

is for the three parties to conclude an agreement stipulating their commitments to enter into the future supply contracts and then to conclude the supply contracts in the two directions. Another approach is for the exporter and the importer to conclude a contract in one direction simultaneously with the assumption by the third-party purchaser (counter-importer) and the counter-exporter of a commitment to conclude a future contract for the supply of goods in the other direction.

56. [48] In many cases, a feature of the tripartite transactions described in the previous two paragraphs is the linkage of payments for the supply contracts in the two directions. The use of such linked payment mechanisms is discussed in chapter IX, "Payment", paragraphs 68, 75 and 76.

57. [49] In a third type of multi-party transaction, the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties. Such a four-party countertrade transaction may be established when the parties to a contract for the supply of goods in one direction are not themselves in a position to conclude a supply contract in the other direction but are interested in the conclusion of such a supply contract. There may be interest in such an arrangement because the conclusion of the second supply contract would enable the parties to link payments for the contracts in the two directions so as to avoid or reduce cross-border currency transfers (linkage of payments in four-party transactions is discussed in chapter IX, "Payment", paragraphs 69, 75 and 77). Another reason for being interested in such an arrangement may be that the supply of goods in one direction is subject to a mandatory requirement of a purchase of goods in the other direction.

58. [new paragraph] It is advisable for the parties to consider at the outset of the transaction the question whether the failure to conclude or perform one of the supply contracts should have an effect on the obligation to conclude or perform another supply contract. This question is discussed in chapter XIII, "Failure to complete countertrade transaction", section E. For a discussion of interdependence between supply contracts when the parties have agreed on linked payments, see chapter IX, paragraphs 72 and 73.

[A/CN.9/362/Add.9]

## IX. PAYMENT

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[*Editorial note:* The present draft chapter is a revision of draft chapter IX, "Payment", published as document A/CN.9/332/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.6 are in italics.]

#### A. General remarks

1. [1] The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. [2] One reason the parties may have for linking payments is *the possibility* that it would be difficult for a party

to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the shipment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (*below*, paragraphs 9 to 13), blocking funds paid under the export contract through blocked accounts or crossed letters of credit to secure their availability to pay for the counter-export contract (*below*, paragraphs 14 to 37), and setoff of countervailing claims for payment (*below*, paragraphs 38 to 57).

3. [3] An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. [*new paragraph*] A characteristic of linked payment mechanisms is the security they provide to the party who has received goods first in that the funds to pay for those goods are not placed at the disposal of the party who has supplied those goods but are reserved to pay for goods subsequently to be supplied in the other direction. This fact may make it easier for that party to obtain a loan to finance its deliveries. The source of financing is often the bank that

is holding the funds to be used for paying subsequent deliveries or the bank that is administering a setoff of countervailing claims for payment.

5. [new paragraph] On the other hand, the party who is the first one to deliver goods, or who has delivered more goods than it has received, faces the risk that it will have to wait for an uncertain period of time before goods of the agreed quality are made available for purchase in return or, if such goods are not made available, that the proceeds from the deliveries that that party had made are released to pay for those deliveries. Because of this risk, a bank may be reluctant or unwilling to finance a delivery of goods if payment for those goods is to be deferred until the goods are purchased in return. As a result, in large-scale and long-term projects such as buy-back or indirect offset transactions it is less likely that a linked payment mechanism will be used.

6. [4] The parties may wish to consider the possibility that hindrances might arise in carrying out the linked payments. For example, a creditor of one of the countertrade parties might obtain a court order to seize proceeds of a supply contract, the bank holding the funds might become insolvent, or a payment may be prevented because of supervening banking or foreign exchange regulations. Those cases could result in the freezing of the payment mechanism until the claim against the countertrade party was adjudicated, the bank became solvent or the regulations were lifted, as the case may be. A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against such external circumstances. Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk that such hindrances might arise.

7. [5] It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

8. [new paragraph] It is advisable that the parties agree on the details of the linked payment mechanism in the countertrade agreement. Depending on the type of the payment mechanism chosen, individual supply contracts may have to contain clauses implementing the method of payment agreed upon in the countertrade agreement.

## B. Retention of funds by importer

9. [6] Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

10. [7] A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the

importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "trust" in which the importer acts as the "trustee" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

11. [8] Furthermore, a disagreement may arise over the type, quality or price of counter-export goods if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods available. Retention of funds by the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

12. [9] An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds are transferred to the exporter.

13. [10] Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest in favour of the exporter. If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn interest at the most favourable rate.

## C. Blocking of funds

### 1. General remarks

14. [11] When the exporter does not wish to leave the funds generated by the export contract under the control of

the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this type: blocked accounts and crossed letters of credit.

15. [12] When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

16. [13] When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

17. [14] A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

18. [15] The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

## 2. Blocked accounts

19. [16] Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "trust" account or "compte

*fiduciaire*"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

20. [17] Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", below, paragraphs 26 to 30). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

### (a) Countertrade agreement

#### (i) Location of account

21. [18] The parties should consider stipulating in the countertrade agreement the location of the account, by identifying the bank, by indicating the country in which the account is to be opened or by providing some other criterion for the selection of the bank. The choice of possible locations of the account may be limited if the national law of the party whose shipment generated the funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

22. [19] When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted above in paragraph 19, a degree of protection may be available under some legal systems against claims of third persons.

#### (ii) Operation of blocked account

23. [20] It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

24. [21] The countertrade agreement may provide that payments into the account would be made through a letter

of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficiary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

### (iii) Other issues

25. [22] It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see below, paragraphs 58 to 65).

### (b) Blocked account agreement

26. [23] The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and by the bank, as well as other provisions concerning the operation of the blocked account. The blocked account agreement would also address issues such as interest and bank charges, and the manner in which trading parties may verify the accuracy of interest calculations and other actions taken by the bank in administering the account. It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

#### (i) Parties

27. [24] The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some national laws require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer is distinct from the exporter and importer, the additional trading party may also be party to the blocked account agreement.

#### (ii) Transfer of funds into and out of account

28. [25] The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see above, paragraphs 23 and 24) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the

invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to its instructions (see below, paragraphs 62 and 63). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

29. [26] It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

#### (iii) Duration and closing of account

30. [27] In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate, in addition to the passage of an agreed upon period of time, circumstances in which the account would close. These could include an event such as termination of the export contract or of the countertrade agreement.

## 3. Crossed letters of credit

31. [28] Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see below, paragraph 59), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

#### (a) Sequence of issuance

32. [29] The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a sequence of issuance may be

an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

33. [30] In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

#### (b) *Instructions for allocation of proceeds*

34. [31] The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

35. [32] *Because of the linkage between the proceeds of the export letter of credit and the counter-export letter of credit the choice as to the method of payment of the export letter of credit is limited to payment at sight or payment on a deferred basis. Payment by a bill of exchange, the other option used in practice to defer payment of a letter of credit, is incompatible with the linked payment objective of the crossed letters of credit. When a bill of exchange is used for paying the beneficiary of the letter of credit, the bank obligated to pay would accept the bill drawn by the importer in favour of the beneficiary of the letter of credit. Such a bill gives the beneficiary the possibility to transfer the bill by endorsement to a third person. If the bill were endorsed to a third person, the bank that issued the export letter of credit and accepted the bill would be obligated to pay the holder of the bill (and the importer would be obligated to reimburse the bank that issued the export letter of credit) independently of the crossed-letter-of-credit payment scheme. If the export letter of credit is payable at sight, the bank issuing the export letter of credit is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.*

36. [33] It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

#### (c) *Expiry dates*

37. [34] It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

### D. *Setoff of countervailing claims for payment*

#### 1. *General remarks*

38. [35] The parties may agree that their mutual claims for payment based on shipments made in each direction would be set off. Under such an arrangement, money is not actually paid; instead, the sum of claims arising from the deliveries in one direction are set off against the sum of claims arising from the deliveries in the other direction. If an outstanding balance arises in the values of the deliveries in the two directions, it can be settled by delivery of additional goods or by payment of money. In some States setoff arrangements are subject to governmental authorization.

39. [36] A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. This section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

40. [37] A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law. Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of

shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an *outstanding balance* in the flow of trade.

41. [38] Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

42. [39] When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed below in paragraphs 60 and 61).

43. [new paragraph] An agreement to set off claims arising from a trade relationship is in a number of national laws recognized as a distinct type of contract involving the two parties in the trade relationship and a third person who is to administer the recording of mutual claims. Terms used for such contracts include "*compte courant*", "*cuenta corriente*" or "*Kontokorrent*", although some of these terms are also used for accounts in which a bank holds funds of a client. Those national laws deal with issues such as obligations of the third person administering the setoff, the effect of the entry of a claim in the setoff account, the action necessary for the setoff of the countervailing claims to take effect, the possibility to dispute an individual claim or the balance of the countervailing claims, or the effect of insolvency or bankruptcy of a party on the individual entries in the setoff account.

44. [40] The Legal Guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the

legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

## 2. Countertrade agreement

### (a) Effecting credit and debit entries

45. [41] The parties may wish to agree that entries in the account will be *triggered by presentation* of documents. The countertrade agreement should stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account).

46. [42] Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by the *customs authority* or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, below, paragraph 53, and settlement of *such balance*, below, paragraphs 54 to 56) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

47. [43] In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the

purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the interbank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

48. [44] Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, *the stipulations in the countertrade agreement concerning the instructions to be given to the issuing banks should be aligned with the current revision of the Uniform Customs and Practice for Documentary Credits prepared by the International Chamber of Commerce, which banks customarily incorporate into their letter-of-credit forms.*

#### (b) Calculation of entries

49. [45] The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (below, paragraph 58). In addition, the parties may wish to address the question whether interest calculated on the amount of an *outstanding balance* would be registered in the setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

50. [46] In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will *not appear in the setoff account*. Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

#### (c) Statements of account

51. [47] *It is advisable to consider the manner in which the participating bank or banks will report on the status of the setoff account to the trading parties and to any other participating bank. Agreement on this issue is particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and*

*contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.*

#### (d) Periodic verification

52. [48] In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

#### (e) Limits on outstanding balance

53. [49] The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party *should not exceed an agreed upon balance limit*. In accordance with such a balance limit (sometimes referred to as a "swing"), debit and credit entries would not be entered in excess of the balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit, *or that an outstanding balance in excess of the limit is to be settled by transfer of money*. Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

#### (f) Settlement of outstanding balance [change of title]

54. [50] It is advisable that the parties agree in the countertrade agreement on the manner of settling an *outstanding balance in the values of the deliveries in the two directions that remains at the conclusion of subperiods of the fulfilment period or at the conclusion of the fulfilment period.*

55. [50] With respect to an *outstanding balance remaining at the conclusion of a subperiod*, it may be agreed that *the balance would be carried over to the next subperiod. Alternatively, it may be agreed that only a balance up to a specified limit would be carried over to the next subperiod, and that the balance in excess of the limit would have to be settled by cash or by deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of an outstanding balance that is carried forward is to prevent the accumulation of a high outstanding balance that would be difficult to rectify by the end of the fulfilment period.*

56. [51] *As to an outstanding balance remaining at the conclusion of the fulfilment period, it may be agreed that the balance is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree that the balance would be settled after the end of the*

*fulfilment period by deliveries of goods within a fixed supplementary period. If an outstanding balance still remains after the conclusion of the supplementary period, it may be stipulated that it is to be settled by a currency transfer within an agreed period of time.*

(g) *Guarantee for payment of outstanding balance*

57. [52] In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding balance. Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of an outstanding balance can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of an outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs [38] to [45].) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

E. *Issues common to linked payment mechanisms*

1. *Currency or unit of account*

58. [53] The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate an outstanding debit balance in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

2. *Designation of banks*

59. [54] The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

3. *Interbank agreement*

60. [55] Where on each side of the countertrade transaction a bank is involved, the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The interbank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. While the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

61. [56] The entry into force and the duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

4. *Transfer of unused or excess funds*

62. [57] It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

63. [58] A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the outstanding balance due under the counter-export will be paid at the time the balance becomes due.

### 5. *Supplementary payments or deliveries*

64. [59] The parties may anticipate that their shipments will not be of *equal* value or in the planned quantity so that the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

### 6. *Bank commissions and charges*

65. [60] It would be advisable for the parties to address in the countertrade agreement the question of payment of *bank charges* for operation of the *payment mechanism*. In order to simplify the operation of the payment arrangement, it may be agreed that *bank commissions and charges* will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the *bank charges* will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the *charges of each bank* will be paid by its respective client. *For example, it may be agreed that the charges for the issuance of a letter of credit will be borne by the purchaser, while charges for negotiation and confirmation, if required, will be borne by the supplier. Charges for extensions or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.*

## F. *Payment aspects of multi-party countertrade transactions*

### 1. *General remarks*

66. [61] A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party *counter-importer* or a *third-party counter-exporter* is involved ("three-party countertrade"); in yet other cases, in addition to the exporter and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third parties", paragraphs \_\_\_\_ to \_\_\_\_). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

67. [62] If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two paragraphs, a party receiving

goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

68. [63] In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

69. [64] In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

70. [65] Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where *no* cross-border transfer of currency takes place, payments would be made in local currency between parties on each side of the transaction.

71. [66] In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and in the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

72. [67] If one of the supply contracts in a multi-party countertrade transaction is not concluded or performed as envisaged, it will be impossible to use the proceeds of the contract between one pair of parties to pay for a contract between another pair of parties. In view of this interdependence of supply contracts, it is important that measures are taken that provide assurance to the parties that the

obligations under the transaction will be carried out as agreed. Accordingly, it is advisable that the obligations incumbent on each party are set out as clearly as possible, in particular the obligations concerning the quality of goods, the sequence of shipments, the manner and sequence of payments, and the instructions to be given to the participating banks. In order to increase the confidence of parties, the parties may agree to carry out, prior to the conclusion of the transaction, an inspection of goods to be delivered, to identify specifically the goods to be delivered, or to place the goods in the custody of a third person pending delivery. In order to facilitate coordination of the obligations of the parties, it is useful to address them in a single countertrade agreement entered into by all the participating parties. Where not all the parties to the multi-party transaction are parties to the countertrade agreement, it is advisable to include in the individual supply contracts terms concerning the linked payment mechanisms.

73. [new paragraph] In order to make the coordination of obligations of the parties to a multi-party countertrade transaction more effective, the parties may wish to stipulate at the outset of the transaction that certain terms of the countertrade agreement or of a supply contract can be modified only if all parties to the transaction agree to the modification. The modifications that should be subject to agreement of the participating parties are in particular those that concern the time of shipments, method of payment, quantity and quality of goods and price. In addition, the parties may wish to consider securing obligations under the transaction by agreeing on liquidated damages or penalties or on independent bank guarantees.

## 2. Blocking of funds in multi-party countertrade

74. [68] As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in above in paragraphs 14 to 37.

75. [69] When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract

would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

76. [70] When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

77. [71] When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issuance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.

[A/CN.9/362/Add.10]

## X. RESTRICTIONS ON RESALE OF COUNTERTRADE GOODS

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[*Editorial note:* The present draft chapter is a revision of draft chapter X, "Restrictions on resale of goods", published as document A/CN.9/WG.IV/WP.51/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.2 are in italics.]

#### A. General remarks

1. [1] Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of all or of a portion of the goods purchased pursuant to the countertrade commitment. The agreed restrictions may, for example, limit the territory where the purchaser may resell goods, set a minimum resale price, or prescribe packaging and marking of goods to be resold. Such restrictions may be applied to the resale of the goods within the country of the purchaser or to the re-export of the goods. A countertrade agreement or supply contract may contain a combination of different types of resale restrictions.
2. [2] Resale restrictions of this type are not particular to countertrade transactions. However, such restrictions are dealt with in the legal guide because they may take on a special importance in countertrade. Resale restrictions may be part of the strategy of a supplier of countertrade goods or of a government that has mandated countertrade when the purpose of requiring the countertrade commitment was to increase the volume of exports to a particular market or to develop new markets for the goods without affecting adversely existing markets for those goods.
3. [3] The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Such mandatory rules may be set forth in a statute and in various types of administrative regulations, *and interpreted by judicial decisions*. The mandatory rules of more than one country may apply. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices. For example, many legal systems provide that agreements restricting the right of resale are prohibited or may be invalidated if the supplier imposing the restriction has a dominant market position, if the restriction has the effect of limiting access to markets or otherwise unduly restraining competition or if the restriction has or may have other adverse effects on trade or economic development. Agreements setting a minimum price are prohibited outright in some legal systems. In other legal systems, minimum price agreements may be permitted only for certain types of goods (e.g., brand-name or luxury goods) or if specified conditions are met (e.g., the price-setting agreement is approved by the competent authority or it is shown that buyers have sufficient possibility to obtain the same or similar goods at prices not subject to a price-setting agreement).
4. [4] In negotiating a restriction on the resale of countertrade goods *it is useful to bear in mind that, depending on the commercial circumstances of the transaction, a restriction might lower the price that the countertrade party purchasing and reselling countertrade goods will be able to offer to the countertrade party supplying the goods. Such may be the effect of a clause prohibiting the resale of the goods in the most attractive market, or of a clause requiring resale terms that result in additional costs to the party reselling the goods.*
5. [5] When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction. Absent a provision in the countertrade agreement on resale restrictions, a demand that the purchase of countertrade goods be subject to a resale restriction may complicate negotiation of a supply contract and may make it difficult to attribute to one of the parties responsibility for a failure to conclude a supply contract. When it is possible that a third party will be engaged to make the purchases necessary to fulfil the countertrade commitment *and the third-party purchaser is to be subject to a resale restriction, it is advisable for the supplier to ensure that the third-party purchaser would be aware that its purchases are subject to that restriction* (see below, paragraphs 23 and 24).
6. [6] The degree to which the countertrade agreement can be specific depends on factors such as whether the type of goods to be purchased has been identified, the nature of the restriction, or the length of time during which the supply contracts will be concluded, and the possibility of third parties being involved in the resale of the goods. In some cases it may be possible to formulate in the countertrade agreement the resale restriction clause that would apply to all purchases made pursuant to the countertrade agreement. In other cases the supplier may not have the necessary information at the time of the conclusion of the countertrade agreement to determine whether a resale restriction would be desirable, but would not wish to be precluded from raising the question of resale restrictions at a later stage. In such cases, the countertrade agreement may identify only the type or commercial purpose of a resale restriction being contemplated. For example, it may be agreed that the parties would negotiate a limitation of the territories in which the purchaser is permitted to resell goods in order to avoid sales of the goods in the supplier's existing markets.
7. [7] In some exceptional circumstances, the countertrade agreement may contain a stipulation that the purchaser may only use the goods in-house and may not resell them. Such a restriction may be imposed, for example, when the goods are supplied on preferential terms (e.g., in order to help the purchaser in a hardship situation) or when the supplier is under an obligation to restrict distribution of the goods because of their particularly sensitive nature or when the resale of the goods would entail disclosure of information that the supplier wishes to keep under its control.
8. [*new paragraph*] Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of

countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction. The purpose of such a restriction may be to enhance the purchaser's ability to resell the countertrade goods or to make the countertrade transaction more profitable for the purchaser. For example, the supplier of countertrade goods may agree not to sell the same type of goods to certain customers or in certain markets. The supplier of countertrade goods might also grant to the other countertrade party exclusive distributorship rights with respect to those goods. The parties might also agree that the supplier will not market the same type of goods at prices lower than those used in the countertrade transaction. Such restrictions applicable to the supplier might be stipulated when in the same transaction the purchaser has agreed to resale restrictions or they may be agreed upon when no resale restrictions have been agreed upon. The warning given in this chapter (above, paragraph 3) that various marketing restrictions may contravene mandatory rules on restrictive business practices is also applicable to marketing restrictions on the supplier of countertrade goods.

#### B. Duty to inform or consult

9. [8] The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods. Information of this kind may be useful to the supplier in monitoring compliance with resale restrictions binding upon the purchaser, in determining whether resale of the goods by the purchaser is achieving the goal of introducing the goods into new markets, in deciding whether to continue to offer those goods in countertrade transactions, in deciding whether the goal of opening new markets or the goal of increasing sales in traditional markets would be served by engaging in further countertrade transactions with the purchaser, or in planning its own marketing or production of the same or similar type of goods. Such an obligation to inform may be agreed upon also when the parties do not agree on a specific resale restriction, *for example*, because the type of goods to be purchased has not been specified at the time of the conclusion of the countertrade agreement.

10. [9] The countertrade agreement should be clear as to whether an obligation to inform or consult is limited to giving information or is intended to provide an opportunity for consultations between the purchaser and the supplier prior to the resale. It is advisable to stipulate the point of time when the supplier is to be informed. If the parties intend to allow for consultations prior to resale, it should be made clear that the purchaser must inform the supplier in sufficient time to allow consultations to take place.

#### C. Territorial and related restrictions

11. [10] The parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods under the countertrade agreement may resell the goods. A territorial restriction may be based on the supplier's desire, *for example*, to generate sales in

new markets, to protect the supplier's existing markets, to ensure that the goods comply with the rules applicable in the markets in which they are to be resold, or to avoid violating restrictions arising from patents held by third persons or from licensing arrangements between third persons and the supplier for technology used to produce the countertrade goods. A further reason may be to prevent interference with exclusive distributorships granted by the party supplying goods under the countertrade agreement. If the supplier has granted an exclusive distributorship in a particular territory, it is inherent in such an arrangement that the supplier would be under a duty not to enter into contractual arrangements that undermine the exclusive distributorship. Sometimes exclusive distributorship agreements provide that the exclusive distributor is entitled to a commission if goods in question are sold in the restricted territory. In such cases the parties to the countertrade agreement might require the purchaser to pay a commission to the exclusive distributor.

12. [11] Identification of the territories where the goods may be resold can be done either by specifying the territories where the goods are not permitted to be resold or by specifying those territories where the goods are permitted to be resold. A provision specifying territories where the goods may be resold should make clear that resale is prohibited in territories that are not listed. The parties should pay attention to the need to use precise terminology. General expressions such as "Caribbean States", "Latin America", "Pacific region", or "Europe" may be interpreted differently and therefore may be inadequate. The territory in which the goods are permitted to be resold may also be limited to those territories in which after-sale service is available either from the purchaser or some other source. In drafting clauses concerning territories of resale, the parties should bear in mind that the right to resell in particular territories is distinct from the question whether the right to resell in those territories is exclusive or non-exclusive.

13. [12] In some cases, the countertrade agreement may provide that only a specified quantity of goods is permitted to be resold in particular territories or that only a specified quantity of goods is permitted to be resold without restriction as to territory. Such an approach may be motivated, *for example*, by the existence of governmental import quotas, by a desire to avoid oversupply in existing markets or by a desire to introduce the goods into new markets.

14. [13] When the countertrade transaction is likely to result in the resale of goods in markets in which the supplier usually does not sell, the supplier may wish to permit the resale of the goods only in territories in which the goods are covered by product liability insurance for claims arising from personal injury or property damage caused by the goods. It may be agreed that the party purchasing the goods under the countertrade agreement and reselling them is to obtain the insurance. Such insurance may be in the interest of the supplier because claims for damage resulting from the use of the goods may be made against the supplier. A clause permitting the resale of the goods only in territories in which the goods are covered by product liability insurance may be considered in particular when the products purchased under the countertrade transaction are

to be resold in a market where the standard of liability or the level of compensation awarded under product liability laws is considerably higher than in the markets in which the products are traditionally sold.

15. [14] Suppliers sometimes prohibit purchasers from selling to particular customers or classes of customers. Such restrictions may be motivated by a desire on the part of the supplier to retain certain customers for itself (e.g., bulk buyers). An aim of this type of restriction may be to prevent competition in the supply of the goods that might result in a lowering of the price. It should be noted that such resale restrictions may violate mandatory rules mentioned *above* (paragraph 3) prohibiting certain types of restrictive business practices. Another possible motivation for such restrictions may be the prevention of resale of goods of a sensitive or hazardous nature to certain buyers.

16. [15] The parties sometimes agree that the resale of goods requires the consent of the supplier. This approach might be taken, for example, when the nature of the goods requires a restriction on their transfer (e.g., hazardous substances or equipment whose use requires special training) or when the supplier contemplates granting exclusive distribution rights in the future and therefore wishes to retain the right to restrict the resale of the goods by the purchaser once those distributorships have been granted. The requirement of consent may be limited to specified territories or to specified classes of customers. The exercise by the supplier of the right to withhold consent may be made subject to objective criteria. It may be agreed, for example, that consent may be withheld only where the goods are to be resold in a market in which an exclusive distributorship has been established, or where existing sales of the goods in question by the supplier or its distributors have reached a specified threshold.

#### D. Resale price

17. [16] Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. As pointed out *above* in paragraph 3, the parties should bear in mind that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is permitted only in limited circumstances.

18. [17] The supplier may wish to set a minimum resale price when the goods to be supplied pursuant to the countertrade agreement are of such a quantity that their resale might destabilize or depress the price for goods of that type. While in many countertrade transactions the quantities of goods involved are such that they would not adversely affect the market price, there are countertrade transactions that result in an abrupt and large increase in the supply of goods of a particular type and that may therefore cause price instability. Minimum resale prices may also be intended to prevent sales at discount prices that might harm the image of a product.

19. [18] A minimum resale price may be stipulated in the countertrade agreement or it may be agreed that a minimum resale price is to be set at a time subsequent to the conclusion of the countertrade agreement (e.g., at the time

of the conclusion of the supply contract or after a specified volume of the goods *has* been resold). In the case of a long term countertrade transaction, the parties may agree that a minimum resale price is to be set periodically. The countertrade agreement should be clear as to the charges and costs that are to form part of the stipulated minimum resale price (e.g., transportation costs, insurance premiums, or taxes). If the minimum price is to be set subsequent to the conclusion of the countertrade agreement, the parties may wish to link the determination of the minimum to an objective standard of the type used in setting a price for the goods as between the parties to the countertrade agreement. Such standards include the price quoted in a market of goods of the type in question, competitor's price or the price charged to the supplier's most favoured customer (see chapter VII, "Pricing of goods", paragraphs 11 to 20).

20. [19] The parties may not wish to set a specific minimum resale price in the countertrade agreement when the goods are of a standardized quality, such as commodities, that are sold in public markets because of the possibility that the market price may fall below a specific minimum resale price set in the countertrade agreement. A purchaser bound by a minimum resale price higher than the market price would find it difficult or impossible to resell the goods. In order to avoid such difficulties, the parties may wish to provide that the minimum resale price is to trace movements in the market price for the goods in question. This could be done by linking the determination of the minimum price to objective standards of the type referred to in the preceding paragraph.

#### E. Packaging and marking

21. [20] The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. Such requirements may obligate the purchaser to repackage or re-mark the goods or to resell the goods with their original packaging or marking. The question of packaging and marking may be important because a goal of many countertrade transactions is to introduce goods in non-traditional markets. The packaging and marking of the goods may be intended to affect the marketability of the goods in those markets, or to comply with legal rules governing packaging and marking. For example, the countertrade agreement may require that the goods be sold under the supplier's trade name, that the goods be sold in a particular form of packaging, that the packaging list the ingredients and composition of the goods, that the packaging indicate the origin of the goods, or that the packaging include instructions for use and that the instructions be in a particular form.

22. [21] The parties should ensure that any packaging or marking requirements in the countertrade agreement do not conflict with mandatory provisions at the place where the goods are to be resold. For example, there may exist requirements as to marking the origin of goods, prohibitions to modify certain elements of markings or packaging, or requirements derived from consumer protection and environmental law. Even when the countertrade agreement does not prescribe repackaging or re-marking, the purchaser may have to repackage or re-mark the goods when

packaging and marking of the goods by the supplier do not conform to the rules applicable in the country where the goods are to be resold.

#### F. Application to third-party purchasers

23. [22] When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in seeing that a resale restriction stipulated in the countertrade agreement will be observed by the third party. For that purpose, the supplier may wish to include in the countertrade agreement a provision obligating the party originally committed to purchase goods to incorporate the resale restriction in the contract through which the party originally committed engages the third party. Furthermore, it is advisable that the supplier include that resale restriction in the supply contract concluded with the third party or in the agreement with the third party by which the third party makes a commitment to the supplier to conclude a future supply contract (see chapter VIII, "Participation of third parties", paragraphs [15] and [16]). In this way the third party would be responsible directly to the supplier for compliance with the resale restriction.

24. [23] As noted in chapter VIII, "Participation of third parties", paragraph [25], the party originally committed to purchase may be liable under the countertrade agreement for a resale of the goods by the third party in violation of a restriction set out in the countertrade agreement. Therefore, the party originally committed would itself have an interest in reflecting in the contract with the third party any resale restriction set out in the countertrade agreement. Furthermore, the party originally committed to purchase

goods may wish to include in its contract with the third party a "hold-harmless" clause committing the third party to indemnify the party originally committed to purchase for any liability to the supplier resulting from a violation by the third party of a resale restriction (for a discussion of "hold-harmless" clauses, see chapter VIII, paragraph [33]).

#### G. Review of restrictions

25. [24] Large-scale countertrade transactions often involve purchase and resale of goods over a long period of time during which the underlying commercial circumstances and interests of the parties may change significantly. The possibility of such changes may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions. A periodic review or a review upon the request of a party may be agreed upon. When the review is to be upon the request of a party, the countertrade agreement may identify the types of changes in the underlying circumstances that would entitle a party to a review. *Even in the absence of a review clause in the countertrade agreement, under some legal systems, in the event of major changes in the circumstances underlying the transaction the parties would be obligated to review the affected restriction.*

26. [25] The extent to which a review procedure is advisable would depend upon the nature of the resale restriction in question. For example, a restriction as to the territory or price of resale linked to a particular type of goods may entail a greater need for possible future modification than a restriction of a less stringent sort such as a requirement that the purchaser consult with the supplier prior to reselling the goods.

[A/CN.9/362/Add.11]

## XI. LIQUIDATED DAMAGES AND PENALTY CLAUSES

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[*Editorial note:* The present draft chapter is a revision of draft chapter XI, "Liquidated damages and penalty clauses", published as document A/CN.9/WG.IV/WP.51/Add.3. The note in square brackets at the beginning of each paragraph

indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.3 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.3 are in italics.]

### A. General remarks

1. [1] Liquidated damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation, or a failure to perform it on time, entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties establish their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or both.<sup>1</sup> Sometimes, the parties agree that the obligation to pay liquidated damages or a penalty is to be secured by a guarantee (see below, paragraph 27).

2. [2] This chapter focuses on liquidated damages and penalty clauses included in countertrade agreements to cover a failure to fulfil the countertrade commitment. The chapter does not address directly the use of liquidated damages or penalty clauses to support performance of supply contracts that form part of a countertrade transaction. Liquidated damages and penalty clauses are frequently used in sales contracts and other types of supply contracts, and the presence of such clauses in supply contracts that form part of a countertrade transaction does not raise issues specific to countertrade. Nevertheless, the discussion in this chapter of the general characteristics of liquidated damages and penalty clauses is relevant to the use of such clauses in supply contracts.

3. [new paragraph] Often the intention of the parties is for the clause to cover non-fulfilment of the countertrade commitment, i.e., that the beneficiary of the clause, by claiming the agreed sum in the case of breach of the countertrade commitment, would forsake fulfilment of the commitment. Sometimes the parties intend the clause to cover delay, i.e., that the countertrade commitment remains outstanding despite payment of the agreed sum (see below, paragraphs 13 to 16).

4. [3] *The obligation to pay the agreed sum arises when the committed party fails to take the action specified in the countertrade agreement as necessary to fulfil the countertrade commitment. As discussed in chapter IV, paragraphs 35 and 36, that action may be either the conclusion of a supply contract or a specified action to be taken to perform the supply contract (e.g., opening the letter of credit or delivery of goods). If the countertrade commitment is to be fulfilled upon performance of the supply contract, failure to render the performance in question may give rise to liability under both the liquidated damages or*

*penalty clause in the countertrade agreement as well as under the supply contract, a duplication of remedies the parties may wish to avoid (see chapter IV, paragraph 36).*

5. [4] The purchaser's commitment to purchase goods may be covered by a liquidated damages or penalty clause in the countertrade agreement, as may be the supplier's commitment to make goods available. *The clause may cover the whole or only a part of the countertrade commitment.* In many countertrade transactions it is only the party who has exported and is committed to counter-import whose commitment is covered by such a clause. That is because that party may be primarily interested in exporting its own goods and may not have the same degree of interest in purchasing goods in return. However, when the party committed to purchase has a particular interest in obtaining the goods, it may be agreed that the party committed to supply the goods would pay an agreed sum in the event that the party committed to supply fails to conclude a supply contract. When both the party committed to purchase and the party committed to supply have a strong interest in the future conclusion of a supply contract, it may be agreed that the commitments of both parties are to be subject to a liquidated damages or penalty clause.

6. [5] *When it is agreed at the time of conclusion of the countertrade agreement that a party should be entitled to monetary compensation if the other party fails to fulfil the countertrade commitment, an agreement on liquidated damages or a penalty has certain advantages.* Firstly, the sum constitutes agreed compensation for such a failure, thereby allowing the parties to avoid the difficulties and expenses that might be involved in proving the extent of resulting losses. Those expenses might be considerable, especially if the aggrieved party had to establish the losses in judicial or arbitral proceedings. Furthermore, the amount of damages that might be awarded in judicial or arbitral proceedings may be uncertain (see chapter XIII, "Failure to complete countertrade transaction", paragraph 12). An agreed sum is certain, and this certainty may be of benefit to both parties in assessing the risks to which they are subject under the countertrade agreement. Secondly, the agreed sum may serve as the limit to the liability for a failure to fulfil the countertrade commitment. The party whose commitment is covered by the clause is assisted by knowing in advance the maximum liability likely to be incurred in the event of its failure to fulfil the countertrade commitment (see, however, the discussion below in paragraph 12, as to the possibility of a claim for damages in excess of the agreed sum). *However, a liquidated damages or penalty clause may be a less attractive option when a purpose of the countertrade transaction is to avoid a transfer of currency.*

7. [6] Many legal systems have rules regulating liquidated damages and penalty clauses, and those rules will often restrict what the parties may achieve through those clauses. Under some legal systems, clauses fixing an agreed sum to stimulate performance are invalid, and the party who fails to perform is liable only for the damages recoverable under the general law. Those legal systems recognize only clauses by which the parties, at the time of contracting, fix an agreed sum payable as compensation for losses caused by a failure to perform. Under other legal

<sup>1</sup>Studies on the nature and operation of liquidated damages and penalty clauses in international contracts are contained in *Yearbook of the United Nations Commission on International Trade Law*, volume X: 1979, part two, I, C, and *ibid.*, volume XII: 1981, part two, I, B, 1. "Uniform Rules on Contract Clauses for an Agreed Sum due upon Failure of Performance" (hereinafter referred to as "Uniform Rules") adopted by the Commission are set forth in the Report of the United Nations Commission on International Trade Law on the work of its sixteenth session, *Official Records of the General Assembly, Thirty-eighth Session, Supplement No. 17 (A/38/17)*, annex I (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, volume XIV: 1983, part one, I, A). By its resolution A/RES/38/135 of 19 December 1983, the General Assembly recommended that States should, where appropriate, implement the Uniform Rules in the form of either a model law or a convention. The Uniform Rules may be used by parties in drawing up liquidated damages and penalty clauses.

systems, however, clauses fixing an agreed sum payable as compensation, or fixing an agreed sum to stimulate performance, or fixing a sum which has both those purposes, are in principle valid. The courts may have the power to reduce the agreed sum in specified circumstances, in particular if the amount is grossly excessive in the circumstances or if there has been part performance. The courts may also have the power to award additional damages when the actual damages exceed the agreed sum. In those legal systems the parties may not be permitted to derogate from the power of the court to reduce the agreed sum or to award additional damages.

8. [7] A committed party may fail to fulfil its countertrade commitment due to a permanent or temporary impediment for which it is not responsible (for a discussion of such impediments, see chapter XIII, "Failure to complete countertrade transaction", paragraphs 13 to 36). The rule in many legal systems is that the agreed sum is not due if the failure to perform the obligation in question is caused by a permanent impediment for which the obligated party is not responsible. Such an approach is *consistent with the rule on exemption from liability for failure to perform found in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79* (see also Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance, article 5 (see note 1)). If an impediment prevents performance of an obligation only temporarily, according to a rule found in many legal systems, the time period for performance of the obligation is extended. In the case of temporary impediments, payment under the liquidated damages or penalty clause would be due only for the countertrade commitment remaining unfulfilled after the lapse of the extended fulfilment period. The countertrade agreement may maintain the applicability of those rules and may contain provisions defining exempting impediments and providing a rule for determining when an impediment is deemed permanent (see chapter XIII, "Failure to complete countertrade transaction", paragraphs 17 to 34).

9. [8] Liquidated damages or penalty clauses should be distinguished from two other types of clauses, i.e. clauses limiting the amount recoverable as damages, and clauses providing alternative obligations. A clause limiting the amount recoverable as damages fixes a maximum amount payable if liability is proved. A plaintiff must prove the amount of its losses, and, if the amount falls below the maximum, only the amount proved is recoverable. In the case of liquidated damages or penalty clauses, the agreed sum is recoverable without proof of loss. A clause providing an alternative obligation gives the obligated party the option either of performing a specified obligation or paying an agreed sum. By exercising either option, the obligated party discharges the obligation. Under liquidated damages or penalty clauses, *the obligated party does not have the option of choosing between either performing the obligation or paying the agreed sum*. If there is any doubt as to whether it is intended that the committed party would have such an option, it is advisable that the question be settled in the clause.

10. [9] Clauses discussed in this chapter should also be distinguished from provisions in countertrade agreements

establishing the obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing claims for payment are to be set off. Such payments to liquidate imbalances serve the function of payment for goods delivered in one direction that were not compensated by deliveries in the other direction. Furthermore, the amounts of such payments are not set in advance as is the case with liquidated damages or penalties. (For a discussion of clauses concerning the settlement of imbalances in barter, see chapter III, "Contracting approach", paragraph 7, and in setoff arrangements, see chapter IX, "Payment", paragraphs 54 to 57.)

11. [10] As discussed in chapter VIII, "Participation of third parties", the countertrade party committed to purchase or to supply goods may have the right to engage a third party to fulfil that commitment. In some of those cases, it is agreed that the party originally committed is to remain liable for fulfilment of the countertrade commitment. When this is the case, the contract by which the third party is engaged may provide that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods. The purpose of payment of the agreed sum would be to indemnify the party originally committed for its liability for a breach of the countertrade commitment due to reasons imputable to the third party. The indemnification by the third party of the party originally committed could also take the form of a "hold-harmless" clause of the type discussed in chapter VIII, paragraph 37. Any commitment to conclude future supply contracts that is made by the third party directly to the countertrade party with whom those supply contracts are to be concluded may also be covered by a liquidated damages or penalty clause. (For a related discussion of the engagement of third parties, see chapter VIII, paragraphs 6, 17 and 18 (third-party purchasers), and paragraphs 49 to 51 (third-party suppliers)).

#### B. Relationship of recovery of agreed sum to recovery of damages

12. [11] Legal systems often regulate the relationship between the recovery of the agreed sum and the recovery of damages. Since one of the objectives of a liquidated damages or penalty clause is to avoid the difficulties of an inquiry into the extent of recoverable damages (see above, paragraph 6), under some legal systems the party to whom the agreed sum is owed is not permitted, in cases where recoverable damages under the rules relating to damages exceed the agreed sum, to waive the agreed sum and claim damages. Nor is the party owing the agreed sum permitted, in cases where the amount recoverable as damages is less than the agreed sum, to assert that that party should only be liable for damages. Under other legal systems, however, the party to whom the agreed sum is owed is permitted to prove that the losses exceed the agreed sum. In those legal systems the aggrieved party can, in addition to the agreed sum, recover damages to the extent that the loss exceeds the agreed sum, either unconditionally or subject to satisfying certain conditions (for example, that the failure of performance was negligent, or was committed with an intention to cause loss, or that there was an express agreement

that damages for the excess are to be recoverable). In view of such disparities among legal systems, and the differing perspectives from which a liquidated damages clause may be interpreted, it is advisable that the parties, to the extent permitted by the applicable law, settle in the clause the question whether the aggrieved party would be entitled to any damages beyond the agreed sum (Uniform Rules, article 7 (see note 1)). (For further discussion of monetary compensation for failure to fulfil the countertrade commitment, see chapter XIII, "Failure to complete countertrade transaction", paragraphs 11 and 12.)

### C. Effect of payment

13. [12] An important question for the parties to consider is whether, *by claiming the agreed sum, the beneficiary of the clause forsakes fulfilment of the underlying obligation*. Often the intention of parties to countertrade transactions is that the beneficiary who, in the case of breach of the countertrade commitment, chooses to claim the agreed sum is precluded from also claiming fulfilment of the countertrade commitment. However, since sometimes the parties intend that the agreed sum is to be payable for delay in fulfilment of the countertrade commitment, in which case the countertrade commitment remains outstanding despite payment of the agreed sum, it is advisable for the liquidated damages or penalty clause to contain a clear provision on the effect of payment of the agreed sum. In the absence of such a provision, the effect of payment would be determined by the applicable law and on the basis of circumstances that indicate the intent of the parties (e.g., the amount of the agreed sum) (Uniform Rules, article 6 (see note 1)).

14. [new paragraph] It should be noted that the nature of the obligation in question may determine whether performance could be enforced. In particular, performance of an obligation to provide services might be unenforceable under the laws of some States, thereby leaving compensation through monetary damages as the remedy.

15. [13] The parties may wish to provide for payment of an agreed sum for delay when it is particularly important for the countertrade commitment to be fulfilled by a specified date or for portions of the countertrade commitment to be fulfilled according to an agreed time schedule. The supplier may be interested in such a clause, for example, when the timely fulfilment of the countertrade commitment in one direction is essential for its ability to meet its payment obligations under the supply contract in the other direction. The purchaser may be interested in such a clause, for example, when a commitment has been made to resell the goods by a particular date. The amount of the agreed sum payable for delay is further discussed below in section D.

16. [14] The question of the effect of payment of an agreed sum would also arise when payment is due for a failure to fulfil the portion of a countertrade commitment allocated to a subperiod of the fulfilment period. In such cases it is advisable to make clear whether any payment is due under the liquidated damages or penalty clause for any unfulfilled portion of the countertrade commitment

that is not carried over or that remains unfulfilled upon the expiry of the overall fulfilment period, or whether any payment is due for any unfulfilled portion of the countertrade commitment that is carried over from one subperiod to the next.

### D. Amount of agreed sum

17. [15] The amount of the liquidated damages or penalty, *whether stipulated for non-fulfilment or for delayed fulfilment of the countertrade commitment*, may be expressed as an absolute amount or as a percentage of the value of the outstanding commitment. Calculating the amount on the basis of a percentage of the outstanding commitment has the advantage of automatically reducing the amount as the countertrade commitment is fulfilled. If there is an independent guarantee to secure payment of the agreed sum (see below, paragraph 27), in view of its independent nature, any reduction of the amount that might become due would not result in an automatic reduction of the amount of the guarantee. Therefore, in order to keep the amount of the guarantee in line with the underlying obligation, it is advisable for the terms of the guarantee to provide that any reduction in the countertrade commitment is to result, upon presentation of agreed documents, in a corresponding reduction in the amount of the guarantee (see chapter XII, "Security for performance", paragraphs 25 and 26). In the case of an accessory guarantee, a reduction in the underlying obligation would result in an automatic reduction of the amount owed under the guarantee (see chapter XII, paragraph 3).

18. [19] When the clause for the payment of liquidated damages or a penalty covers delay, an agreed sum to be paid is often fixed by way of increments, a specified amount being due for a specified time unit of delay. In such cases it is advisable that a limit be placed on the cumulative amount of the increments. The parties may wish to address the possibility that the failure to fulfil the commitment would continue after the limit is reached. One approach would be to provide that the beneficiary of the liquidated damages or penalty clause is not entitled to recover either further increments in the liquidated damages or penalty, or damages for losses suffered as a result of non-fulfilment of the countertrade commitment after the date on which the limit was reached. Under another approach, after the limit is reached, the beneficiary of the liquidated damages or penalty clause is still entitled to claim fulfilment of the commitment. In this case the parties may agree that if the committed party fails to fulfil the countertrade commitment within an agreed period after the cumulative limit has been reached, the beneficiary of the liquidated damages or penalty clause is entitled to claim an additional agreed sum for non-fulfilment of the commitment. Under either approach it is advisable to provide that the beneficiary of the liquidated damages or penalty clause is entitled to terminate the countertrade commitment once the cumulative amount of the payments for delay is reached.

19. [16] Determining the appropriate amount for the agreed sum presents certain difficulties. In a long-term countertrade transaction, it may be difficult to estimate at the time of the conclusion of the countertrade agreement

the losses that may be suffered at the time of a breach of the countertrade commitment, and accordingly it may be difficult to quantify the amount of the agreed sum that would make it either truly compensatory, or adequate to stimulate performance. From the point of view of the beneficiary of the liquidated damages or penalty clause, the agreed sum should not be fixed at such a low level that the beneficiary will suffer serious uncompensated losses upon a failure of the other party to fulfil the countertrade commitment. Furthermore, a sum that is less than what the obligated party would save by failing to fulfil the countertrade commitment would not serve as a stimulus to fulfil properly and on time. Indeed, it may serve as a stimulus not to do so. *[the following sentence is a revision of the first sentence in paragraph 18 in A/CN.9/WG.IV/WP.51/Add.3]* The beneficiary of the clause may find it useful to have the agreed sum set at a level that provides both reasonable compensation and, to the extent permitted by the applicable law, a moderate pressure to fulfil the commitment.

20. [18] Excessive sums should be avoided, as they may deter some potential trading partners from entering into a countertrade agreement. Excessive sums may also make it more difficult to find a third party willing to become involved in the fulfilment of the countertrade commitment subject to a "hold-harmless" clause (see above, paragraph 11, as well as chapter VIII, "Participation of third parties", paragraph 37). An excessive sum may also have no special deterrent effect if it can be predicted that in all likelihood it will be declared invalid or reduced in legal proceedings (see above, paragraph 7). Furthermore, a party committed to purchase goods and requested to accept an agreed sum set at a particularly high level may as a counterbalance seek a lower price for the goods that party is to purchase, or that party may seek a higher sale price for its own goods.

21. [18] Where the applicable law only permits an agreed sum to serve as compensation, parties should attempt to estimate as accurately as possible the losses the purchaser is likely to suffer. *[the following sentence is a revision of paragraph 17 in A/CN.9/WG.IV/WP.51/Add.3]* The parties should bear in mind that, under such laws, the amount of the agreed sum might be viewed by a court as an important factor in determining whether the obligation to pay the agreed sum was intended to compensate for damages or to stimulate performance (see above, paragraph 7). Any records relating to the basis of the estimate and the calculations should be preserved as evidence that the sum was not fixed arbitrarily. In addition, the parties may wish to include a statement in the countertrade agreement that the amount set in the clause represents a good faith estimate of the damages that would be suffered as a result of a breach of the countertrade commitment.

22. [18] In determining what sum is reasonable for an agreed sum to cover non-fulfilment of the countertrade commitment, parties may consider such factors as the price the supplier would obtain in a substitute sale, the price the purchaser would have to pay in a substitute purchase, losses that might result from non-fulfilment of the countertrade commitment, the extent of the risk that the

countertrade commitment will not be fulfilled and the fact that the sum should be substantial enough to induce performance.

23. *[new paragraph]* In determining what sum is reasonable for an agreed sum to cover delay in fulfilment of the countertrade commitment, parties may take into account circumstances that influenced the decision to include a liquidated damages or penalty clause in the countertrade agreement (see above, paragraph 15). For example, if the importer relies on timely counter-exports for repaying a bank loan, the basis for setting the amount of the agreed sum may be the financing costs that would have to be incurred as a result of late purchases under the countertrade agreement. If the counter-importer is to be the beneficiary of the liquidated damages or penalty clause, a relevant factor may be the consequences the counter-importer would face due to its inability to resell the countertrade goods by a particular date.

### E. Obtaining agreed sum

24. [20] The parties may wish to provide that the aggrieved party loses the right to claim the agreed sum if a claim is not made within a specified period of time following the expiry of the fulfilment period (e.g., thirty days). The purpose of such a provision is to resolve questions of liability for a failure to fulfil the countertrade commitment within a reasonable period of time following the expiry of the fulfilment period. The period of time for making a demand should be sufficient to permit the parties to determine whether fulfilment of the countertrade commitment has taken place. This would be of particular importance where actions fulfilling the countertrade commitment might be taken shortly before the close of the fulfilment period or where supply contracts are to be concluded with persons other than the party to whom the commitment is owed.

25. [21] In the case of a fulfilment period divided into subperiods, it is advisable that the countertrade agreement indicate whether payment of the agreed sum is due following each subperiod in which there has been a failure to fulfil or only at the end of the entire fulfilment period. If payment is due following each subperiod, a period of time following the expiry of each subperiod could be provided during which payment of the agreed sum could be claimed (see the preceding paragraph).

26. [22] Legal proceedings that might be necessary to recover the agreed sum entail time and expense. The need to institute legal proceedings may be reduced if the countertrade agreement authorizes the beneficiary to deduct the agreed sum from funds of the other party in the hands of the beneficiary or to set off the claim for the agreed sum against funds due by the beneficiary to that party. For example, when it is agreed that the proceeds of the export contract are to be held to pay for the counter-export contract, it may be agreed that the counter-exporter may withhold an amount equivalent to the agreed sum if the counter-importer fails to honour its commitment to enter into a contract for the purchase of counter-export goods (see chapter IX, "Payment", paragraphs 12 and 62). Where the beneficiary of the liquidated damages or penalty clause does not retain the proceeds

of a shipment in such a manner, the objective of securing payment of the agreed sum may be achieved by authorizing deduction from funds or claims that are unrelated to the countertrade transaction in question. It may be noted, however, that under some legal systems provisions authorizing deductions and setoff are regulated by mandatory rules. *One such rule found in the laws of a number of States is that a setoff is permitted only if the claims to be set off arose from the commercial relationship between the parties.* Furthermore, a deduction or a setoff might later be invalidated if the agreed sum deducted or set off was held by a court to be excessive, and was reduced.

27. [23] The beneficiary of the liquidated damages or penalty clause may wish to include a provision in the countertrade agreement requiring the other party to arrange for a financial institution to give a guarantee in respect of the agreed sum. The beneficiary could then claim the agreed sum from the financial institution according to the terms of the guarantee. *Such guarantees are typically of an independent nature, although the possibility of using an accessory guarantee is not excluded. For a discussion on independent guarantees, their distinction from accessory guarantees and on possible payment terms of guarantees, see chapter XII, "Security for performance", in particular paragraphs 3, 4 and 18.*

#### F. Termination of countertrade commitment and clauses for payment of agreed sum

28. [24] Parties may wish to provide that, where an agreed sum for delay is payable by way of increments with a limit on the cumulative amount recoverable (see above, paragraph 18), the countertrade commitment may not be terminated until the limit is reached on the ground of the failure to fulfil for which the agreed sum is provided.

29. [25] The parties may also wish to provide that termination after the limit is reached is not to affect any obligations to pay liquidated damages or penalties that became due prior to the termination. This would avoid the ambiguity that may result due to the rule in some legal systems that the termination of a contract affects obligations that became due prior to the termination of the contract. If, however, the countertrade commitment is terminated before the limit is reached (e.g., when the beneficiary of the liquidated damages or penalty clause terminates the countertrade commitment for a failure other than the one for which the agreed sum has been stipulated), the parties may wish to provide that the termination does not affect the right to recover an agreed sum due on the date of termination, but that no amount becomes due as the payment of an agreed sum after the termination.

[A/CN.9/362/Add.12]

## XII. SECURITY FOR PERFORMANCE

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[Editorial note: The present draft chapter is a revision of draft chapter XII, "Security for performance", published as document A/CN.9/332/Add.7. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in

document A/CN.9/332/Add.7 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.7 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

### A. General remarks

1. [1] *This chapter focuses on guarantees (also referred to in practice as "bonds" or "indemnities") in a countertrade transaction supporting the countertrade commitment. Guarantees supporting the performance of individual supply contracts are not specifically addressed since they do not raise issues particular to countertrade. In a given countertrade transaction, guarantees may be used to support the obligation to purchase goods, the obligation to supply goods, or both these obligations. Sometimes a guarantee supports the countertrade commitment by way of securing payment under a liquidated damages or penalty clause covering the countertrade commitment. Guarantees may also be used to support liquidation of imbalances in the flow of trade (below, paragraphs 40 to 48).*

2. [2] *Requiring guarantees may have the general advantage of preventing parties who are unreliable or who do not have sufficient financial resources from participating in the countertrade transaction. Guarantor institutions generally make careful inquiries about a party whose obligations they are asked to guarantee, and will normally provide guarantees only when they have reasonable ground for believing that the party can successfully perform the obligation. This may be of particular advantage to importers or exporters who are otherwise unable to determine whether a proposed counter-party is reliable.*

3. [3] *Depending upon its terms, a guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor is obligated to pay when the party to whom the underlying obligation is owed (the "beneficiary") presents to the guarantor the demand for payment and any additional document required under the terms of the guarantee. A required document may be, for example, a beneficiary's statement that the party who procures the guarantee (the "principal") is in breach of the underlying obligation, a beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person or entity stating that the breach of the underlying obligation has occurred. The third person or entity, designated in the guarantee or in accordance with the guarantee, may be, for instance, an expert, a supervisory body, an arbitral tribunal or a court. An independent guarantee assures the beneficiary that, upon presenting the demand and any required document, prompt payment will be made even if there remains disagreement between the principal and the beneficiary as to whether the underlying obligation has been breached. The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and any supporting document conform to the requirements specified in the guarantee. (For further discussion on possible payment conditions, see below, paragraph 18.) If the question arises whether the principal is entitled to the recovery of the amount paid on the ground that the underlying obligation had not been breached, that question would be determined in any subsequent proceedings between the principal and the beneficiary. Even though the guarantor's obligation to pay is independent from the underlying obligation, the payment claim by the beneficiary under the guarantee may,*

*in exceptional circumstances, be excluded under the law applicable to the guarantee, in particular when the claim by the beneficiary is fraudulent.*

4. [4] *Under an accessory guarantee, the guarantor must pay only when the principal is in fact in breach of the guaranteed obligation. Such accessory guarantees are referred to in national laws by terms such as "suretyship", "cautionnement", "fianza", and "Bürgschaft". The guarantor must, before paying a claim, ascertain whether the underlying obligation was breached in order to establish whether the claim is justified, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary.*

5. [5] *The discussion in this chapter is limited to independent guarantees, without thereby implying a preference for this type of guarantee. Generally, independent guarantees are used to support obligations set out in the countertrade agreement. While principals tend to prefer accessory guarantees, beneficiaries are normally reluctant to accept such guarantees because of the possible delays involved in obtaining payment. Moreover, guarantors, in particular banks, tend to prefer independent guarantees because they do not wish to investigate the performance of the underlying obligation. While the various legal regimes governing accessory guarantees are well established, independent guarantees, essentially a creation of banking and commercial practice, are not yet firmly established in all national laws and there is no uniformity as regards the extent to which independent guarantees are recognized.*

6. [6] *In some countries banks issue "stand-by letters of credit", which are the functional equivalent of independent guarantees. Accordingly, the discussion in the legal guide on guarantees for security for performance by the principal applies to stand-by letters of credit.*

### B. Guarantee provisions in countertrade agreement

7. [7] *When the parties decide to use a guarantee to support the countertrade commitment, they should include in the countertrade agreement certain basic provisions concerning the issuance and terms of the guarantee. The parties may also wish to consider appending to the countertrade agreement a form of a guarantee to be followed by the issuer in establishing the guarantee. In formulating the terms of the future guarantee in the countertrade agreement, the parties should be sure that the agreed formulation would be accepted by the guarantor.*

8. [8] *Typically it is the party committed to purchase whose commitment is supported by a guarantee. This is because the primary objective of that party in agreeing to a countertrade commitment is to secure a sale of its own goods, rather than to obtain goods from the other party. When the party committed to purchase goods has a particular interest in obtaining the goods, the supplier's commitment to conclude a contract for the supply of the agreed goods may be supported by a guarantee. As noted in paragraph 1, in some cases the countertrade agreement may require both the purchaser and the supplier to obtain guarantees to support their commitments. When the parties to*

the countertrade agreement foresee that a third person may assume the countertrade commitment, the parties may wish to consider whether the guarantee should be procured by the *third party or by the party originally committed* (see chapter VIII, "Participation of third parties").

9. [9] When the guarantee supports the principal's obligation under a liquidated damages or penalty clause, the question whether a payment under the guarantee would free the principal from liability for fulfilment of the countertrade commitment *or from liability for any damages beyond the amount of the guarantee* would be settled by the terms of the liquidated damages or penalty clause and the rules applicable to the clause (see chapter XI, "Liquidated damages and penalty clauses", sections B and C). When the guarantee does not support a liquidated damages or penalty clause and the parties intend, as is sometimes the case, that payment under the guarantee would have the effect of freeing the principal from the countertrade commitment or from liability for any damages exceeding the amount paid under the guarantee, they should state their intention in the countertrade agreement. Without a provision to this effect, it cannot be assumed that payment under the guarantee would free the principal from the countertrade commitment or from liability for damages. *It should further be noted that the fact that the obligation is supported by a guarantee does not give the obligated party the option of choosing between fulfilling the underlying contractual obligation and having the guarantee amount paid.*

### 1. Choice of guarantor

10. [10] The parties may wish to specify in the countertrade agreement a guarantor who would be acceptable to both parties. That would enable the beneficiary to be satisfied that the guarantee would be issued by a guarantor that had the necessary financial reserves and that was otherwise acceptable. The identification of the guarantor could be useful to both parties in that it would limit subsequent disagreements and enable the parties to know the cost of the guarantee at the outset.

11. [11] If the guarantor is not identified at the time of the conclusion of the countertrade agreement, the parties may provide, for example, that the guarantor *must* be a first class bank, be agreeable to the beneficiary or be an institution from the home country of one of the parties.

12. [12] A beneficiary may wish to have the guarantee issued by an institution in its home country because enforcement of a claim for payment against such an institution *might* be easier than against a foreign institution. However, requiring the use of a local guarantor *might* be disadvantageous to the extent that the principal *would be prevented* from using a guarantor with whom it has an established relationship and who *might* provide the same guarantee at a lower cost. *Furthermore, the guarantor in the beneficiary's country may require that reimbursement of any payment under the guarantee be secured by a bank acting in behalf of the principal, which may involve additional cost (see below, paragraph 14).*

13. [13] In some States, mandatory rules applicable to the beneficiary provide that a guarantee may be accepted

only if it is issued by a financial institution in the country or a financial institution authorized to issue guarantees involving payment in a foreign currency or if the selection of the guarantor is approved by the competent authority.

14. [new paragraph] When the guarantee is to be issued by a bank in the beneficiary's country, that bank will often issue the guarantee only if reimbursement is secured through the issuance of a "counter-guarantee". The counter-guarantee entitles the bank issuing the guarantee to claim prompt reimbursement from the counter-guarantor in accordance with the terms of the counter-guarantee. The counter-guarantee would often be issued by the principal's bank that has instructed the guarantor to issue the guarantee.

15. [new paragraph] A similar requirement that payment be guaranteed by a bank in the beneficiary's country may apply when the security takes the form of a stand-by letter of credit. Such a requirement may be met by confirmation by a local bank of the stand-by letter of credit issued by a foreign bank. The confirming bank would obtain reimbursement from the issuing bank. Also a security in the form of a guarantee is sometimes confirmed by a bank in the beneficiary's country. In the case of both a confirmed stand-by letter of credit and a confirmed guarantee, the beneficiary has an option between claiming payment from the confirming bank or from the issuing bank.

16. [14] There have been instances where an undertaking to pay a sum of money, termed a "guarantee", supporting the countertrade commitment or the payment of related liquidated damages or penalties has been made by the party whose countertrade commitment is to be guaranteed. The effect of such a "guarantee" is that the party-guarantor promises to pay the other party under the terms of the guarantee without raising any defence that could not have been raised by a third-party guarantor, and that it is up to the party-guarantor to sue for reimbursement of the funds paid if it is claimed that the underlying obligation had not been breached. Such a guarantee might be acceptable to the beneficiary if the guarantee is independent from the underlying transaction and is issued by a trading party whose commercial integrity and financial adequacy are regarded by the beneficiary as being beyond doubt. However, it is not clear that such a guarantee gives the beneficiary legal rights in addition to those arising from the obligation being guaranteed.

### 2. Conditions for obtaining payment under the guarantee

17. [15] The countertrade agreement should clearly set forth the conditions that have to be fulfilled in order for the guarantor to be obligated to pay, in particular, as to any documents that have to be submitted in support of a claim for payment. *If there is a lack of clarity, there is a greater likelihood that disputes would arise due to uncertainty as to whether the documents presented by the beneficiary conform to the terms of the guarantee.*

18. [16] The terms of an independent guarantee may provide that a demand for payment alone would suffice, *with the possible additional requirement* that the demand

would have to be accompanied by the beneficiary's statement concerning the breach. A general declaration to that effect may be sufficient. Alternatively, the beneficiary may be required to state more details, such as the nature of the principal's breach, that the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid. In addition to the demand for payment, the beneficiary may be required to present a document issued by a third person relating to the default by the principal; *such a document may be, for example, a certificate of an independent expert, an arbitral award or a first-instance court decision stating that the default has occurred.* The guarantee may provide that the requirement of a third-person statement would *not apply* if the principal makes an admission of default in writing. In all these cases, the guarantor merely ascertains whether the documents conform on their face to the requirements of the guarantee and is not to inquire into the underlying transaction. In particular, the guarantor is not to investigate whether the statements contained in a document are founded.

19. [17] Sometimes the parties agree that the beneficiary must notify the principal of the intention to call the guarantee and that the claim cannot be made before the expiry of a specified period of time following the notice. The purpose of such a notice requirement is to provide an opportunity to the principal to cure a breach or to settle a disagreement. A corollary guarantee term would require the beneficiary to submit with the demand for payment documentary evidence that notice had been given to the principal.

20. [18] Where the guarantee supports the payment obligation under a liquidated damages or penalty clause, the parties may wish to stipulate that among the payment conditions would be a requirement that the beneficiary *must* provide a statement that payment under the liquidated damages or penalty clause was due.

21. [19] In addition to documentary conditions, a guarantee will usually specify requirements that do not pertain to the performance of the underlying obligation. Such requirements, which do not involve the presentation of a document, most frequently concern the time period within which a claim can be made, the amount of the guarantee, and the office of the guarantor where the claim is to be submitted.

22. [20] It is advisable that the countertrade agreement, in addition to setting out the agreement of the parties as to the guarantee, provide that the beneficiary is entitled to claim under the guarantee only if there is in fact a failure to fulfil the commitment. Such a provision might facilitate recovery by the principal of losses suffered in the event that a claim is paid without there having been a breach of the underlying obligation.

### 3. Amount of guarantee and reduction of amount

23. [21] The parties should agree on the amount of the guarantee, as well as the currency in which it is to be denominated and payable. The amount of the guarantee is expressed as a specified amount or as a percentage of the value of the outstanding commitment. If the guarantee is to

support payment under a liquidated damages or penalty clause, the guarantee clause in the countertrade agreement may call for *the guarantee to cover* payment of the entire amount of the liquidated damages or penalty or of a portion thereof. The liquidated damages or penalty may itself be a certain percentage of the unfulfilled countertrade commitment. (*Concerning the amount of the liquidated damages or a penalty, see chapter XI, section D.*)

24. [22] In determining the amount of the guarantee, or of the liquidated damages or penalty covered by the guarantee, the parties would take into account factors such as the extent of the losses expected to be suffered in the event of non-fulfilment and the risk of failure to fulfil, as well as the limits which guarantors would usually observe in respect of similar contracts. Another factor may be the ease with which payment of a claim under the guarantee *could* be obtained. In this respect, the beneficiary generally has a trade-off to make. The closer the terms of the guarantee approach that of a simple demand guarantee and the easier it will be to obtain payment, the less willing the principal *might be to provide* a guarantee covering a high percentage of the countertrade commitment. On the other hand, if the documentary conditions are more difficult to meet when the principal has not breached the commitment (e.g., when an arbitral or court decision must be presented), the principal *might be* willing to agree on a higher amount for the guarantee.

25. [23] The parties may wish to include in the terms of the guarantee a mechanism to reduce the amount of the guarantee as fulfilment of the countertrade commitment progresses. Reduction of the guarantee amount would have the advantage of reducing the exposure under the guarantee and possibly the cost of the guarantee. If the guarantee secures payment of liquidated damages or a penalty, the provisions on the reduction of the guarantee should be consistent with any reduction mechanism for the sum of the liquidated damages or penalty.

26. [24] It is advisable that the reduction mechanism operate on the basis of the presentation to the guarantor of specified documents evidencing fulfilment of the countertrade commitment, without the guarantor being obligated to verify the degree to which the countertrade commitment has been fulfilled. These documents may include shipping documents, copies of supply contracts, purchase orders, letters of release or other documents recording fulfilment. The parties may also find it useful to stipulate the issuer of the documents and the party responsible for forwarding them to the guarantor. Where the fulfilment period is divided into subperiods, the parties may wish to provide that the guarantee will be reduced by the amount allocated for each subperiod and not claimed within the agreed period of time.

### 4. Time of providing guarantee

(a) *At entry into force of countertrade agreement or shortly thereafter*

27. [25] The parties are advised to agree on the point of time when the guarantee is to be issued. It may be agreed, for example, that the guarantee should be issued to the

beneficiary when the countertrade agreement enters into force or shortly thereafter (e.g., thirty days after entry into force of the countertrade agreement). The parties may obtain assurance that the guarantee would be procured at the agreed time by providing that the countertrade agreement would not enter into force without procurement of the guarantee or that the principal would be deemed to have breached the countertrade commitment if the guarantee was not procured within the agreed period of time.

28. [26] When a contract in one direction (export contract) is concluded together with the countertrade agreement, the parties could agree that the issuance of a guarantee supporting fulfilment of the countertrade commitment is a condition for the entry into force of the export contract. Such a provision would assure the importer of not being bound under the export contract before issuance of a guarantee to support the countertrade commitment.

#### (b) *Later in fulfilment period*

29. [27] The parties may agree that the guarantee *would only* have to be procured at a certain date later in the fulfilment period *if by that time* fulfilment of the commitment was not yet completed. The agreed date may be, for example, three months before the end of the fulfilment period or three months before the end of each yearly segment of a multi-year fulfilment schedule. This approach has the advantage that the amount of the guarantee could be calculated as a percentage of the then outstanding countertrade commitment. By making the amount of the guarantee dependent on the outstanding balance rather than on the entire countertrade commitment and by limiting the length of time during which a guarantee is in effect, the extent of exposure under the guarantee as well as the cost of the guarantee are likely to be reduced.

30. [28] Since such an approach exposes the beneficiary to the risk that the guarantee will not be procured, the parties may wish to agree on the beneficiary's rights in the event the guarantee is not procured as agreed. It may be agreed that the beneficiary would be permitted to regard the countertrade commitment as breached and to claim payment under a liquidated damages or penalty clause. Furthermore, it might be agreed that the beneficiary would be entitled to deduct the amount of the liquidated damages or penalty from any amounts becoming due under the export contract after the failure to procure the guarantee.

### 5. *Duration of guarantee*

#### (a) *Expiry date*

31. [29] It is advisable for the parties to agree on the clause that should be included in the guarantee concerning the length of time the guarantee is to remain in force. It should be noted that, in view of the independence of the guarantee from the underlying countertrade agreement, the clause in the countertrade agreement concerning the period of validity of the guarantee will not determine the duration of the guarantee as specified in the guarantee. Guarantees usually contain a fixed expiry date. Another

possibility would be to provide for an open-ended guarantee that would terminate only when the countertrade commitment was fulfilled or the committed party was otherwise released from the commitment (see chapter IV, "Countertrade commitment", paragraphs 35 to 37). It should be noted that most guarantors would be willing to issue guarantees only if the expiry date is fixed. It should also be noted that the laws of some States contain mandatory rules governing the validity period of guarantees.\*

32. [30] It is advisable that the expiry date of the guarantee fall after the end of the period for the fulfilment of the countertrade commitment. A period of time between expiry of the fulfilment period and expiry of the guarantee (e.g., thirty days) would allow the beneficiary to await the conclusion of supply contracts until the close of the fulfilment period without foregoing the possibility of claiming payment under the guarantee. Furthermore, the beneficiary, at its discretion, would be able to allow minor delays attributable to the principal in the fulfilment of the countertrade commitment without foregoing the possibility of claiming payment under the guarantee. At the same time, if kept relatively short, the interval would allow the liability of the guarantor to be resolved relatively soon after the alleged non-fulfilment of the countertrade commitment has taken place. The parties may also wish to apply such an approach in relation to guarantees covering subperiods of a fulfilment period.

33. [new paragraph] In the absence of a provision in the guarantee defining the effect of the expiry date, it is widely understood that a demand for payment, accompanied by any required documents, must be made before or on the expiry date, and that, accordingly, the guarantor is not obligated to pay any demand made after that date. However, according to the interpretation of courts of some jurisdictions, absent a provision to the contrary, the demand for payment can validly be made after the expiry date, provided that the contingency for which the guarantee had been given has occurred before or on the expiry date. Under such an interpretation, a demand for payment may be made either within a reasonable period of time after the expiry date or, according to some courts, even during a period of limitation or prescription.

[31] \*

#### (b) *Return of guarantee instrument*

34. [32] In some States a guarantee may remain in force even after the expiry date if the guarantee instrument is not returned by the beneficiary. The countertrade agreement should therefore obligate the beneficiary to return the guarantee promptly upon fulfilment of the guaranteed obligation. However, the obligation to return the guarantee should be drafted so as not to imply that if the guarantee is not returned it remains in force even after the expiry date.

#### (c) *Extension*

35. [33] For various reasons, the time period for fulfilment of the countertrade commitment may be extended and as a result continue beyond the expiry date of the guarantee

(see chapter IV, "Countertrade commitment", paragraphs 13 to 16, concerning extension of the fulfilment period). The countertrade agreement might provide that, if the fulfilment period is extended, the principal would be obligated to arrange within a reasonable period of time a corresponding extension of the guarantee. Alternatively, the guarantee might provide for an automatic extension to cover any extension of the underlying fulfilment period agreed to by the parties. However, such a provision might not be acceptable to a guarantor who *did not* wish to be bound by a guarantee the duration of which would depend on an agreement to which the guarantor was not a party.

36. [34] With respect to the cost of extending the period of validity of the guarantee, the parties may wish to agree that the party responsible for the extension of the fulfilment period would be obligated to bear the costs of the extension of the guarantee period.

#### 6. Modification or termination of countertrade agreement

37. [35] In national laws that recognize the agreement of the parties to establish an independent guarantee, an independent guarantee would remain in effect as stipulated regardless of changes in the underlying commitment. If the change in the underlying contract affects the possibility to obtain the documents required to support of the payment claim under the independent guarantee, it should be ensured that the change in the underlying contract is reflected by a corresponding modification of the guarantee terms.

38. [36] Under some national laws that do not fully recognize an independent guarantee, an alteration of the underlying commitment may result in the release of the guarantor; under other such national laws, the guarantee may be deemed to cover only the commitment of the principal existing at the date of issuance of the guarantee. With a view to avoiding undesired consequences, the parties may provide that the guarantee would remain in force despite modifications of the countertrade agreement.

39. [37] The modification of the countertrade agreement may extend the liability of the principal beyond the amount of the guarantee. The parties may wish to provide in the countertrade agreement that in those cases the principal would be obligated to ensure that the amount of the guarantee would be modified accordingly.

#### C. Guarantee for imbalance in trade

40. [38] The parties may agree that goods will be shipped in exchange for goods and that the shipments in each direction will not be paid for in money. This type of transaction may be based on a charter contract (see chapter III, "Contracting approach", paragraphs 3 to 8) or on the setoff of countervailing claims for payment (see chapter IX, "Payment", section D). In such cases a supplier runs the risk that the value of its shipments may exceed the value of goods received from the other party and that this imbalance is not liquidated, either by supplies of goods or through payment in money. In order to address this risk,

the parties may use guarantees to secure liquidation of an imbalance that may develop in the flow of trade. *It may be agreed that the imbalance should be liquidated at the end of the period for the fulfilment of the countertrade commitment or at specified points of time during that period.*

41. [39] The amount of the guarantee should be linked to the amount of the imbalance in the flow of trade, with an upper limit. This upper limit for the guarantee could be set at the level of imbalance permitted under the countertrade transaction. It may be agreed that the amount that could be claimed under the guarantee would cover less than the full extent of the imbalance (e.g., 80 per cent). The purpose of such an approach would be to discourage the calling of the guarantee except as a last resort. A beneficiary who *could not* recover the full amount of the imbalance by calling the guarantee would have a greater incentive to achieve the agreed balance in the flow of trade through ordering goods from the other party.

42. [new paragraph] When a third person holds information concerning the flow of the deliveries between the parties (e.g., the bank administering the setoff account), it can be stipulated in the guarantee that a demand for payment must be accompanied by a statement by that third person certifying the amount of the outstanding imbalance. Furthermore, the guarantee can stipulate that the guarantor is authorized to pay a demand only up to the amount of the certified imbalance.

#### 1. Guarantee for shipment in one direction

43. [41] Where a particular sequence of shipments in the two directions is stipulated, the countertrade agreement may provide that the party scheduled to receive goods first must provide a guarantee supporting the obligation to ship goods in return. This guarantee would cover the risk taken by the party that ships first that the return shipment fails to take place by the agreed date or is not of the agreed value or quantity. When the first shipment is to take place in stages, it may be agreed that with each partial shipment a separate guarantee is to be provided corresponding to the value of that shipment; alternatively, *the parties and the guarantor may agree that the guaranteed amount will increase* upon the presentation of documents evidencing additional shipments.

44. [41] With respect to the timing of the issuance of the guarantee, the countertrade agreement may provide that the guarantee is to be handed over to the beneficiary in exchange for the shipping documents relating to the first delivery. Such a procedure would safeguard against the possibility that the party scheduled to ship first *would be given the guarantee but would then fail to ship*. In order to ensure that the beneficiary of the guarantee (the party that has shipped first) would not be in a position to claim payment under the guarantee once the principal (the party shipping second) has fulfilled its obligation to ship goods, the countertrade parties may agree that the beneficiary of the guarantee would obtain documents of title to the second shipment only upon surrender of the guarantee instrument.

45. [42] Guarantees may be used in a similar fashion in multi-party countertrade transactions. When the parties link deliveries in such a fashion that the importer, in exchange

for goods received from the exporter, ships goods to a third-party counter-importer, the third-party counter-importer pays the exporter (see chapter IX, "Payment", *paragraph 68*). The guarantee, provided by the importer, would support the obligation to counter-export after receiving the export goods. When the exporter is to be paid by the counter-importer upon shipment of the export goods, the counter-importer would be the beneficiary of the guarantee. Such a guarantee would cover the risk taken by the counter-importer in paying the exporter prior to receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon receipt of the counter-export goods, the exporter would be the beneficiary of the guarantee. Such a guarantee would cover the risk that the exporter, having shipped goods, failed to be paid by the counter-importer because the counter-export did not take place.

46. [43] A similar guarantee may be used when the exporter, instead of being paid by the importer, receives goods from a third-party counter-exporter, who in turn is paid by the importer (see chapter IX, *paragraph 68*). In this case, it may be agreed that the exporter would be given a guarantee covering the risk that, having shipped first, the exporter failed to be compensated by a shipment of goods from the counter-exporter.

47. [44] A guarantee may be employed in a similar fashion when both the counter-importer and the counter-

exporter are separate parties from the exporter and the importer (see chapter IX, *paragraph 69*). It may be agreed that the importer must provide a guarantee to the exporter to support the importer's obligation to pay the price of the export goods. When the exporter is to receive payment from the counter-importer upon shipment of the export goods, the beneficiary would be the counter-importer. This would protect the counter-importer against the risk of paying the exporter without receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon shipment of the counter-export goods, the beneficiary of the guarantee would be the exporter. This would protect the exporter against the risk of shipping goods without being paid.

## 2. Mutual guarantees

48. [45] When the parties agree to exchange goods for goods, they may do so without stipulating a particular sequence in which the shipments in the two directions should take place. This is particularly likely when multiple shipments in each direction are envisaged. In such situations, both parties encounter the risk of an imbalance in the flow of trade which needs to be redressed either through the shipment of goods or through the payment of a sum of money. To address this risk, it may be agreed that each party is to provide a guarantee to secure liquidation of an imbalance in favour of the other party.

[A/CN.9/362/Add.13]

## XIII. FAILURE TO COMPLETE COUNTERTRADE TRANSACTION

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[*Editorial note:* The present draft chapter is a revision of draft chapter XIII, "Failure to complete countertrade transaction", published as document A/CN.9/WG.IV/WP.51/Add.4. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.4 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.4 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

## A. General remarks

1. [1] This chapter discusses remedies for non-fulfilment of the countertrade commitment (sections B and C). *The chapter* also discusses circumstances in which a party would be exonerated from liability for a failure to fulfil the countertrade commitment (section D). A further issue discussed in the present chapter is the effect of a failure to fulfil the countertrade commitment or of the failure to perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section E). Not discussed are remedies for non-performance of a supply contract concluded pursuant to the countertrade agreement, since such remedies are of a type available under contract law generally and do not raise issues specific to countertrade.

2. [*new paragraph*] The discussion in this chapter is set in the context of "firm" countertrade commitments, i.e., commitments in which a party undertakes to actually conclude a supply contract in accordance with the terms stipulated in the countertrade commitment. As noted in chapter IV, paragraph 2, the Legal Guide does not deal with countertrade commitments containing a lower degree of commitment (e.g., "best efforts" or "serious intention" types of commitment), under which the undertaking is limited to an obligation to negotiate in good faith without promising that a contract will actually be entered into.

3. [2] Failure by a party to fulfil its obligations under the countertrade transaction could have serious repercussions for the other party. The repercussions may be, for example, that a prospective supplier will not earn convertible funds planned to be used for the purchase of other goods, that a prospective supplier will be hampered in carrying out its plan to introduce countertrade goods into new markets, or that a prospective purchaser will not receive goods to be resold in order to pay for goods shipped in the other direction.

4. [3] It is advisable that the countertrade agreement stipulate the remedies for a failure to fulfil the countertrade commitment. National laws generally do not contain rules specifically tailored to countertrade, and general rules applicable to contractual obligations may not provide satisfactory answers when problems occur in fulfilling the countertrade commitment. The remedies that the parties might wish to address in the countertrade agreement include release from the countertrade commitment and liquidated damages or a penalty (see below, paragraphs 5 to 13). It is also advisable that the countertrade agreement define the circumstances in which a party would be exonerated

from liability for a failure to fulfil the countertrade commitment (see below, paragraphs 14 to 37).

5. [4] The remedies for non-fulfilment of the countertrade commitment that the parties have decided to include in a countertrade agreement may not be appropriate in every circumstance. Therefore, while a party has the right to insist upon the remedies set forth in the countertrade agreement, the parties may find it desirable to negotiate in the light of the available remedies before resorting to the procedures available to enforce them (see discussion on negotiation in chapter XV, "Settlement of disputes", paragraphs 8 to 11).

## B. Remedies

### 1. Release from part or all of countertrade commitment

6. [5] There are various circumstances in which a party may be released from its obligations under the countertrade commitment. Such a release can result from a payment of liquidated damages or a penalty stipulated in the countertrade agreement for non-fulfilment of the countertrade commitment (*see chapter XI, "Liquidated damages and penalty clauses", paragraph (12)*) or when the countertrade commitment is terminated after the payment of liquidated damages or a penalty covering delay have reached the agreed cumulative limit (*see chapter XI, paragraph (19)*). A release of a party may also result when an action or omission by the other party causes the failure to fulfil the commitment (see paragraph 6 below). A further ground for a release may be the occurrence of circumstances that the applicable law or the countertrade agreement defines as exempting impediments (see paragraphs 14 to 37 below). Yet another situation in which a party may be released is when the supply contract in the other direction is terminated (see paragraph 48 below). A party may be released from all of the unfulfilled countertrade commitment or from only a portion thereof. If the circumstances that give rise to the release affect only a portion of the unfulfilled countertrade commitment, the remaining portion of the countertrade commitment remains in effect.

7. [6] A party may be entitled, in accordance with legal rules generally applicable to the breach of a contractual obligation, to be released from the countertrade commitment if the other party fails to take the action necessary to fulfil the commitment. Nevertheless, the parties may wish to address in the countertrade agreement the question of the release from the countertrade commitment in order to establish a clear understanding as to the instances in which a party is to be released and as to the extent of release. This could take the form of a clause to the effect that, if the party committed to supply breaches its obligation to make available a portion or all of the goods in accordance with the terms of the countertrade agreement, the party committed to purchase is released from an equivalent portion or all of the countertrade commitment. Similarly, the parties may wish to agree that, if the party committed to purchase breaches its obligation to purchase a portion or all of the goods made available in accordance with the terms of the countertrade agreement, the party committed to supply is released from an equivalent portion or all of the

countertrade commitment. When the parties so agree, they may wish to establish a notice requirement. Such a requirement might specify that the aggrieved party has to deliver a notice to the party in breach specifying the breach and informing the party in breach that the aggrieved party would be released from its obligations under the countertrade commitment to the extent that the breach was not remedied within a period of time specified in the notice or in the countertrade agreement. The period of time should be of a sufficient length to allow the remedying of the breach. The parties may wish to provide that the period of time commences to run from the date of the delivery of the notice. The parties may wish to consider whether it would be desirable to provide that, for the release to take effect, a second written notice would have to be delivered by the party claiming release.

8. [7] Sometimes the countertrade agreement sets subperiods within the fulfilment period in which specified portions of the countertrade commitment must be fulfilled (for a discussion of such subperiods, see chapter IV, "Countertrade commitment", paragraphs 17 to 20). Such schemes often provide that a committed party that fails to fulfil the commitment allocated to a given subperiod may carry over a portion of the unfulfilled commitment to the following subperiod and that the party in breach must pay liquidated damages or a penalty on the unfulfilled portion that is not carried over. In such cases it may be provided that the party in breach is to be given an additional period of time, after the expiry of the subperiod, to remedy the breach (see the preceding paragraph).

9. [8] It should be noted that, *as to the termination of contracts as a result of a breach*, some national laws contain special requirements. For example, it may be required that additional time be granted to remedy the breach, that notice of intent to terminate be given, or that judicial consent be given. *To the extent a countertrade agreement is regarded as governed by the rules applicable to contracts, those requirements would be applicable.*

10. [9] The countertrade agreement may provide that, if a release results from circumstances not attributable to either party (e.g., an exempting impediment), each party is to bear its own expenses and losses.

## 2. Monetary compensation

[10] \*

[11] \*

11. [12] It might be possible for the party who suffered loss as a result of a failure to fulfil a countertrade commitment to claim, on the basis of legal rules generally applicable to a breach of a contractual obligation, damages from the party who failed to fulfil the commitment. The problem of liability for failure to fulfil a countertrade commitment raises the question of pre-contractual liability. The answer to this question is often not clear in *national laws*, the approaches to the question differ under *the laws of various States*, and in *some States* the law of pre-contractual liability is undeveloped. A further source of uncertainty is the

basis on which the extent of the damages would be calculated. If the important terms of the future supply contract (in particular type, quality and price of goods) are not sufficiently defined in the countertrade agreement, there would be an insufficient basis on which to calculate damages resulting from a failure to conclude that contract.

12. [new paragraph] If the parties agree that a party should obtain monetary compensation as a result of non-fulfilment of the countertrade commitment, they may, in order to avoid the uncertainties mentioned in the previous paragraph, include in the countertrade agreement a clause on liquidated damages or a penalty (see chapter XI, "Liquidated damages and penalty clauses").

[12] \*

## C. Exempting impediments

13. [14] During the course of the period for fulfilment of the countertrade commitment, events may occur that impede a committed party to conclude an envisaged supply contract. An impediment may be of a legal nature, such as a change of regulations in the purchaser's or the supplier's country prohibiting the import or export of certain types of goods. An impediment may also be of a physical nature, such as a natural disaster preventing the production, transport or taking delivery of countertrade goods. Impediments may prevent fulfilment of the countertrade commitment permanently or only temporarily. The party who fails to fulfil its countertrade commitment due to an impediment may, subject to the applicable law and to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or be released altogether from the countertrade commitment, and be exonerated from liability to pay damages. Impediments that give rise to such an exemption are referred to in the Legal Guide as "exempting impediments".

14. [15] Many *national laws* contain rules concerning exempting impediments. *If an event impeding fulfilment of the countertrade commitment has the characteristics set forth in the applicable law (such as that the event was unforeseeable and unavoidable) the parties would be released from the commitment as a result of those rules.* However, those rules may lead to results that are incompatible with the circumstances and needs of international countertrade transactions or do not allocate the risk of occurrence of exempting impediments as desired by the parties. Therefore, the parties may wish to include in their countertrade agreement an exemption clause defining exempting impediments and specifying the legal consequences of those impediments. It is advisable for the parties to select terminology that is, in the light of the applicable law, consistent with their intentions (see chapter V, "General remarks on drafting", paragraph 6).

15. [16] In the negotiation of the clause in the countertrade agreement on exempting impediments, it is in the interest of each party to have included in the clause the types of exempting impediments that could affect the ability of that party to take the actions required to fulfil the countertrade commitment. For example, the party commit-

ted to purchase would be interested in covering impediments such as import restrictions and physical impediments to the taking of delivery or the use of the goods. The party committed to supply goods would be interested in covering impediments such as restrictions on goods permitted to be exported in countertrade transactions and other export restrictions and certain impediments affecting the ability to produce the goods. *Under the generally accepted principle of freedom of contract, the parties have latitude to agree on which of the parties is to bear the risk that a particular type of event that impedes performance may occur. Accordingly, they could exclude from the list of exempting impediments events that would be treated as exempting impediments by the applicable law and to include other events that would not be so treated by the applicable law. It should be noted, however, that some national laws establish mandatory limits to the freedom of a party to waive its right to rely on exempting impediments recognized under the law.*

16. [17] The treatment in various national laws of the subject of exemption differs with respect to the conceptual underpinnings of the subject and the terminology used. In relation to exemptions in the context of sales contracts, those differences have been bridged by the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), article 79.<sup>1</sup> The approach adopted in that Convention has been designed to take into account the particular circumstances and needs of international trade. The parties may find that approach to be a useful guide in formulating an exemption clause in a countertrade agreement. The discussion in this chapter of the legal consequences of exempting impediments and the definition of exempting impediments is based upon the approach taken in the Convention.

### 1. Legal consequences of exempting impediments

17. [18] The parties may wish to provide that, when fulfilment of the countertrade commitment is prevented by exempting impediments not exceeding a specified duration (e.g., 6 months), the fulfilment period would be extended for a period of time corresponding to the duration of the impediment. The purpose of such a provision would be to ensure that exempting impediments of a limited duration would not release the parties from the countertrade commitment. The parties may wish to stipulate in the countertrade agreement that, if an exempting impediment invoked by a party lasts longer than a specified duration, the other party may claim release from the countertrade commitment, or it may be agreed that either party may do so. The parties may wish to include in such a stipulation the obligation to engage in negotiations aimed at modifying the countertrade agreement in order to preserve the countertrade commitment.

18. [19] As discussed in chapter XI, "Liquidated damages and penalty clauses", paragraph [7], in order to eliminate any uncertainty, the parties may wish to provide ex-

pressly that a party failing to fulfil the countertrade commitment due to an exempting impediment is exempt from the payment of liquidated damages or penalties, or of any damages that would otherwise be due under the applicable law.

### 2. Defining exempting impediments

19. [20] *While many national laws contain definitions of exempting impediments, the parties may wish, for reasons noted above in paragraph [15], to include in the countertrade agreement a definition of exempting impediments. The parties may wish to adopt one of the following approaches: (a) providing only a general definition of exempting impediments; (b) combining a general definition with a list of exempting impediments; (c) providing only an exhaustive list of exempting impediments.*

#### (a) General definition

20. [21] A general definition of exempting impediments would enable the parties to ensure that all events having the characteristics set forth in the definition would be considered as exempting impediments. The purpose of a general definition is also to exclude events that do not meet those characteristics. This approach would avoid the need to compile a list of exempting impediments, and would avoid the risk of omitting from the list events that the parties would have considered as exempting impediments. On the other hand, it could be difficult in some cases to determine whether or not a particular event was covered by the general definition.

21. [22] The parties may wish to clarify in the definition that fulfilment of the countertrade commitment must be prevented by a physical or legal impediment (see above, paragraphs 14 and 15), and not, for instance, only made inconvenient or more expensive. It should be noted, however, that a change in circumstances may occur that makes fulfilment of the countertrade commitment, while still physically possible, excessively costly, beyond what a party could be expected to have foreseen and to have to bear. Such an extreme change in circumstances may be regarded under the applicable law as an exempting impediment. In addition, the parties may wish to provide that the impediment must be beyond the control of the party failing to fulfil a countertrade commitment and that that party could not reasonably be expected to have taken the impediment into account at the time the countertrade agreement was entered into or to have avoided or overcome the impediment or its consequences (*this wording is modelled on article 79 of the United Nations Sales Convention*).

22. [23] Contractual clauses on exempting impediments sometimes merely list a number of exempting impediments and indicate that other similar events would also be considered as exempting impediments. In such a clause, the listed events serve as an indication whether an event not included in the list should be regarded as an exempting impediment. Nevertheless, inclusion of a general definition in the clause is likely to reduce uncertainty as to whether an event not included in the list should be regarded as an exempting impediment.

<sup>1</sup>Official Records of the United Nations Conference on Contracts for the International Sale of Goods (document A/CONF.97/18, annex 1); Yearbook of the United Nations Commission on International Trade Law, vol. XI:1980, part three, B.

(b) *General definition with list of exempting impediments*

23. [24] A general definition of exempting impediments might be followed by either an illustrative or exhaustive list of events that are to be regarded as exempting impediments. This approach would combine the flexibility afforded by a general definition with the certainty arising from the specification of exempting impediments.

(i) *General definition with illustrative list*

24. [25] Examples of exempting impediments to be included in an illustrative list may be chosen so as to clarify the scope of the general definition. Such an approach could give guidance as to the intended scope of the general definition and ensure that the events set forth in the list would be treated as exempting impediments if they meet the criteria set forth in the general definition.

(ii) *General definition with exhaustive list*

25. [26] A general definition of exempting impediments might be followed by an exhaustive list of events that are to be regarded as exempting impediments if *in a given case* they meet the criteria contained in the definition. An exhaustive list may be inadvisable unless the parties are certain that they can foresee and list all events which they would wish to be regarded as exempting impediments.

(iii) *General definition with list of exempting impediments whether or not they come within definition*

26. [27] A general definition of exempting impediments might be followed by a list of events that are to be regarded as exempting impediments whether or not they come within the general definition. This approach may be useful where parties choose a narrow general definition of exempting impediments, but wish certain events that do not fall within the scope of that definition to be regarded as exempting impediments. Since those events would constitute exempting impediments independently of the general definition, the remarks in paragraph 28 below, concerning safeguards that may be adopted when providing a list of exempting impediments without a general definition, are also applicable here.

(c) *Exhaustive list of exempting impediments without general definition*

27. [28] It is possible for an exemption clause simply to provide an exhaustive list of events that are to be considered exempting impediments, without a general definition. This approach has the disadvantage of not providing general criteria in a definition that the listed events must meet in order to be regarded as exempting impediments. Since such general criteria are not provided, it is advisable for the parties to describe the exempting impediments on the list as precisely as possible. The advantage of such precision is certainty as to the allocation of risk between the parties.

(d) *Possible exempting impediments*

28. [29] If the parties set forth in the exemption clause a list of events that are to be considered exempting impediments,

with or without a general definition, they may wish to consider whether it is desirable to include events such as fire, explosion and trade embargo. Furthermore, the parties may wish to narrow the scope of the events listed below.

29. [30] *Natural disasters.* Natural disasters such as storms, cyclones, floods or sandstorms may be normal conditions at a particular time of the year at the relevant location. In such cases, the countertrade agreement contract might preclude a party from invoking them as exempting impediments if they were foreseeable and if effective counter-measures could have been taken (see paragraph 23 above).

30. [31] *War (whether declared or not), other military activity or civil unrest.* It may be difficult to determine when a war, other military activity or civil unrest can be considered as preventing performance of an obligation. For instance, hostilities may be taking place in the country of a party, but, if commercial activities by that party continue, the hostilities may not actually prevent a party from fulfilling the countertrade commitment. If the countertrade agreement does not contain a general definition of exempting impediments, it may be desirable to specify clearly when a war, other military activity or civil unrest is considered to prevent fulfilment of a countertrade commitment.

31. [32] *Strikes, boycotts, go-slows and occupation of factories or premises by workers.* The parties may wish to consider whether and the extent to which these events are to be considered as exempting impediments. On the one hand, such events could in a real sense prevent a party from fulfilling its commitment. On the other hand, the parties might consider that it would not be advisable for a party to be exempted from the consequences of a failure to fulfil a commitment when the failure resulted from the conduct of its own employees. In addition, it may be difficult to determine whether or not strikes by employees and other labour disputes are avoidable by a party, and what measures the party might reasonably be expected to take to avoid or to end the strike or dispute (e.g., meeting the strikers' demands). \*

32. [33] *Shortages of raw materials needed in production.* The parties may wish to consider whether this is to be considered as an exempting impediment. They might, for example, consider that it is the obligation of a party to procure raw materials in time and, therefore, preclude a claim for an exemption if the raw materials had not been procured. In some cases, the party may fail to have the materials available on time due to a delay by its supplier. For those cases, however, it would be advisable for the party to ensure that the contract with its supplier of the materials provides for damages for failure to supply the materials.

(e) *Exclusion of impediments*

33. [34] Whichever approach to defining exempting impediments is adopted, the parties may wish further to clarify the scope of an exemption clause by expressly excluding some events. For example, the parties may wish to

exclude from exempting impediments events that occur after a breach of the countertrade commitment by a party and that, but for the breach, would not have prevented fulfilment of the commitment by that party.

34. [35] The parties may wish to consider whether certain acts of a State or of State organs are to be regarded as exempting impediments. A party may be required to secure a licence or other official approval for the conclusion of a supply contract. The countertrade agreement might provide that, if the licence or approval is refused by a State organ or if it is granted but later withdrawn, the party that was required to obtain the licence or approval cannot rely on the refusal or withdrawal as an exempting impediment. The parties might consider that it is equitable for the consequences of the absence of the licence or approval to be borne by the party that had the duty to obtain it, since that party undertook the countertrade commitment knowing of the necessity to obtain the licence or approval and the possibility of its being refused. Moreover, it might be difficult for the other party to determine whether the measures taken to obtain the licence or approval were reasonable (see paragraph 23 above). *The parties may wish to stipulate the circumstances in which the party who is required to obtain the licence could be exonerated by proving that the licence was refused or withdrawn for a reason not attributable to that party (for example, when after the conclusion of the countertrade agreement the Government imposed a licence requirement or changed its policy regarding granting or withdrawing licences).*

### 3. Notification of impediments

35. [36] It is desirable for the countertrade agreement to clarify that a party invoking an exempting impediment must give written notice of the impediment to the other party without undue delay after the party invoking the impediment learned of the occurrence of the impediment. This notification could facilitate the taking of measures by the other party to mitigate any loss. *Such an obligation of notification and mitigation of losses exists under the general principles of contract law of many national laws.* It may be required that the notice specify details of the impediment, together with evidence that the fulfilment of a countertrade commitment by the party is prevented or is likely to be prevented, and, if possible, the anticipated duration of the impediment. The party invoking the exempting impediment might also be required to continue to keep the other party informed of all circumstances that may be relevant for an ongoing appraisal of the impediment and its effects, and to notify the other party of the cessation of the impediment. It may be provided that a party who fails to notify the other party in time of the exempting impediment loses the right to invoke the exempting impediment. Alternatively, it may be provided that a party who fails to give the required notification in time remains entitled to invoke the clause, but is liable to compensate the other party for losses resulting from the failure. The countertrade agreement might also provide that an exempting impediment, or certain types of exempting impediments, must be verified, for example, by a public authority, notary public, a consulate or chamber of commerce in the country where the impediment occurred.

36. [37] Further, the parties may wish to provide that, upon notification of an exempting impediment, they are to consider *jointly* what measures to take in order to prevent or limit the effects of the impediment, and to prevent or mitigate any loss that may be caused by it. These measures might include renegotiation of the countertrade agreement (see paragraph 18 above).

### D. Effect on countertrade transaction of failure to conclude or perform supply contract

37. [38] A basic feature of a countertrade transaction, as noted in chapter II, paragraph 1, is the link between the supplies of goods in the two directions in that the conclusion of the contract for the supply of goods in one direction is conditioned upon the conclusion of the contract for the supply of goods in the other *direction*. In view of this link, a question may arise whether a failure to conclude a supply contract or a failure to perform an existing supply contract in one direction should have an effect on the obligation to conclude a supply contract or to perform an existing supply contract in the other direction. For example, if in a counter-purchase transaction the export contract is terminated, the question may arise whether the exporter is entitled to be released from its obligations to purchase goods pursuant to the countertrade commitment. Similarly, if in a counter-purchase transaction the exporter fails to take the action necessary to fulfil the countertrade commitment, the question may arise whether the counter-exporter is entitled to suspend payment under the export contract or to terminate the export contract.

38. [new paragraph] Such questions of interdependence may arise also in multi-party countertrade transactions. For example, in a tripartite transaction involving the exporter, the importer who is also the counter-exporter, and a third-party purchaser, the question may arise whether the failure by the third party to purchase the goods entitles the importer to suspend payment for goods purchased from the exporter. In another example, in a four-party countertrade transaction, the question may arise whether the failure to conclude or perform a supply contract between one pair of parties entitles a party to the contract in the other direction to suspend performance of the contract or to terminate the contract. (Multi-party countertrade is described in chapter VIII, section D; for a discussion of linked payment mechanisms in multi-party countertrade, see chapter IX, section F.) The discussion in this section applies to countertrade transactions between two parties as well as to transactions involving more than two parties.

39. [new paragraph] While it is advisable, as discussed below, to include in the countertrade agreement provisions dealing with the interdependence of obligations, it is also advisable, when a problem arises in the completion of the transaction, for the parties to endeavour to find a negotiated solution. Negotiating a modification of the countertrade transaction is often preferable to a suspension or termination of the countertrade commitment or a supply contract.

40. [39] Many national laws contain general rules that provide an answer regarding interdependence of obligations incorporated in one contract. The general principle is

that non-performance by one party of its contractual obligations under a contract authorizes the other party not to perform its obligations under that contract, and that in some circumstances the other party is authorized to terminate the contract. Usually non-performance of one's own contract obligations or termination of the contract is not authorized when the failure of the other party is not sufficiently serious. National laws normally do not provide a specific answer to the question of interdependence of obligations involved in various types of countertrade transactions and also do not clarify to what extent the above-mentioned general principles of contract law can be applied in a countertrade transaction.

41. [40] It is often suggested that the particular contract structure of the countertrade transaction is an important element in determining the interdependence of obligations in countertrade transactions. If the contractual terms concerning the countertrade commitment or supply contracts in the two directions are embodied in one contract, it is generally considered that the mutual obligations are likely to be considered as interdependent (see chapter III, "Contracting approach", paragraphs 10, 17, 18). If, however, separate contracts are used, it has been suggested that under many national laws the two sets of obligations would likely be regarded as independent, except to the extent specific contract provisions establish interdependence (the separate-contracts approach is discussed in chapter III paragraphs 11 to 23).<sup>\*</sup> On the other hand, it has been suggested that despite the use of separate contracts, the obligations in a countertrade transaction could be regarded as interdependent on the ground that those obligations embodied in separate contracts are commercially inter-related and thus form part of a single transaction.

42. [41] Because there is a dearth of judicial and arbitral decisions on the question of interdependence of obligations in countertrade transactions, generalizations cannot be made. The extent of interdependence will depend on the circumstances and contractual provisions of each case. In order to avoid disagreements as to whether a party is entitled to withhold fulfilment of its obligation as regards the supply of goods in one direction on the ground that the other party has failed to fulfil its obligation as regards the supply of goods in the other direction, the parties might wish to include in the countertrade agreement specific provisions indicating the extent of interdependence of obligations. Provisions determining the extent of interdependence of obligations may be included to address in particular the following problems in the fulfilment of the countertrade transaction: (1) failure to conclude a supply contract as stipulated in the countertrade agreement, (2) termination of a supply contract, (3) failure to meet a payment obligation under a supply contract, and (4) failure to deliver goods under a supply contract.

#### 1. Failure to conclude supply contract

43. [42] In transactions in which the parties first conclude the supply contract in one direction (export contract) and leave the conclusion of the supply contract in the other direction (counter-export contract) to a later time (see

chapter III, "Contracting approach", paragraphs 13 to 19), the parties may wish to consider whether the failure of the exporter (counter-importer) to take an action necessary to fulfil the countertrade commitment should entitle the importer to suspend payment for the imported goods, or even to terminate the export contract. Such interdependence may be viewed favourably by an importer whose ability to meet payment obligations under the export contract depends on the proceeds of the counter-export contract to be concluded pursuant to the countertrade agreement.

44. [43] In considering whether to establish such interdependence between the countertrade commitment and the export contract, the parties may wish to take into account the possible amount of the counter-exporter's loss arising from the failure to fulfil the countertrade commitment and the possible amount of the exporter's loss arising from the suspension of payment under the export contract or from the termination of the export contract. It may not be desirable to allow a problem in the fulfilment of the countertrade commitment to disrupt the performance of the export contract. The parties may make such an assessment when the price to be paid under the export contract or the possible loss from the termination of the export contract is considerably higher than the possible loss from the failure by the counter-importer to fulfil the countertrade commitment. Furthermore, interdependence may not be desirable because of the possibility that the parties would disagree as to responsibility for the failure to conclude a supply contract. The possibility of suspension of payment under the export contract until the resolution of such a disagreement might introduce an unacceptable degree of uncertainty in the transaction. Moreover, the risk of non-payment under the export contract because of a problem in the fulfilment of the countertrade commitment may make it difficult for the exporter to find a financial institution to finance the export or to insure a non-payment risk. A reason for the financial institution's reluctance may be the fact that a possible difficulty the exporter may face in fulfilling the countertrade commitment is a circumstance extraneous to the export contract and difficult for the financial institution to assess. For reasons discussed in paragraphs 39 to 41, above, the parties may wish to express in the countertrade agreement such independence of the export contract from the fulfilment of the countertrade commitment.

45. [44] However, in order to protect the interests of the counter-exporter, it may be appropriate to provide in the countertrade agreement for compensation of the loss expected to be suffered as a result of a failure to conclude the counter-export contract. The obligation to provide such compensation may be established by a liquidated damages or penalty clause in the countertrade agreement (see paragraphs 10 to 13 above, as well as chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance"). Furthermore, the countertrade agreement may grant the counter-exporter the right to deduct from payments due under the export contract the amount of liquidated damages or a penalty due for the failure to fulfil the countertrade commitment (see chapter IX, "Payment", paragraphs 12 and 62, and chapter XI, "Liquidated damages and penalty clauses", paragraph 22).

46. [45] In transactions in which a countertrade agreement is concluded before the conclusion of supply contracts in either direction (see chapter III, "Contracting approach", paragraphs 20 and 21), the parties may not find it useful to entitle a party to suspend performance of, or to terminate, a concluded supply contract in one direction in response to a failure by the other party to take an action necessary to conclude a supply contract in the other direction. In such transactions, the countertrade agreement often provides for the conclusion of a series of supply contracts in both of the two directions. Making the performance of contracts that have already been concluded in one direction dependent on the conclusion of contracts in the other direction may disrupt rather than stimulate orderly implementation of such a countertrade transaction. Accordingly, for reasons discussed above in paragraphs 39 to 41, the parties may wish to indicate expressly in the countertrade agreement that the obligations under the supply contracts in one direction are independent from the fulfilment of the countertrade commitment in the other direction.

47. [46] In some cases the countertrade agreement may provide that a failure by a party to conclude supply contracts in one direction entitles the other party to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction. Such an approach may be used in particular when it is agreed that during the course of the countertrade transaction the value of the goods supplied in one direction should not exceed the value of the goods supplied in the other direction by more than an agreed amount or percentage. This approach may be agreed upon when the parties stipulate that their mutual payment claims arising from the supply contracts in the two directions are to be set off and that the imbalance in the value of goods shipped in the two directions should not exceed an agreed limit (see chapter IX, "Payment", paragraphs 38 to 57, in particular paragraph 53). In order to monitor the level of trade between the parties and to specify the situations in which a party is entitled to suspend conclusion of contracts or supplies of goods, the parties might agree that their mutual supplies of goods are to be recorded in an "evidence account" (see chapter IV, "Countertrade commitment", paragraphs 68 to 74).

48. [47] When the countertrade agreement provides that the countertrade commitment in one direction should not affect obligations under existing supply contracts in the other direction, the countertrade agreement may nevertheless establish sanctions for the failure to fulfil the countertrade commitment. For example, in transactions in which countervailing claims for payment for the supply of goods in the two directions are to be set off, the countertrade agreement may provide that a party that receives more goods than it ships is to liquidate the imbalance either through cash payments or through the shipment of additional goods (see chapter IX, "Payment", paragraphs 53 to 56). When the goods supplied in the two directions are to be paid for independently, the countertrade agreement may contain a liquidated damages or penalty clause or provide for the issuance of a bank guarantee or stand-by letter of credit covering non-fulfilment of the countertrade commitment (see chapter XI, "Liquidated damages and penalty clauses", and chapter XII, "Security for performance").

## 2. Termination of supply contract

49. [48] A supply contract may be terminated, for example, as a result of a breach of the contract by one party or as a result of an exempting impediment. For reasons discussed in paragraphs 39 to 41 above, the parties may wish to clarify in the countertrade agreement whether such a termination of a supply contract in one direction is to affect the obligations of the parties to conclude a future supply contract in the other direction or to perform an existing supply contract in the other direction. Various solutions can be considered:

- (i) not to allow the termination of a supply contract in one direction to affect the *commitment to conclude* a supply contract in the other direction, or any obligations under an existing supply contract in the other direction;
- (ii) to provide that termination of a supply contract in one direction is to release the parties from the countertrade commitment stipulating the conclusion of a supply contract in the other direction, but that, if a supply contract in the other direction has already been concluded, that supply contract is not to be affected;
- (iii) to provide that termination of the supply contract in one direction is to result in the release from the countertrade commitment to conclude a supply contract in the other direction as well as in the termination of any existing supply contract in the other direction, unless specified actions for performance of the existing supply contract have already been taken (e.g., goods have been prepared for shipment or have been shipped).

50. [49] The solution under (i) may be appropriate in transactions in which the countertrade agreement provides for the conclusion of a series of supply contracts in both directions. In counter-purchase and buy-back transactions, it may also be appropriate to provide that the termination of a given counter-export contract should not affect the export contract. In these cases it may be possible for the parties to conclude a substitute supply contract for a terminated supply contract (see paragraph 54 below). Because of this possibility, as well as the possibility of exercising remedies available under the terminated supply contract, the parties may not wish that the termination of a given supply contract in one direction should affect the conclusion or performance of contracts in the other direction. *Furthermore, a possibility that the termination of the counter-export contract may affect the export contract may make it impossible for the exporter to obtain insurance cover for non-payment risk under the export contract. Inability to insure that risk may make it difficult or impossible for the exporter to obtain financing for the export contract (see chapter III, section C).*

51. [50] As to the possible effects of the termination of the export contract in a counter-purchase, buy-back or indirect offset transaction, the solution under (i) may be preferred by the importer (counter-exporter). An important objective of the importer for engaging in countertrade is often to find an outlet for its goods, and the need to find such an outlet would usually not be diminished by termi-

nation of the export contract. This solution may also be favoured by a third-party purchaser engaged by the exporter to fulfil the exporter's countertrade commitment; the third-party purchaser may be interested in the countertrade commitment remaining effective in order to be able to earn the fee agreed upon with the exporter or in order to recoup expenses incurred in anticipation of the purchase and resale of the countertrade goods (see chapter VIII, "Participation of third parties", paragraph 35). The exporter (counter-importer), on the other hand, is likely to favour solution (ii), in particular if the exporter does not expect a profit through the purchase and resale of the countertrade goods. In these types of transactions the exporter usually assumes a countertrade commitment in order to be able to export its own goods and would therefore not wish to remain subject to the countertrade commitment upon termination of the export contract, but at the same time would not wish to terminate existing counter-export contracts. In indirect offset transactions there is an additional reason for adopting the solution under (ii), namely, that the exporter (counter-importer) concludes counter-import contracts with third-party suppliers and it would be undesirable to terminate those contracts due to circumstances that do not concern those third parties.

52. [51] The question may arise whether, despite the release from the countertrade commitment, pursuant to the solution in (ii), of the party originally committed to purchase, a third-party purchaser engaged by the exporter (counter-importer) would continue to be entitled to receive a fee from the exporter (counter-importer) for purchases made from the counter-exporter after the release. As discussed in chapter VIII, "Participation of third parties", paragraph 35, it is advisable that the parties provide an express answer to this question in the countertrade agreement.

53. [52] The solution under (iii) might be adopted when the parties consider that the countertrade transaction cannot proceed if a supply contract in one direction is terminated. This might be the case, for example, when the parties agree to link their payment obligations so that the proceeds of the supply contract in one direction would be used to pay for the supply contract in the other direction (chapter IX, "Payment"), or when, as in a direct offset transaction, the goods supplied by one party are to be incorporated in the goods to be supplied in the other direction. The solution under (iii) would also be indicated in buy-back transactions in which the possibility of fulfilling the countertrade commitment is contingent upon the performance of the export contract.

54. [53] When solution (ii) or (iii) is adopted, the parties may wish to clarify in the countertrade agreement that a party would be released from its obligations under the countertrade commitment or an existing counter-export contract on the basis of the termination of the export contract only if that party was not responsible for the termination of the export contract. The countertrade agreement may further provide that when one of the parties is responsible for the termination of the export contract (e.g., because of delivery of defective goods, because of the failure to obtain administrative approval for the contract, or because of the failure to obtain the issuance of a letter of credit), the other party has an option either of maintaining in effect the countertrade

commitment or the counter-export contract or of being released from its obligations thereunder.

55. [54] Paragraphs 48 to 54, above, addressed the question whether a termination of a supply contract in one direction is to affect the obligations of the parties to conclude or perform a supply contract in the other direction. The parties may also wish to consider whether the termination of a supply contract in a given direction should obligate the parties to conclude a substitute supply contract in that same direction. An obligation to conclude a substitute supply contract may be considered appropriate in particular when the countertrade agreement provides for the conclusion of multiple supply contracts or when the countertrade agreement lists different types of countertrade goods.

### 3. Failure to pay

56. [55] In many countertrade transactions it is agreed that payment under the supply contract in one direction is to be made independently from payment under the supply contract in the other direction. For example, if under a counter-purchase or buy-back transaction the importer would delay its payments to the exporter, the exporter (counter-importer) would not be entitled to withhold payment under the counter-import contract or to set off its claim under the export contract against its payment obligation under the counter-import contract. Similarly, if the counter-importer would delay payment to the counter-exporter, the counter-exporter (importer) would not be entitled to withhold payment under the export contract or to set off the payment claims in the two directions. It is advisable that such agreement on independence of payment obligations be expressed in the countertrade agreement.

57. [56] It may be agreed, however, that, if a supplier has not been paid for goods delivered in one direction, that supplier is entitled to withhold payment for goods delivered in the other direction up to the amount of the outstanding claim or to set off the two countervailing claims.

58. [57] The advantage of independence of payment obligations is that the risk of non-payment under a supply contract in one direction is not increased by making the payment obligation under that contract dependent on the successful performance of a supply contract in the other direction. With such an approach, financing for a supply contract may be easier to obtain because the financing institution, in assessing the risk of non-payment, would not have to take into account circumstances extraneous to the supply contract to be financed (see also paragraph 43 above).

59. [58] The advantage of making the payment obligations interdependent is that of additional security to a party who does not receive payment for the goods it has supplied. If that party withholds payment or sets off the claims for payment under the supply contracts in the two directions, the result would be similar to a linked payment mechanism discussed in chapter IX, "Payment" (i.e., retention of funds, blocking of funds or setoff of countervailing claims for payment). The difference is that in the case discussed in this section the withholding of payment or setoff of claims is a fall-back right given to a party who does not

receive payment, whereas under the linked payment mechanisms discussed in chapter IX, the linkage of payments is the anticipated method of payment.

60. [59] When it is agreed that a party is entitled to withhold payment or to set off the two countervailing payment obligations, it is sometimes also stipulated that the party who delivered goods first (exporter) is entitled to take possession of the goods that are to be delivered by the other party (importer). Taking possession of the goods would enable the exporter, who is holding the outstanding claim, to obtain value and establish a payment obligation that could be set off against the outstanding claim. Such a stipulation is possible where the countertrade agreement specifies the goods that are to be counter-exported. In order to implement such an approach, it is advisable to identify clearly the goods and their location and to consider taking such additional measures as granting the exporter a security interest in those goods and giving the exporter an express right to claim their possession. A further measure may be for the countertrade parties to agree that the counter-exporter is to deposit the goods with a third person and to provide for the release of those goods to the counter-importer under specified conditions.

#### 4. Failure to deliver goods

61. [60] The parties may wish to clarify in the countertrade agreement the consequences for the countertrade transaction of a failure to deliver, delayed delivery, or delivery of non-conforming goods under a supply contract in one direction. For delivery problems that result in the termination of a supply contract in one direction, the parties may wish to clarify in the countertrade agreement, as discussed in paragraphs 48 to 54 above, whether the termination is to affect the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. For delivery problems under a supply contract in one direction that do not result in termination of that supply contract, the parties may wish, for reasons explained in paragraphs 39 to 41 above, to provide expressly in the countertrade agreement that there should be no effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction. Such an independence of the obligations with respect to the shipments in the two directions may not be appropriate in buy-back transactions in which the counter-export of goods is contingent upon the proper implementation of the export contract.

[A/CN.9/362/Add.14]

## XIV. CHOICE OF LAW

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[Editorial note: The present draft chapter is a revision of draft chapter XIV, "Choice of law", published as document A/CN.9/WG.IV/WP.51/Add.5. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.5 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.5 are in italics.]

#### A. General remarks

1. [3] This chapter focuses on the choice by the parties to the countertrade transaction of the law applicable to the countertrade agreement, the supply contracts in the two directions, and the contract by which a party committed to fulfil a countertrade commitment engages a third party to

fulfil that commitment. The chapter considers also the question whether the countertrade agreement and the contracts forming part of the transaction should be made subject to a single national law or to different national laws (section C). This chapter does not discuss the law applicable to other related arrangements in which a person who is not a party to the countertrade transaction is involved. Such other arrangements may include a guarantee supporting fulfilment of a countertrade commitment, an agreement between countertrade parties and their banks concerning linked payment arrangements, and an interbank agreement between banks involved in carrying out payment arrangements. Certain aspects of the law applicable to such arrangements are discussed in chapter XII, "Security for performance", paragraphs [3], [5] and [13], and chapter IX, "Payment", paragraphs [4], [7], [16], [18], [19], [24] and [37].

2. [1] Under the rules of private international law of many national laws, the parties are permitted by agreement to choose the applicable law, though under some of those laws there are certain restrictions on that choice (rules of private international law are in some legal systems referred to as "conflict of laws" or "choice of law" rules). If the parties do not choose the applicable law, the applicable law is determined by the application of rules of private international law.

3. [2] It should be noted that by choosing the applicable law the parties are not making a choice as to jurisdiction for settlement of any disputes. Issues relating to jurisdiction are discussed in chapter XV, "Settlement of disputes".

4. [4] Whatever be the law applicable to the countertrade agreement or the supply contracts, particular aspects of the countertrade transaction may be affected by mandatory legal rules of an administrative or other public nature in force in the countries of the parties or in the country where their obligations are to be performed. Those mandatory legal rules may regulate certain matters in the public interest, for example, international transfers of funds, the types of goods that may be traded in countertrade transactions, and restrictive business practices (see below, section D).

5. [5] In addition, the extent to which the parties may designate particular issues to be governed by the chosen law may be limited. For example, regardless of the choice by the parties, the law of the State where goods are situated may govern the transfer of ownership of those goods, and the law of the State in which the bank holding funds is located may govern disposition of the funds. The question of which State's procedural law is to govern arbitral or judicial proceedings for the settlement of disputes arising in connection with the countertrade transaction is discussed in chapter XV, "Settlement of disputes".

6. [6] A sales contract forming part of the countertrade transaction may be subject to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). According to its article 1, the Convention applies to contracts of sale of goods between parties whose places of business are in different States: (a) when the States are Contracting States, or (b) when the rules of private international law lead to the application of the law of a Contracting State. It should be noted that, even if the law of a State that is a party to the Convention is the applicable law, there is a divergence of opinion as to whether the Convention would apply to a countertrade agreement containing a commitment to conclude a supply contract in the future. However, uncertainty appears not to exist in the laws of some States as to the applicability of the Convention to a countertrade agreement that contains all the essential elements of the supply contract yet to be actually concluded. This is because, in those States (as noted in chapter IV, paragraph 40), a party refusing to honour such a commitment may be deemed to have consented to the actual contract of sale.

7. [7] For a discussion of contract drafting in the light of the applicable law, see chapter V, "General remarks on drafting", paragraph 6.

## B. Choice of applicable law

8. [8] It is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts. Such an identification of the applicable law is useful because it enables the parties to gear the actions they take to fulfil their contractual obligations, or the actions taken pursuant to their contractual rights, to the requirements found in the applicable law. If the parties do not choose the applicable law, the result provided by rules of private international law may not be satisfactory to the parties. For example, absent a contrary choice by the parties, sales contracts in a counter-purchase or offset transaction are likely to be, according to the rules of private international law, subject to the law of the seller. If in such a transaction the countertrade agreement is not subject, by the rules of private international law, to the same law as the sales contract to be concluded pursuant to that countertrade agreement, contractual terms common to both the countertrade agreement and the supply contract may not be given the same meaning (see below, paragraph 25).

9. [9] An express choice of the law applicable to the countertrade agreement and the supply contracts is advisable also to avoid uncertainty as to what law applies. Uncertainty in the absence of a choice of law may arise from two factors.

10. [10] First, the applicable law is determined by the application of rules of private international law of a national law. When a dispute arises concerning the countertrade agreement or a supply contract that is to be settled in judicial proceedings, the rules of private international law applied by the court settling the dispute will determine the applicable law. A court will apply the rules of private international law of its own country. If there is no exclusive jurisdiction clause agreed upon by the parties (see chapter XV, "Settlement of disputes", paragraph 41), the courts of several countries may be competent to decide the dispute (e.g., the countries in which the parties to the dispute have their places of business or the country in which the obligation in question is to be performed). There may therefore be several possible systems of private international law that could determine the law applicable to the countertrade agreement or the supply contract. When disputes are to be settled in arbitral proceedings, the arbitral tribunal will determine what law is applicable, unless the parties have chosen the applicable law. In some cases, the arbitral tribunal will determine the applicable law according to the private international law rules that the tribunal considers appropriate; in other cases, the arbitral tribunal will directly determine the applicable law that the tribunal considers appropriate for the case, without express reference to the rules of private international law. It may be difficult to predict on which criteria or rules the arbitral tribunal will rely in determining the applicable law.

11. [11] The second factor producing uncertainty as to the applicable law is that, even if it is known which system of private international law will determine the applicable law to govern the countertrade agreement and the supply contracts, the criteria and concepts used in that system may be too general or vague to enable the parties

to predict with reasonable certainty which law will be determined to be applicable. This difficulty is compounded in the case of countertrade agreements because of possible uncertainty as to the legal nature of the countertrade agreement and the consequent uncertainty as to which rule of private international law should determine the applicable law.

12. [12] *[paragraph 13 as it appeared in A/CN.9/WG.IV/WP.51/Add.5 has been incorporated in the present paragraph]* The extent to which the parties are allowed to choose the applicable law will be determined by the rules of private international law being applied. Under some systems of private international law, the autonomy of the parties is limited and they are permitted to choose only a national law that has some connection with the contract, such as the law of the country of one of the parties or of the place of performance. *Such a limitation is sometimes referred to as the "nexus" rule. Under other systems of private international law, the parties are permitted to choose the applicable law to govern the countertrade agreement and the supply contracts without those restrictions.* Since a court that is to settle a dispute will apply the rules of private international law in force in its country, the parties should agree upon a choice of law that would be upheld by the rules of private international law in the countries whose courts might be competent to settle their disputes. If the parties are considering an exclusive jurisdiction clause, they should pay particular attention to whether courts in the contemplated jurisdiction would uphold their choice of law. *If a dispute is settled in arbitral proceedings, the law chosen by the parties will normally be applied by the arbitral tribunal. In order to avoid the application of a nexus rule, parties sometimes expressly stipulate in the choice-of-law clause that that rule should not apply. It should be noted that such a stipulation may have no effect inasmuch as the nexus rule is likely to be considered mandatory. The likelihood that such a stipulation would be upheld appears to be greater in arbitration proceedings.*

13. [14] When choosing the law to govern the countertrade agreement or the supply contracts, it is in general advisable for the parties to choose the law of a particular country. The rules of private international law of a country where legal proceedings may be instituted in the future may not recognize the validity of a choice of general principles of law or of principles common to several countries (e.g., of the countries of both parties). Even if such a choice would be valid, it may be difficult to identify principles of law that could resolve disputes of the type arising in connection with a countertrade agreement or a supply contract. Nevertheless, such a choice *might* be feasible in certain circumstances.

14. *[new paragraph]* When an international convention relevant to the countertrade transaction is in force in a State, it is widely accepted that the choice of the law of that State will include that international convention. Such a choice of a convention through the choice of the national law is expressly recognized in article 1(b) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). Article 1(b) provides that the Convention applies to contracts of sale between parties

whose places of business are in different States when the rules of private international law lead to the application of the law of a Contracting State.

15. *[new paragraph]* In some States it is recognized that parties can agree that their transaction should not be governed by a national law but by an international convention or by other rules of law such as an international legal text not having the force of an international treaty or a set of legal principles dealing with international trade. Other States, however, require the applicability of a national law, so that any international convention or other rules chosen by the parties will apply in so far as they do not contravene the mandatory provisions of the applicable national law.

16. [15] In many national laws a choice-of-law clause is interpreted as not to include the application of the rules of private international law of the chosen national law even if the clause does not expressly so provide. However, if that interpretation is not certain, the parties may wish to indicate in the clause that the substantive legal rules of the national law they have chosen are to apply. Otherwise, the choice of the national law may be interpreted as including the private international law rules of that national law and those rules might provide that the substantive rules of another national law are to apply.

17. [16] The parties may wish to choose as the applicable law the law of the country of one of the contracting parties. Alternatively, they may prefer to choose the law of a third country which is known to both parties and which deals in an appropriate manner with the legal issues arising from the countertrade agreement or from the supply contract. If the countertrade agreement or a supply contract provides for the jurisdiction of the courts of a particular country to settle disputes between the parties, the parties may wish to choose the law of that country as the applicable law. This could expedite judicial proceedings and make them less expensive, since a court will normally have less difficulty in ascertaining and applying its own law than the law of a different country.

18. [17] In the case of countries that have two or more territorial units in which different laws are applicable (as in some federal States), it is advisable to specify which one of those laws is to be applicable in order to avoid uncertainty.

19. [18] The parties may also wish to take the following factors into consideration in choosing the applicable law: (a) the parties' knowledge of, or possibility of gaining knowledge of, the law; (b) the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship between the parties (for example, the parties may wish that their countertrade commitment to enter into future contracts would be given effect under the chosen law); (c) the extent to which the law contains mandatory rules that would prevent the parties from settling by agreement questions that arise in their contractual relationship.

20. [19] Changes legislated in the law chosen by the parties to govern the countertrade agreement and the supply contract may or may not affect contracts in existence at the time those changes are made. If the parties wish that

only the legal rules in force at the time the countertrade agreement or supply contracts are entered into are to apply, it is advisable that they expressly so provide. However, parties should be aware that such a restriction will not be effective if the application of the changes in the legislation to existing contracts is mandatory.

21. [20] Different approaches are possible with respect to the drafting of a choice-of-law clause. One approach may be merely to provide that the *countertrade agreement or the contract* is to be governed by the chosen law. This approach may be sufficient if it is clear that the body chosen to settle disputes between the parties will apply the chosen law to all the issues that the parties desire to be regulated by it. A second approach may be to provide that the chosen law is to govern the *countertrade agreement or contract* in question, and also to include an illustrative list of the issues that are to be governed by that law (e.g., *formation of contract, or breach, termination, or invalidity of the countertrade agreement or contract*). This approach may be useful if the parties consider it desirable to ensure that the issues contained in the illustrative list in particular will be governed by the chosen law.

22. [21] Under the *private international law* of some countries a choice-of-law clause may be considered to be an agreement separate from the rest of the contract between the parties. Under those laws, the choice-of-law clause may remain valid even if the rest of the contract is invalid, unless the grounds for invalidity also extend to the choice-of-law clause. Where the contract is invalid but the choice-of-law clause remains valid, the formation, the lack of validity, and consequences of the invalidity of the contract will be governed by the chosen law.

23. [22] Under most systems of private international law the chosen law may govern the prescription of rights, while under some systems rules relating to prescription (limitation of actions) are of a procedural character and cannot be chosen by the parties in their contract; in those cases the procedural rules of the place where the legal proceedings are brought will apply. The Convention on the Limitation Period in the International Sale of Goods (New York, 1974) as amended by the Protocol of 1980 provides in its article 3 that, unless the Convention provides otherwise, the Convention applies irrespective of the law which would otherwise be applicable by virtue of the rules of private international law. As discussed above in paragraph 6, it may be uncertain whether countertrade agreements committing the parties to the future conclusion of a sales contract fall within the scope of application of the United Nations Convention on Contracts for the International Sale of Goods. Similarly, it may be uncertain whether such countertrade agreements fall within the scope of application of the Convention on the Limitation Period in the International Sale of Goods.

24. [23] The parties may include in the countertrade agreement a choice-of-law clause that will designate the applicable law not only for the countertrade agreement but also for the future supply contracts to be concluded pursuant to the countertrade agreement. In this way the parties may settle in the countertrade agreement an issue that they would otherwise address in each supply contract.

### C. Choosing the same or different national laws to govern countertrade agreement and supply contracts [title changed]

25. [24] In making an express choice of the applicable law, the parties may wish to consider whether the countertrade agreement and any future supply contracts to be concluded in one direction or in both directions pursuant to that countertrade agreement should be made subject to a single national law or to different national laws. The application of a single national law may be desirable when the countertrade agreement stipulates terms of the future supply contracts and the parties wish to ensure that the legal meaning of terms stipulated in the countertrade agreement would remain the same when those terms are subsequently incorporated in a supply contract. Consistency of legal meaning may be desirable in particular with regard to terms concerning payment mechanisms (see chapter IX, "Payment", paragraph [16]), quality of the goods, and terms of delivery.

26. [25] If the parties have structured their obligations in such a way that their obligations arising from the supply contracts in the two directions are interrelated to a high degree, they may find it appropriate to subject all their mutual rights and obligations to a single national law. The obligations of the parties are closely interrelated, in particular, in barter transactions (see chapter III, "Contracting approach", paragraphs 3 to 8) and in direct offset transactions (see chapter II, "Scope and terminology of Legal Guide", paragraph 17). The application of more than one national law to such transactions may lead to inconsistency between obligations of the parties.

27. [26] In the case of counter-purchase, buy-back and indirect offset transactions, the obligations of the parties arising, on the one hand, under the supply contract in one direction (export contract) and, on the other hand, under the countertrade agreement and the supply contract in the other direction (counter-export contract) are usually not interrelated to the same degree as the obligations are interrelated in barter or direct offset transactions. In these cases, no generally valid advice can be given as to whether it would be preferable for the parties to subject their obligations to one national law or to different national laws. In some of these cases, the parties may wish to subject all their obligations to one law. They may wish to do so since it may be simpler to administer the countertrade transaction and to obtain the necessary legal advice with a view to a single national law rather than to have to take into account more than one national law. There may, however, be situations in which the parties decide to subject the export contract to one law and the counter-export contract to another law. The parties might choose different laws when, on the one hand, there are special reasons for making one of the contracts subject to the law of a particular State and, on the other hand, the parties do not wish to subject the entire transaction to that law. Such special reasons concerning one of the contracts may be, for example, mandatory rules of a State of a party requiring certain types of contracts to be subject to the laws of that State, trade practice according to which one of the contracts is traditionally made subject to a particular national law, or the conclusion of the contracts by different sets of parties. If the parties

decide to subject the supply of goods in the two directions to different *national laws*, the parties may wish to consider, as noted above in *paragraph 25*, to subject the countertrade agreement and the supply contract to be concluded pursuant to it to the same law.

28. [27] When the party originally committed to purchase engages a third party to fulfil that commitment, the party originally committed and the third party may wish to subject the contract by which the third party is engaged to the law governing the countertrade agreement. Such a choice would help to ensure that terms found both in the countertrade agreement and the contract engaging the third party would be given the same meaning. (The need for coordination between the contract engaging a third party and the countertrade agreement is discussed in chapter VIII, "Participation of third parties", paragraphs [22] to [25]. Certain other aspects of the law applicable to participation by third parties are mentioned in paragraphs [7], [9], [13] and [16] of chapter VIII.)

29. [28] When the countertrade agreement is incorporated in an export contract (see chapter III, "Contracting approach", *paragraph 17*), a choice-of-law clause in the export contract would, absent a contrary provision, cover the clauses making up the countertrade agreement.

#### D. Mandatory legal rules of public nature

30. [29] In addition to the applicable law, mandatory rules of an administrative or other public nature in force in the countries of the parties and in other countries (e.g., the country of a third-party purchaser or of a third-party supplier or the country in which the proceeds of the supply in one direction are being held) may affect certain aspects of the countertrade transaction. These mandatory rules may be addressed to residents or citizens of the State that issued the rules, or to certain business activities being carried out or having an effect in the territory of the State. They may be enforced primarily by administrative officials. Their purpose is to ensure compliance with the economic, social, financial or foreign policy of the State. The parties should take these mandatory rules into account in drafting the countertrade agreement and the supply contracts. (Mandatory govern-

mental regulations are also discussed in chapter II, "Scope and terminology of Legal Guide", *paragraphs 9 and 10*.)

31. [30] Such rules may be of a general nature, applicable to various types of commercial transactions, or they may be specific to countertrade. Rules of a general nature often relate to safety requirements, environmental protection, health and labour conditions, consumer protection, employment of local personnel, restrictive business practices (see chapter X, "Restrictions on resale of countertrade goods", *paragraph 3*), customs duties, taxes, and restrictions on exports, imports, transfer of technology and payment of foreign exchange.

32. [31] Mandatory rules specific to countertrade may provide, for example, that: (a) specified types of countertrade transactions require governmental approval; (b) importing of certain types of goods may be carried out only within the framework of specified forms of countertrade; (c) only certain types of goods are permitted to be offered in a countertrade transaction (see chapter VI, "Type, quality and quantity of goods", *paragraphs 3 and 40*); (d) goods purchased in fulfilment of a countertrade commitment must meet origin requirements (see chapter VI, *paragraph 4*, and chapter IV, "Countertrade commitment", *paragraph 26*); (e) evidence accounts are permitted to be used only under specified conditions (see chapter IV, "Countertrade commitment", *paragraph 69*); (f) the purchase of certain types of goods is to be credited towards the fulfilment of the countertrade commitment at specified rates (see chapter IV, "Countertrade commitment", *paragraphs 31 to 34*); (g) prior governmental authorization is required for linked payment arrangements restricting foreign currency payments into the country (see chapter IX, "Payment", *paragraphs 5 and 18*); (h) specified financial institutions must be used for payment (see chapter IX, *paragraphs 24 and 37*).

33. [32] The parties may wish to address in the countertrade agreement the possibility that fulfilment of the countertrade commitment would be impeded by the promulgation or modification of a mandatory rule after the conclusion of the countertrade agreement. Such clauses are discussed in chapter XIII, "Failure to complete countertrade transaction", *section D*.

[A/CN.9/362/Add.15]

## XV. SETTLEMENT OF DISPUTES

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[*Editorial note:* The present draft chapter is a revision of draft chapter XV, "Settlement of disputes", published as document A/CN.9/WG.IV/WP.51/Add.6. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/WG.IV/WP.51/Add.6 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/WG.IV/WP.51/Add.6 are in italics. An asterisk indicates the place where text has been deleted without adding new language.]

#### A. General remarks

1. [1] Disputes may arise in a countertrade transaction with respect to the countertrade agreement, and with respect to the supply contracts concluded pursuant to the countertrade agreement. It is advisable that the parties agree on the manner in which any future disputes arising out of the countertrade agreement and the related supply contracts are to be settled.

2. [2] In general, it is desirable for the parties initially to attempt to settle their disputes through negotiation (*section B*). If negotiation is not successful, the parties might wish to refer their dispute to an independent conciliator, who is to make recommendations to the parties on how to settle the dispute (*section C*). If those methods of dispute settlement fail, there are basically two methods available of obtaining a *binding* decision: arbitration and judicial proceedings. Arbitration is a process by which parties refer disputes that might arise between them or that have already arisen for decision by an arbitral tribunal composed of one or more impartial persons (arbitrators) selected by them (*section D*). Arbitral proceedings may be initiated only on the basis of an arbitration agreement. In general, the parties are obligated to accept the decision of the arbitral tribunal (arbitral award) as final and binding. The arbitral award is usually enforceable in a manner similar to a court decision. In the absence of an arbitration agreement, disputes between the parties will have to be settled in judicial proceedings (*section E*).

3. [3] This chapter does not deal with procedures agreed upon by the parties for determining terms of a supply contract that have been left open in the countertrade agreement. Such methods include procedures to be observed by the parties in negotiating supply contract terms, standards and guidelines to be used in setting the terms, designation of a third person to determine a contract term, or authorizing one of the parties to determine a contract term within agreed parameters. Such methods are discussed generally in chapter IV, "Countertrade commitment", para-

graphs 38 to 60, and with respect to specific types of contract terms in chapter VI, "Type, quality and quantity of goods", paragraphs 25, 26, 34, 39, and chapter VII, "Pricing of goods", paragraphs 11 to 47.

4. [4] The implementation of a countertrade transaction usually includes ongoing discussions between the parties that may permit many problems and misunderstandings to be resolved without recourse to dispute settlement proceedings. If such discussions result in an amendment of the countertrade agreement or of a supply contract, it is advisable to express the agreement in writing (see chapter V, "General remarks on drafting", paragraphs 3 to 5).

5. [5] When the parties embody all of their contractual obligations in the two directions in a single contract (see chapter III, "Contracting approach", paragraphs 2 to 10), a broadly worded dispute settlement clause in that contract would, in the absence of a contrary provision, govern all disputes arising from the contract. However, usually the parties embody their obligations in the two directions in more than one contract (see chapter III, paragraphs 11 to 23). In multi-contract countertrade transactions, the parties may consider it useful to agree that all of the supply contracts, a contract by which a third party is engaged to purchase or to supply goods, as well as the countertrade agreement, are subject to one dispute settlement clause.

6. [5] When the countertrade agreement provides for the future conclusion of supply contracts, the parties may stipulate in the countertrade agreement that all of those contracts are to be subject to a particular method of dispute settlement. In this way the countertrade agreement may settle an issue that would otherwise be addressed in each supply contract.

7. [*new paragraph*] In some States restrictions exist as to the freedom of a State agency or some other entity of the State to conclude an arbitration agreement or to agree to the jurisdiction of a court of a foreign State. The right to enter into such dispute settlement clauses may be limited to certain types of transactions or to transactions with a foreign party, or such clauses may be subject to an authorization. It is advisable for the parties to investigate dispute settlement aspects in such cases in order to be assured that they are free to enter into a binding dispute settlement clause.

#### B. Negotiation

8. [6] The most satisfactory method of settling a dispute between parties is usually reaching an amicable settlement of the dispute by negotiation between the parties. An ami-

cable *settlement* may avoid disruption of the business relationship between the parties. In addition, it may save the parties the considerable cost and the greater amount of time that are normally required for the settlement of disputes by other means. Furthermore, negotiation may be a particularly attractive approach in long-term countertrade transactions in which the countertrade agreement indicates the terms of the future supply contracts in a general rather than in a specific manner.

9. [7] Even though the parties may wish to attempt to settle their disputes through negotiation before invoking other means of dispute settlement, it may not be desirable for the dispute settlement clause to prevent a party from resorting to other means of settlement until a period of time allotted for negotiation has expired. If the clause stipulates that other dispute settlement proceedings may not be initiated during the negotiation period, it is advisable to permit a party to initiate other proceedings even before the expiry of that period in certain cases, e.g., where a party states in the course of negotiations that it is not prepared to negotiate any longer, or where the initiation of arbitral or judicial proceedings before the expiry of the negotiation period is needed in order to prevent the loss or prescription of a right. It is advisable to require a settlement reached through negotiation to be reduced to writing.

10. [8] Since the outcome of a dispute between two parties to a countertrade transaction might affect the interests of another party to the countertrade transaction, it might be agreed that the party not directly involved in a dispute should be permitted to participate in the negotiations. Such a situation may arise when a third party is engaged to purchase countertrade goods and the dispute occurs between the third party and the supplier. In this case the party originally committed to purchase goods may be liable for payment of an agreed sum in the event that the intended purchase by the third party fails to take place and the countertrade commitment is not fulfilled. Similarly, a party committed to supply who engages a third-party supplier may have an interest in the outcome of the dispute between the third-party supplier and the purchaser. The right to such participation in the negotiation of a settlement may be limited to the case in which the party that engages the third party remains liable for the fulfilment of the countertrade commitment. In the case of a multi-party countertrade transaction, it may be agreed that all parties to the transaction would participate in the negotiations.

11. [9] In long-term countertrade transactions, the parties may establish a joint committee to coordinate and monitor implementation of the countertrade transaction (see chapter IV, "Countertrade commitment", paragraph 64). Such a committee may permit the parties to detect possible sources of difficulties and disputes at an early stage and may be an appropriate vehicle for settling disputes through negotiation.

### C. Conciliation

12. [10] If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceed-

ings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator respected by both parties. In contrast to an arbitrator or judge, the conciliator does not decide a dispute; rather, the conciliator assists the parties in reaching an agreed settlement, often by proposing solutions for their consideration.

13. [11] Conciliation is non-adversarial and confidential. The parties are more likely to preserve the good business relationship that exists between them than in arbitral or judicial proceedings. Conciliation may even improve the relationship between the parties, since the scope of the conciliation and the ultimate agreement of the parties may go beyond the strict confines of the dispute that gave rise to the conciliation. Conciliation may also permit the participation in the settlement of the dispute of parties that are not directly involved in the dispute but who have an interest in the outcome of the dispute. On the other hand, a potential disadvantage of conciliation is that, if the conciliation were to fail, the money and time spent on it would be wasted. \* It is advisable that, before initiating conciliation, the parties consider carefully whether there exists a real likelihood of reaching a settlement.

14. [12] If the parties provide for conciliation, they will have to settle a number of issues for the conciliation to be effective. It is not feasible to settle all of those issues in the body of the countertrade agreement; rather, the parties may incorporate into their agreement by reference a set of conciliation rules prepared by an international organization, such as the UNCITRAL Conciliation Rules.<sup>1</sup>

15. [13] It is often advisable to commence conciliation proceedings before resorting to arbitral or judicial proceedings. If during conciliation proceedings arbitral or judicial proceedings have been initiated, the parties might still find it useful to continue with the conciliation. Conciliation may also be initiated after the commencement of arbitral or judicial proceedings.

### D. Arbitration

16. [14] There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions. Arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the work of its thirteenth session (1980), *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 106 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XI, 1980, part one, II, A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations Publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads: "Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules has been recommended by the United Nations General Assembly in its resolution 35/52 of 4 December 1980.

countertrade agreement or a related contract. The parties can choose as arbitrators persons who have expert knowledge of the subject-matter in dispute. The parties may choose the place where the arbitral proceedings are to be conducted. They may also choose the language or languages to be used in the arbitral proceedings. In addition, the parties can choose the *applicable law*, and that choice will almost always be respected by the arbitral tribunal; the same is not always true of judicial proceedings (see chapter XIV, "Choice of law", paragraph 12). Where parties agree to arbitration, neither party submits to the courts of the country of the other party. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Arbitral proceedings tend to be more expeditious and may be less costly than judicial proceedings. It may be noted, however, that some States provide for summary judicial proceedings for disputes involving a sum of money that does not exceed a certain amount. Under some national laws, an arbitral tribunal may have more latitude than a court to grant to the claimant the remedy of specific performance. Finally, as a result of international conventions that assist in the recognition and enforcement of foreign arbitral awards, those awards are frequently recognized and enforced more easily than foreign judicial decisions. One such convention to which many States are parties is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).<sup>2</sup>

17. [15] On the other hand, an arbitral award may be set aside in judicial proceedings. The initiation of those proceedings will delay the final settlement of the dispute. However, under many legal systems, an arbitral award may be set aside only on a limited number of grounds, for example that the arbitral tribunal lacked authority to decide the dispute, that a party could not present its case in the arbitral proceedings, that the rules applicable to the appointment of arbitrators or to the arbitral procedure were not complied with, or that the award was contrary to public policy. It may also be noted that, in some States, it is not possible for parties to preclude courts from settling certain types of disputes. In addition, a court may award and enforce to a broader extent than an arbitral tribunal provisional measures of protection or injunctions.

#### 1. Scope of arbitration agreement and mandate of arbitral tribunal

18. [16] In general, arbitral proceedings may be conducted only on the basis of an agreement by the parties to arbitrate. The agreement may be reflected either in an arbitration clause included in the countertrade agreement or a related contract, or in a separate arbitration agreement concluded by the parties before or after a dispute has arisen. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction. However, under some legal systems, an agreement to arbitrate is procedurally and

substantively effective only if it is concluded or confirmed after a dispute has arisen.

19. [17] The arbitration agreement should indicate what disputes are to be settled by arbitration. For example, the arbitration clause may stipulate that all disputes arising out of or relating to the countertrade agreement or the breach, termination or invalidity thereof are to be settled by arbitration. In some cases, the parties may wish to exclude from that wide grant of jurisdiction certain disputes that they do not wish to be settled by arbitration.

20. [18] If permitted under the law applicable to the arbitral proceedings, the parties may wish to authorize the arbitral tribunal to order interim measures pending the final settlement of a dispute. However, under some legal systems arbitral tribunals are not empowered to order interim measures. Under other legal systems where interim measures of protection can be ordered by an arbitral tribunal, they cannot be enforced; in those cases it may be preferable for the parties to rely on a court to order interim measures. Under many legal systems a court may order interim measures even if the dispute is to be or has been submitted to arbitration.

21. [19] It is desirable for the arbitration agreement to obligate the parties to implement arbitral decisions, including decisions ordering interim measures. The advantage of including such an obligation in the agreement is that under some legal systems, where an arbitral award is not enforceable in the country of a party, a failure by the party to implement an award when obligated to do so by the agreement might be treated in judicial proceedings as a failure by the party to perform a contractual obligation.

22. [20] If judicial proceedings are instituted in respect of a dispute that is covered by a valid arbitration agreement, upon a timely request the court will normally refer the dispute to arbitration. However, the court may retain the authority to order interim measures and will normally be entitled to control certain aspects of arbitral proceedings (e.g., to decide on a challenge to arbitrators) and to set aside arbitral awards on certain grounds (see above, paragraph 17).

23. [21] Parties that are considering authorizing the arbitral tribunal to decide disputes *ex aequo et bono* or to act as *amiable compositeur* should bear in mind that arbitrators are not permitted to do so under some legal systems. In addition, such authorizations may be interpreted in different ways and lead to legal insecurity. For example, the terms might be interpreted as authorizing the arbitral tribunal to be guided either only by principles of fairness, justice or equity, or, in addition, by those provisions of the *applicable law* regarded in the legal system of that law as fundamental. If the parties wish to authorize the arbitral tribunal to decide disputes without applying all legal rules of a State, they may wish to specify the standards or rules according to which the arbitral tribunal is to decide the substance of the dispute. Moreover, in order to avoid any misunderstanding, the parties may wish to make it clear that the arbitral tribunal is to decide in accordance with the terms of the supply contract or the countertrade agreement and the relevant usages of trade applicable to the transaction.

<sup>2</sup>United Nations, Treaty Series, vol. 330, p. 38, No. 4739 (1959).

## 2. Type of arbitration and appropriate procedural rules

24. [22] The parties are able to select the type of arbitration that best suits their needs. It is desirable that they agree on appropriate rules to govern their arbitral proceedings. There is a wide range of arbitration systems available, with varying degrees of involvement of permanent bodies (e.g., arbitration institutions, courts of arbitration, professional or trade associations and chambers of commerce) or third persons (e.g., presidents of courts of arbitration or of chambers of commerce). At one end of the spectrum is the pure ad hoc type of arbitration, which does not involve a permanent body or third person in any way. This means, in practical terms, that no outside help is available (except, perhaps, from a national court) if, for example, difficulties are encountered in the appointment or challenge of an arbitrator. Moreover, any necessary administrative arrangements have to be made by the parties or the arbitrators themselves. At the other end of the spectrum there are arbitrations fully administered and supervised by a permanent body, which may review terms of reference and the draft award and may revise the form of the award and make recommendations as to its substance.

25. [23] Between these two types of arbitration there is a considerable variety of arbitration systems, all of which involve an appointing authority but differ as to the administrative services that they provide. The essential, although not necessarily exclusive, function of an appointing authority is to compose or assist in composing the arbitral tribunal (e.g., by appointing the arbitrators, deciding on challenges of an arbitrator or replacing an arbitrator). Administrative or logistical services, which may be offered as a package or separately, could include the following: forwarding written communications of a party or the arbitrators; assisting the arbitral tribunal in establishing and notifying the date, time and place of hearings and other meetings; providing, or arranging for, meeting rooms for hearings or deliberations of the arbitral tribunal; arranging for stenographic transcripts of hearings and for interpretation during hearings and possibly translation of documents; assisting in filing or registering the arbitral award, when required; holding deposits and administering accounts relating to fees and expenses; and providing other secretarial or clerical assistance.

26. [24] Unless the parties opt for pure ad hoc arbitration, they may wish to agree on the body or person to perform the functions that they require. Among the factors worthwhile considering in selecting an appropriate body or person are the following: willingness to perform the required functions; competence, in particular in respect of international matters; appropriateness of fees measured against the extent of services requested; seat or residence of the body or person and possible restriction of its services to a particular geographic area. The latter point should be viewed in conjunction with the probable or agreed place of arbitration (see below, paragraphs 35 to 39). However, certain functions (e.g., appointment) need not necessarily be performed at the place of arbitration, and certain arbitral institutions are prepared to provide services in countries other than those where they are located.

27. [25] In most cases, the arbitral proceedings will be governed by the procedural law of the State where the proceedings take place. Many States have laws regulating various aspects of arbitral proceedings. Some provisions of these laws are mandatory; others are non-mandatory. In selecting the place of arbitration, the parties may wish to consider the extent to which the law of a place under consideration recognizes the special needs and features of international commercial arbitration and, in particular, whether it is sufficiently liberal to allow the parties to tailor the procedural rules to meet their particular needs and wishes while at the same time ensuring that the proceedings are fair and efficient. A recent trend in this direction, discernible from modern legislation in some States, is being enhanced and fortified by the UNCITRAL Model Law on International Commercial Arbitration.<sup>3</sup> The UNCITRAL Model Law is becoming increasingly accepted by States of different regions and different legal and economic systems.

28. [26] Since the procedural rules in the arbitration laws of some States are not necessarily suited to the particular features and needs of international commercial arbitration, and since, in any case, those laws do not contain rules settling all procedural questions that may arise in relation to arbitral proceedings, the parties may wish to adopt a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution, and may refuse to administer a case if the parties have modified provisions of those rules that the institution regards as fundamental to its arbitration system. Most arbitral institutions, however, offer a choice of two or sometimes more sets of rules and often allow the parties to modify any of the rules. If the parties are not required by an institution to use a particular set of arbitration rules or to choose among specified sets of rules, or if they choose ad hoc arbitration, they are free to choose a set of rules themselves. In selecting a set of procedural rules, the parties may wish to consider its suitability for international cases and the acceptability of the procedures contained in them.

29. [27] Of the many arbitration rules promulgated by international organizations or arbitral institutions, the UNCITRAL Arbitration Rules<sup>4</sup> deserve particular mention. These Rules have proven to be acceptable in the various

<sup>3</sup>Report of the United Nations Commission on International Trade Law on the work of its eighteenth session (1985), *Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17)*, para. 332 and annex I (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. XVI: 1985, part three, I (United Nations publication, Sales No. E.87.V.4)). The United Nations General Assembly, in its resolution 40/72 of 11 December 1985, recommended "that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice".

<sup>4</sup>Report of the United Nations Commission on International Trade Law on the work of its ninth session (1976), *Official Records of the General Assembly, Thirty-first Session, Supplement No. 17 (A/31/17)*, para. 57 (also reproduced in *Yearbook of the United Nations Commission on International Trade Law*, vol. VII: 1976, part one, II, A (United Nations publication, Sales No. E.77.V.6)). The use of the UNCITRAL Arbitration Rules has been recommended by the United Nations General Assembly in its resolution 31/98 of 15 December 1976.

legal and economic systems and are widely known and used in all parts of the world. Parties may use them in pure ad hoc arbitrations as well as in arbitrations involving an appointing authority with or without the provision of additional administrative services. A considerable number of arbitration institutions in all regions of the world have either adopted these Rules as their own institutional rules for international cases or have offered to act as appointing authority in conjunction with the use of those Rules. Most of them will provide administrative services in cases conducted under the UNCITRAL Arbitration Rules.

30. [28] Where a model clause accompanies the arbitration rules to govern arbitrations under the countertrade agreement or is suggested by an arbitral institution, adoption of that clause by the parties may help to enhance the certainty and effectiveness of the arbitration agreement. Some model clauses, such as the one accompanying the UNCITRAL Arbitration Rules, invite the parties to settle certain practical matters by agreement. These include the involvement of an appointing authority, as well as the number of arbitrators (see below, paragraphs 31 to 33), the appointment of arbitrators (see below, paragraph 34), the place of arbitration (see below, paragraphs 35 to 39) and the language or languages to be used in the arbitral proceedings (see below, paragraphs 40 and 41).<sup>5</sup> [new footnote]

### 3. Number of arbitrators

31. [29] The parties may wish to specify in the arbitration clause the number of arbitrators who are to comprise the arbitral tribunal. If the parties fail to do so, the chosen arbitration rules or, in some cases, the law applicable to the arbitral proceedings will either specify that number or the manner by which it is to be determined. Agreement by the parties on the number of arbitrators will enable the parties to ensure that the number conforms to their particular needs and wishes, and will provide certainty in respect of that aspect of the appointment process. However, parties should be aware that some national laws restrict their freedom to agree upon the number of arbitrators by, for example, prohibiting an even number of arbitrators.

32. [30] Other than the possible legal restriction just referred to, the considerations that may be relevant to the question of the number of arbitrators are essentially of a practical nature. In order to ensure the efficient functioning of the arbitral proceedings and the taking of decisions, it is usually desirable to specify an uneven number, i.e., one or three, although in practice parties sometimes specify two-member panels, coupled with a mechanism for involving a

<sup>5</sup>[new footnote] The following clause is recommended in the UNCITRAL Arbitration Rules: "Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force."

*Note -- Parties may wish to consider adding:*

- (a) The appointing authority shall be ... (name of institution or person);
- (b) The number of arbitrators shall be ... (one or three);
- (c) The place of arbitration shall be ... (town or country);
- (d) The language(s) to be used in the arbitral proceedings shall be ...

third arbitrator, "umpire" or "referee", to overcome any impasse between the two.

33. [31] As to whether one or three arbitrators should be specified, the parties may wish to consider that arbitral proceedings conducted by a sole arbitrator are generally less costly and tend to be more expeditious than proceedings where the fees of three arbitrators have to be paid and where three time schedules have to be accommodated. On the other hand, three arbitrators may bring a wider range of expertise and background to the proceedings. Since the desirable expertise and background can be of different types, different methods of appointing the arbitrators may be envisaged.

### 4. Appointment of arbitrators

34. [32] On the one hand, in an international case, each party may want to have one arbitrator of its choice who would be familiar with the economic and legal environment in which that party operates. Therefore, the parties might agree on a method by which each party appoints one arbitrator and the third arbitrator is chosen by the two thus appointed or by an appointing authority. On the other hand, in complex disputes involving legal, technical and economic issues, it may be of considerable advantage to have arbitrators with different qualifications and expertise in the relevant fields. Where parties attach particular importance to this aspect, they may wish to entrust an appointing authority with the appointment of all three arbitrators and, possibly, specify the qualifications or expertise required of the arbitrators.

### 5. Place of arbitration

35. [33] The parties may wish to specify in the arbitration agreement the place where the proceedings are to be held and where the arbitral award is to be issued. The selection of an appropriate place of arbitration may be crucial to the functioning of the arbitral process and to the enforceability of the arbitral award. The following considerations may be relevant to the selection of the place of arbitration.

36. [34] Firstly, the parties may consider it desirable to choose a place of arbitration such that an award issued in that place would be enforceable in the countries where the parties have their places of business or substantial assets. In many States, foreign awards are readily enforceable only by virtue of multilateral or bilateral treaties, and often only on the basis of reciprocity. In some States enforcement is available on the basis of legislation providing for the reciprocal enforcement of awards made in certain other States. The parties may thus wish to choose a place of arbitration in a State that is in such a treaty relationship, or has reciprocal legislative arrangements, with the States where enforcement might later be sought.

37. [35] Secondly, the parties may consider it desirable to choose a place where the arbitration law provides a suitable legal framework for international cases. Some arbitration laws might be inappropriate because, for example,

they unduly restrict the autonomy of the parties or fail to provide a comprehensive procedural framework to ensure efficient and fair proceedings.

38. [36] Considerations of a more practical nature include the following: the convenience of the parties and other persons involved in the proceedings; the availability of necessary facilities, including meeting rooms, support services and communication facilities; the availability of administrative services of an arbitral institution or chamber of commerce, if so desired by the parties; relevant costs and expenses, including expenses for travel, accommodation, meeting rooms and support services; the ability of the parties' counsel to represent the parties without the need to retain local lawyers. Another relevant consideration is that it may be advantageous for the arbitral proceedings to be held in a place which is near to the subject-matter in dispute.

39. [37] Yet other considerations often lead parties to agree on a place other than in the States where they have their places of business. For example, the parties may select a third State because each party may have misgivings about arbitrating in the other party's country; a party in whose State the proceedings are conducted might be thought by the other party to benefit from a familiar legal and psychological environment and from other circumstances facilitating the presentation of the case.

## 6. Language of proceedings

40. [38] The parties may also wish to specify the language to be used in the arbitral proceedings. The choice of the language may influence the efficiency with which the proceedings are conducted and the cost of the proceedings. Whenever possible, it is desirable to specify a single language, such as the language in which the *documents related to the transaction* are written. When more than one language is specified, the costs of translation and interpretation from one language to the other are usually considered to be part of the costs of arbitration and apportioned in the same way as the other costs of arbitration.

41. [39] The parties may wish to specify the types of documents or communications that must be submitted in or translated into the specified language. They may, for example, require the written pleadings, oral testimony at a hearing, and any award, decision or other communication of the arbitral tribunal to be in the specified language. The tribunal may be given the discretion to decide whether and to what extent documentary evidence should be translated. Such discretion may be appropriate in view of the fact that documents submitted by the parties may be voluminous and that only a part of a document may be relevant to a dispute.

## E. Judicial proceedings

42. [40] Disputes that are not settled through negotiation or conciliation will, if the parties do not agree to arbitration, have to be settled in judicial proceedings. Courts of two or more countries may be competent to decide a given

dispute between the parties, and in some cases the manner in which a dispute is decided *depends* upon which court decides the dispute. For example, the validity and effect of a choice by the parties of the applicable law will depend upon the rules of private international law in the country of the court deciding the dispute (see chapter XIV, "Choice of law", paragraph 12).

43. [41] The uncertainties that arise when more than one court is competent to decide a dispute may be reduced by an exclusive jurisdiction clause, obligating the parties to submit disputes that arise between them to a specified court in a specified place in a specified country. However, the parties should bear in mind that, under many legal systems, a clause conferring exclusive jurisdiction on a court is valid only if the selected court *would, in the absence of the choice-of-jurisdiction clause, have authority* to decide the *type of dispute* that is submitted to it under the clause. Therefore, in selecting a court, the parties should ascertain that the court is legally competent to decide the types of disputes that are to be submitted to it. It is advisable for the clause to specify a court in the selected country, rather than to refer simply to "a competent court" in that country, in order to avoid questions as to which court was to decide a given dispute. The clause may stipulate the types of disputes that are subject to it in a manner similar to the specification in an arbitration agreement (see above, paragraph 19).

44. [42] In referring disputes to the courts of a particular State, the parties should bear in mind the extent to which a judicial decision made in that State would be enforceable in the countries of the parties, or in any other country in which enforcement may be sought (see above, paragraph 36).

45. [43] While an exclusive jurisdiction clause may reduce uncertainties with respect to matters such as the *applicable law* and the enforceability of a decision, and may facilitate the multi-party settlement of disputes (see below, paragraphs 50 to 53), it may also have certain disadvantages. If a court in the country of one of the parties is given exclusive jurisdiction, and the exclusive jurisdiction clause is invalid under the law of the country of the selected court, but valid under the law of the country of the other party, difficulties may arise in initiating judicial proceedings in either of the countries. Difficulties connected with initiating judicial proceedings may be magnified if the parties confer exclusive jurisdiction on a court in a third country.

## F. Multi-contract and multi-party dispute settlement

46. [44] Countertrade transactions often involve several contracts in the two directions, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court. If disputes are to be settled judicially, the parties may wish to confer exclusive jurisdiction on a particular court (see above, paragraphs 43 to 45). If the parties opt for arbitration or conciliation, they may wish to agree that the arbitral tribunal or conciliator appointed to settle the first dispute that arises will also be

appointed to settle any subsequent disputes that may arise in the countertrade transaction.

47. [45] The selection of a single body to settle disputes would be useful when the disputes to be resolved raise similar questions of fact or law. This may promote economy and efficiency in dispute settlement, facilitate consolidation of dispute settlement proceedings, and lessen the possibility of inconsistent decisions. Even if disputes that may arise under the countertrade transaction do not all raise similar questions of law or fact, the selection of a single dispute settlement body may be advantageous because it may allow the parties to reduce the cost of legal advice and facilitate administration of the transaction.

48. [46] There may, however, be circumstances in which the parties agree to the submission of disputes under a given supply contract to a particular dispute settlement body, but decide to submit disputes under other contracts to a different body. Such circumstances may exist, for example, when it is customary in the practice of the parties or in the trade, or it is required by mandatory rules, that a particular supply contract be submitted to a particular dispute settlement method or body, and the parties do not wish to submit the other contracts in the transaction to that same method or body.

49. [47] The possibility of disputes under more than one contract involving similar questions of fact or law may exist in a number of situations. One such situation is when the subject-matter of the supply contracts in one direction is related to the subject-matter of the supply contracts in the other direction. This may be the case in a buy-back transaction in which, for example, a dispute as to the quality of the counter-export goods manufactured by equipment supplied under the export contract is related to a dispute as to the quality of that equipment. Similarly, in a direct offset transaction, in which the goods supplied in one direction are incorporated into the goods supplied in the other direction, a dispute as to the quality or timeliness of delivery of the goods in one direction may be related to a dispute as to the quality or timeliness of delivery of the goods in the other direction. Another situation in which related disputes may arise is when the countertrade agreement establishes a linked payment mechanism through which proceeds generated by the shipment of goods in one direction are to be used to pay for the shipment of goods in the other direction (see chapter IX, "Payment"). For example, when the importer, in accordance with the countertrade agreement, retains the proceeds of the export contract, a dispute as to the responsibility for a failure to conclude a counter-export contract may lead to a related dispute concerning the transfer of proceeds of the export contract to the exporter. When the countertrade agreement provides for the setoff of payment claims for supply contracts concluded in the two directions, a dispute as to settlement of imbalances may involve questions of fact or law pertaining to supply contracts in either direction. Yet another situation in which related disputes may arise is when the countertrade agreement provides that a problem in the conclusion or performance of supply contracts in one direction is to have an effect on the obligations of the parties with respect to the conclusion or performance of supply contracts in the other direction (see chapter XIII, "Failure to complete countertrade transaction", paragraphs [38] to [60]).

50. [48] Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods (see above, paragraph 10). For example, when there is a dispute between the counter-exporter and the *party originally committed to purchase* as to whether liquidated damages are payable for a failure to purchase goods, a third-party purchaser engaged by the *party originally committed to purchase* those goods would have an interest in the dispute if a "hold-harmless" clause has been agreed upon between the third-party purchaser and the *party originally committed to purchase* (see chapter VIII, "Participation of third parties", paragraph [33]). Similarly, the *party originally committed to purchase* would be interested in the outcome of a dispute between a third-party purchaser and the counter-exporter if the *party originally committed to purchase* remains liable for the fulfilment of the countertrade commitment despite the engagement of the third-party purchaser. A further example of a multi-party dispute would be when both the party originally committed to purchase and the third-party purchaser are liable to the supplier for the fulfilment of the countertrade commitment and the supplier decides to pursue a claim against both of them.

51. [49] In the types of cases referred to in the preceding paragraph, it may be desirable to settle all related issues in the same dispute settlement proceedings. This could prevent inconsistent decisions, facilitate the taking of evidence, and reduce costs. However, multi-party proceedings tend to be more complicated and less manageable, and a party may find it more difficult to plan and present its case in such proceedings.

52. [49] Many legal systems provide a means for disputes involving several parties to be settled in the same multi-party judicial proceedings. In order to enable disputes involving several parties to be settled in multi-party judicial proceedings, it may be desirable for related contracts to contain a clause conferring exclusive jurisdiction on a court that has the power to conduct multi-party proceedings (see above, paragraphs 43 to 45).\*

53. [new paragraph] Multi-party arbitration proceedings are usually possible only if all the participating parties conclude an arbitration agreement submitting their dispute to the same panel of arbitrators. The parties may wish to conclude such a multi-party arbitration agreement at the outset of the transaction, or they may decide to do so after the dispute has arisen when the matters at issue indicate the usefulness of a multi-party arbitration. In some States, after a dispute has arisen, courts are able to assist the parties to implement the multi-party arbitration agreement by deciding procedural issues on which the parties cannot agree (e.g., the question whether an issue is covered by the multi-party arbitration clause, appointment of a single arbitral tribunal, or determination of the place of arbitration). There are also some States in which courts may, under certain conditions, order consolidation of two or more arbitral proceedings into a single arbitration even if not all the parties involved have agreed on the submission of the dispute to a single panel of arbitrators. However, it may be doubtful whether an award rendered in proceedings consolidated by a court order would be enforceable against a party that had not consented to those proceedings.

[A/CN.9/362/Add.16]

## DRAFT ILLUSTRATIVE PROVISIONS

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## Introduction

1. The Working Group on International Payments decided that the Legal Guide should include a limited number of illustrative provisions (A/CN.9/357, paras. 93 and 94). The Working Group expressed support for the selection made in document A/CN.9/WG.IV/WP.51/Add.7 of the issues to which illustrative provisions should be added. The present document contains a revision of illustrative provisions published in document A/CN.9/WG.IV/WP.51/Add.7.

2. It is suggested that the illustrative provisions be included in the Legal Guide as footnotes.

3. As noted in document A/CN.9/WG.IV/WP.51/Add.7, paragraph 2, the preparation of the illustrative provisions has been influenced by the following considerations. Firstly, the draft Legal Guide discusses possible contractual solutions in such a way that the reader can derive from the draft chapters guidance to drafting clauses for a countertrade agreement. Secondly, illustrative provisions must of necessity be drafted in a general manner and may therefore not take into account the actual circumstances in a given countertrade transaction. These considerations reduce the number of illustrative provisions that can usefully be added to the Legal Guide.

4. In the Working Group it was suggested that in each illustrative provision reference should be made to the warning set out in chapter I, "Introduction", paragraph 13, that illustrative provisions should not necessarily be regarded as appropriate models for inclusion in individual agreements (A/CN.9/357, para. 93). In order to implement the suggestion, it is proposed that the following title be given to each set of illustrative provisions placed at the end of a given chapter: "*Illustrative provisions to chapter .. (care should be taken in using them, see 'Introduction', paragraph 13)*".

## Chapter VI. Type, quality and quantity of goods

[*Editorial note:* The following footnote to paragraph 25, except for the modifications in italics, appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chap-

ter V, Type, quality and quantity of goods, Footnote to paragraph 13".]

## Footnote to paragraph 25

Assuming that "*Y Company*" is committed to purchase goods from "*X Company*", the clause in the countertrade agreement may contain the following elements:

"When *X Company* makes, pursuant to the countertrade agreement, an offer for the conclusion of a supply contract, the goods offered for purchase must:

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

(b) be fit for any particular purpose expressly or impliedly made known to *X Company* at the time of the conclusion of the countertrade agreement;

(c) possess qualities consistent with those of the sample or model presented by *X Company* to *Y Company*;

(d) be contained or packaged in the manner usual for such goods or, where no such usual manner has been established, in a manner adequate to preserve and protect the goods."

(The clause is modelled on article 35 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)).

## Chapter VII. Pricing of goods

[*Editorial note:* The following footnote to paragraph 48, except for the addition in italics, appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter VI, Pricing of goods, Footnote to paragraph 37".]

## Footnote to paragraph 48

Assuming that the currency of payment is the Austrian schilling and that the reference currency is the Swiss franc, the clause may read as follows:

"If, on the date of actual payment, the exchange rate between the Austrian schilling and the Swiss franc is at variance from the exchange rate . . . [specify exchange rate prevailing at a particular place] as it was on the date of conclusion of the countertrade agreement by more than . . . [e.g., 5 per cent, or some other percentage specified by the parties], the price in Austrian schillings shall be increased or decreased so that that price, as converted into Swiss francs, would remain unchanged from the price as expressed in Swiss francs on the date of conclusion of the countertrade agreement." *(It should be noted that the foregoing clause may lead to an unintended and unsuitable result if the applicable exchange rate were to be set by an administrative decision independent of events in the currency market (see paragraph 49)).*

### Chapter VIII. Participation of third parties

[*Editorial note:* The following footnotes to paragraphs 12, 18 and 23 are revisions of the footnotes to paragraphs 10, 16 and 21, which appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter VIII, Participation of third parties". The revisions are underlined. The footnote to paragraph 18, third sentence, is new.]

#### Footnote to paragraph 12

Assuming that "Y Company" is the party originally committed to purchase, the clause may read as follows:

"Y Company is authorized to engage a third-party purchaser to make the purchases necessary to fulfil the countertrade commitment." *(To this clause, the parties may add a stipulation discussed in paragraph 18 indicating whether or not, after the engagement of the third party, the party originally committed continues to be liable for the fulfilment of the countertrade commitment.)*

#### Footnote to paragraph 18, third sentence

[*new footnote*] Assuming that "Y Company" is the party originally committed to purchase and "X Company" is the supplier, the clause in the countertrade agreement may read as follows:

"The fact that Y Company engages a third party to make the purchases necessary to fulfil the countertrade commitment and that the third party makes a commitment to X Company to make those purchases does not release Y Company from liability for a failure to fulfil the countertrade commitment."

#### Footnote to paragraph 18, sixth sentence

Assuming that "Y Company" is the party originally committed to purchase, and "X Company" is the supplier, the clause in the countertrade agreement may read as follows:

"Y Company will be released from liability for fulfilment of the countertrade commitment when, upon the engagement of a third-party purchaser by Y Company, the commitment of Y Company to purchase goods from X Company is transferred to the third-party purchaser. [The transfer includes the obligation to pay the liquidated damages in the case of a failure to make the

purchases.] For such a transfer to be effective, Y Company, X Company and the third-party purchaser must agree to the transfer."

#### Footnote to paragraph 18, seventh sentence

Assuming that "Y Company" is the party originally committed to purchase, and "X Company" is the supplier, the clause in the countertrade agreement may read as follows:

"Y Company undertakes to release X Company from liability for fulfilment of the countertrade commitment when, upon the engagement of a third-party purchaser by Y Company, X Company and the third-party purchaser conclude an agreement whereby the third-party assumes a commitment to make the purchases necessary to fulfil the countertrade commitment of Y Company."

*If the foregoing provision is included in the countertrade agreement, the actual release of X Company from liability for fulfilment of the countertrade commitment can be expressed in the following form:*

"X Company, having agreed with Z Company (third-party purchaser) that Z Company assumes the commitment to make the purchases necessary to fulfil the countertrade commitment of Y Company, consents to the release of Y Company from the liability for the fulfilment of the countertrade commitment. The release of Y Company becomes effective when the agreement between X Company and Z Company becomes effective."

#### Footnote to paragraph 23

Assuming that "Z Company" is the third-party purchaser, "Y Company" is the party originally committed to purchase, and "X Company" is the supplier, the clause in the contract between Y Company and Z Company may read as follows:

"Z Company shall conclude with X Company an agreement in which Z Company will agree to make the purchases necessary to fulfil the countertrade commitment set forth in the countertrade agreement between Y Company and X Company, a copy of which is attached to this contract. Z Company agrees to be bound by all the terms and conditions of that countertrade agreement, and in particular Z Company agrees to pay the liquidated damages stipulated in the countertrade agreement in the event Z Company fails to make the purchases necessary to fulfil the countertrade commitment."

### Chapter X. Restrictions on resale of goods

[*Editorial note:* The following footnote to paragraph 10 appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter X, Restrictions on resale of goods, footnote to paragraph 9". No substantive change to the text of the footnote has been made.]

#### Footnote to paragraph 10

Assuming that "Y Company" is the party purchasing goods pursuant to the countertrade agreement and that "X Company" is the supplier, the clause may read as follows:

"Y Company must inform X Company

[*alternative A:*] of the resale of those goods; the information shall be given within ... days after the conclusion of the resale contract.

[*alternative B:*] of the negotiations for the resale of the countertrade goods; Y Company shall give X Company [...] days] [sufficient time] to make any observations or suggestions on the intended resale, and Y Company shall refrain from concluding the resale contract under negotiation before the expiry of that time period.

The information to be given must indicate ... [include some or all of the following: country, region within a country, or city to which the countertrade goods are to be shipped; place of business of the person to whom the goods are being resold; resale price; whether the countertrade goods have been re-marked or repackaged prior to resale and, if so, what packaging or marking has been used.]"

## Chapter XI. Liquidated damages and penalty clauses

[*Editorial note:* The following footnotes to paragraphs 6, 12 and 26 of draft chapter XI appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter XI, Liquidated damages and penalty clauses" as footnotes to paragraphs 5, 12 and 22. The modifications of the footnotes are in italics].

### Footnote to paragraph 6

Assuming that "X Company" is the supplier, "Y Company" is the party committed to purchase, and the Austrian schilling is the currency of payment, the clause may read as follows:

[*For failure to purchase goods*]

"(1) If Y Company fails to make the purchases necessary to fulfil the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, Y Company will be obligated to pay to X Company an amount in Austrian schillings equivalent to ... per cent of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, Y Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

(2) To the extent that the failure by Y Company results from a failure by X Company to make goods available in conformity with this countertrade agreement, paragraph (1) will not apply."

[*For failure to supply goods*]

"(1) If X Company fails to make the goods available for the fulfilment of the countertrade commitment before the expiry of the period stipulated for the fulfilment of the countertrade commitment, X Company will be obligated to pay to Y Company an amount in Austrian

schillings equivalent to ... per cent of the unfulfilled portion of the countertrade commitment. Upon payment of that amount, X Company will be released from the portion of the unfulfilled countertrade commitment for which the agreed sum was claimed.

(2) To the extent that the failure by X Company results from a failure by Y Company to fulfil its obligations under this countertrade agreement, paragraph (1) will not apply."

*Footnote to paragraph 12 (provision that could be added to any liquidated damages or penalty clause)*

"No damages are recoverable in addition to the agreed sum for the failure for which the agreed sum is payable."

*Footnote to paragraph 26 (provision that could be added to any liquidated damages or penalty clause)*

Assuming that "X Company" is the beneficiary of the clause and "Y Company" is the party obligated to pay the agreed sum, the stipulation may read as follows:

"If payment of the agreed sum becomes due in accordance with paragraph (1), X Company has the right to deduct the agreed sum from funds of Y Company held by X Company or to set off the claim for the agreed sum against a countervailing claim by Y Company against X Company. [A deduction or setoff is permitted only if the funds held by X Company, or the claim by Y Company, arise from the following contracts ...]"

## Chapter XIII. Failure to complete countertrade transaction

[*Editorial note:* The following footnotes to paragraphs 7, 21, 23, 44 and 50 appeared in document A/CN.9/WG.IV/WP.51/Add.7 under the title "Chapter XIII, Failure to complete countertrade transaction" as footnotes to paragraphs 6, 22, 24, 43 and 49. Slight editorial changes are in italics.]

### Footnote to paragraph 7

Assuming that "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

"If X Company fails to accept a purchase order made by Y Company in accordance with this countertrade agreement [or a purchase order made by a third-party purchaser engaged by Y Company pursuant to this countertrade agreement], Y Company is entitled to declare the amount of the outstanding countertrade commitment reduced by the amount of the purchase order that was not accepted."

When it is agreed that Y Company must give an additional period to X Company, the following clause may be added to the previous one:

"In order to avail itself of the right to declare the outstanding countertrade commitment reduced, Y Company must give X Company written notice specifying that the failure to accept the purchase order constituted a breach of the countertrade commitment and that the

outstanding countertrade commitment will be reduced by the amount of the unaccepted purchase order if X Company does not make the goods available within the additional period of [e.g., 30] days."

#### Footnote to paragraph 21

Assuming that "Y Company" is the party committed to purchase and that "X Company" is the supplier, the clause may read as follows:

"(1) [Y Company] [X Company] is exempt from the payment of damages, or of an agreed sum, in respect of a failure to fulfil its obligations under the countertrade agreement if that party proves that the failure was due to a physical or legal impediment beyond its control and that the party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the countertrade agreement or to have avoided or overcome it or its consequences.

(2) The period for the fulfilment of the countertrade commitment will be extended by a period of time corresponding to the duration of the impediment. If the impediment lasts longer than [e.g., six months], [the party against which the impediment is claimed] [either party] may terminate the countertrade agreement by written notice."

#### Footnote to paragraph 23

[General definition of exempting impediment followed by illustrative or exhaustive list]

"(1) [Same text as in para. (1) of the illustrative provision to paragraph 21]

(2) [Illustrative list:] The following are examples of events that are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1): . . . [Exhaustive list:] Only the following events are to be regarded as exempting impediments, provided that those events satisfy the criteria set forth in paragraph (1)."

#### Footnote to paragraph 44

Assuming that "Y Company" is the exporter (counter-importer) and that "X Company" is the importer (counter-exporter), the clause would read as follows:

"A failure by Y Company to purchase goods pursuant to this countertrade agreement does not entitle X Company to suspend or withhold payment due by X Company to Y Company under the contract for the supply of . . ."

#### Footnote to paragraph 50, first sentence

"If a contract for the supply of goods in one direction is terminated, neither party is entitled, irrespective of the cause for the termination, to suspend conclusion of contracts in the other direction or to suspend or withhold performance of obligations under concluded contracts in the other direction."

#### Footnote to paragraph 50, second sentence

"If a contract for the supply of goods by X Company to Y Company concluded pursuant to this countertrade agreement is terminated, neither party is entitled, irre-

spective of the cause for the termination, to suspend or withhold performance under the contract for the supply of goods by Y Company to X Company."

### Chapter XIV. Choice of law

[Editorial note: The footnotes to paragraph 21 (to the second sentence and the fourth sentence) appeared in document A/CN.9/WG.IV/WP.51/Add.7 as footnotes to paragraph 20. The modifications in the text of the footnote to paragraph 21, second sentence, are in italics. The footnotes to paragraphs 15 and 24 are new.]

#### Footnote to paragraph 15

[new footnote] "This countertrade agreement as well as the contracts entered into pursuant to it are to be governed by the rules of (specify the set of rules such as the United Nations Convention on Contracts for the International Sale of Goods)."

#### Footnote to paragraph 21, second sentence (illustrative provision for the countertrade agreement and for a supply contract)

"This . . . (specify countertrade agreement or supply contract) is to be governed by the law of . . . (specify a country or a particular territorial unit) [as in force on . . . (specify date the countertrade agreement or the supply contract is entered into)]. [This designation refers to the substantive law of (specify the same country or territorial unit as above) and not to its conflict-of-laws rules.]"

#### Footnote to paragraph 21, fourth sentence (illustrative provision for the countertrade agreement and for a supply contract)

[Same as in footnote to paragraph 21, second sentence, with the addition, after the first sentence, of the following:] "The selected law governs in particular the formation of and validity of the contract and the consequences of its invalidity."

#### Footnote to paragraph 24

[new footnote] "This countertrade agreement is to be governed by the law of . . . (specify a country or a particular territorial unit) [as in force on . . . (specify date the countertrade agreement or the supply contract is entered into)]. The contracts concluded pursuant to this countertrade agreement are to be governed by (specify the same law as in the previous sentence or a different law). [The rules of private international law of . . . (specify the same country or territorial unit as in the previous two sentences) do not apply.]" (For the discussion of the question whether the same national law or different national laws should be chosen, see paragraphs 25 to 29.)

### Chapter XV. Settlement of disputes

The model clauses recommended in the UNCITRAL Conciliation Rules and in the UNCITRAL Arbitration Rules are incorporated in footnotes to paragraphs 14 and 30 of chapter XV (A/CN.9/362/Add.15). In order to imple-

ment the decision of the Working Group on International Payments that the Legal Guide should indicate that there exist a number of different conciliation and arbitration rules (A/CN.9/357, para. 101), the following modifications are suggested to draft chapter XV (A/CN.9/362/Add.15):

In paragraph 14, last sentence, delete the words "prepared by an international organization" and add at the end of the paragraph the following sentence: "Other sets of conciliation rules have been prepared by various international and national organizations."

At the end of footnote 1, add the following sentence: "The use of other conciliation rules may also be appropriate in a given case."

In paragraph 30, second sentence, delete the words: "such as the one accompanying the UNCITRAL Arbitration Rules".

At the end of footnote 4, add the following sentence: "The use of other arbitration rules may also be appropriate in a given case."

At the beginning of footnote 5, add the following text: "A number of model arbitration clauses exist. Generally, it is advisable to use the model clause that pertains to the chosen arbitration rules."

[A/CN.9/362/Add.17]

## CHAPTER SUMMARIES

The Working Group on International Payments decided that, in order to facilitate the use of the Legal Guide, each chapter should be preceded by a summary (A/CN.9/357, para. 15). In accordance with that decision, the present addendum contains summaries of chapters II to XV of the draft Legal Guide.

### II. Scope and terminology of Legal Guide

Countertrade transactions covered by the Legal Guide are those transactions in which one party supplies goods, services, technology or other economic value to the second party, and, in return, the first party purchases from the second party an agreed amount of goods, services, technology or other economic value. A distinctive feature of these transactions is the existence of a link between the supply contracts in the two directions in that the conclusion of the supply contract or contracts in one direction is conditioned upon the conclusion of the supply contract or contracts in the other direction (paragraph 1). The discussion in the Guide on goods is generally applicable also to services, and can be used as a broad guidance also for transactions involving technology (paragraph 2). The focus of the Guide is on countertrade transactions in which the goods are delivered across national boundaries (paragraph 3).

Countertrade transactions take a variety of forms and display differing features. The discussion in the Legal Guide is relevant generally to all types of countertrade unless otherwise indicated (paragraphs 4 to 6).

The Guide focuses on the drawing up of contractual clauses that are specific to or of particular importance for

international countertrade (paragraph 7). As a rule, it does not deal with the content of the contracts for individual supplies of goods under a countertrade transaction since those contracts generally resemble contracts concluded as discrete and independent transactions (paragraph 8).

In some countries, countertrade is subject to governmental regulations, which may promote or restrict countertrade in a variety of ways. In addition, various aspects of countertrade transactions are likely to be subject to regulations that are not specifically oriented to countertrade. Since the regulations are disparate and often changed, advice is given, where appropriate, in the form of a general warning that a matter being discussed may be subject to mandatory regulations (paragraphs 9 and 10). Private law questions involved in countertrade generally do not vary from region to region (paragraph 11).

Terminology used in countertrade varies, and no prevailing terminology has developed. The chapter establishes the terminology used in the Legal Guide for various types of countertrade transactions as well as for parties, contracts and subject-matters involved in a transaction (paragraphs 12 to 28).

The terms used for various types of countertrade are: "barter" (paragraph 14); "counter-purchase" (paragraph 15); "buy-back" (paragraph 16); "direct offset" and "indirect offset" (paragraph 17).

The terms used to denote parties to countertrade transactions are: "purchaser"; "supplier" or "party" (paragraph 18); "exporter" or "counter-importer" (paragraph 19); and "importer" or "counter-exporter" (paragraph 20).

The term "countertrade transaction" is used to refer to the whole countertrade arrangement (paragraph 23). The expressions for various contracts forming part of a countertrade transaction are: "countertrade agreement" (an agreement setting forth various stipulations on the manner in which the countertrade transaction is to be implemented (paragraph 24)); "countertrade commitment" (a commitment of the parties to enter into a future contract (paragraph 25)); "supply contracts" (paragraph 26); "export contract", "import contract", "counter-export contract" and "counter-import contract" (paragraph 27).

The use of the term "goods" is explained in paragraph 28.

### III. Contracting approach

Parties may embody their obligations in regard to the shipments of goods in the two directions in a single contract or in separate contracts. A single contract may take the form of a barter contract, which is a contract involving an exchange of goods for goods, or the form of a "merged contract", an arrangement in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation (paragraphs 1 to 10).

When the shipments in the two directions are embodied in separate contracts, various contracting approaches are

used. Under one approach, the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently (paragraphs 11 to 19). This approach is used when the parties wish to finalize a contract for the shipment in one direction (export contract) before they are able to agree on the contract for the shipment in the other direction (counter-export contract). The purpose of the countertrade agreement in such a case is to express the commitment to conclude a counter-export contract or contracts and, to the extent possible, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under another approach, the countertrade agreement is concluded prior to the conclusion of any definite supply contracts. This approach is usually used when the parties wish to lay down a contractual framework within which a certain level of reciprocal trade should be generated over a period of time. The aim of the countertrade agreement in such a case is to express the commitment to conclude supply contracts in the two directions and, to the extent possible, to outline the terms of the future contracts and to establish procedures for concluding and carrying out those contracts (paragraphs 11, 12, 20 and 21). Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under yet another approach, the parties conclude simultaneously the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between those contracts (paragraphs 11, 12, 40 and 41). Since this approach does not require a commitment to conclude future contracts, this contracting approach raises a limited number of issues. The main issue to be addressed in the countertrade agreement is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked. Other possible issues are mentioned in paragraphs 41 and 42.

In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. Insurable risks include commercial and non-commercial risks. Among the principles on which the export-credit insurance is based, some are particularly relevant to countertrade transactions (paragraphs 43 to 51, in particular 49 to 52).

Parties often require financing in order to be able to carry out the transaction. An important factor in the consideration by the financial institution whether to grant financing is the ability of the party requesting financing to insure its risk that the payment claim arising from its delivery of goods will not be paid. Financing may be in the form of a supplier credit or a buyer credit (paragraphs 53 to 55).

#### IV. Countertrade commitment

A countertrade commitment is an undertaking to conclude a future contract or a series of supply contracts in one or in both directions (paragraph 1). A commitment may be a "firm" commitment or a more limited "best-efforts" type of commitment. The Legal Guide focuses on firm countertrade commitments (paragraph 2).

The extent of a countertrade commitment, i.e., the amount of goods to be purchased, may be expressed as an absolute monetary value, as a percentage of the value of the goods delivered, or as a number of units of a given type of goods (paragraphs 3 and 4). The countertrade agreement may provide that only the purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment ("additionality") (paragraphs 5 and 6).

The parties may specify in the countertrade agreement that the period for fulfilment of the countertrade commitment is to commence on a fixed date and to expire on a fixed date (paragraph 7), or that the fulfilment period of an agreed length is to commence when an event specified in the countertrade agreement takes place (paragraph 8). A number of factors are relevant in the determination of the length of the fulfilment period (paragraph 9 to 12). The fulfilment period may be extended in certain circumstances (paragraphs 13 to 16). Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods (paragraphs 17 to 20).

The parties should define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts"). Eligible supply contracts may be defined by specifying the type of goods to be purchased (paragraphs 21 to 25), by the geographical origin of the goods (paragraphs 26 and 27), by the identity or the type of the supplier (paragraph 28), or by the identity or type of purchaser (paragraph 29). It may be agreed that under certain circumstances non-conforming purchases will be counted towards fulfilment of the countertrade commitment (paragraph 30).

In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the deducted amount is referred to as "fulfilment credit"). Sometimes it is agreed that fulfilment credit will be granted at a rate higher or lower than the full purchase price, depending on the type of goods purchased, the identity of the supplier or the time when a purchase is made (paragraphs 31 to 34).

It is advisable that the countertrade agreement indicate the specific action that must be taken in order for the countertrade commitment to be fulfilled. The parties may agree either that fulfilment occurs upon the conclusion of a supply contract or upon the performance of a supply contract (paragraphs 35 to 37).

It is advisable that the parties include in the countertrade agreement, in as definite a manner as feasible, the terms of the future contract (paragraphs 38 to 43) or provide for means for subsequent determination of those terms. Those means include standards or guidelines to be used in determining a particular contract term (paragraphs 44 to 46), determination of a contract term by a third person (paragraphs 47 to 54), and determination of a contract term by a contract party (paragraphs 55 and 56). In addition, the countertrade agreement may provide for negotiation procedures for the conclusion of a supply contract (paragraphs 57 to 60).

The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment (paragraph 61). Such procedures include the exchange of information (paragraphs 62 to 64), the confirmation of fulfilment of a countertrade commitment (paragraphs 65 to 67), and "evidence accounts" (paragraphs 68 to 74).

## V. General remarks on drafting

The parties may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts) (paragraphs 1 and 2). The applicable law may require that the contracts should be in writing; even if no such requirement exists, it is recommended that the contracts be in writing (paragraph 3).

In drawing up contracts that make up the countertrade transaction, the following matters should be taken into account: the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents, on the other hand (paragraph 4); designation of one person primarily responsible for supervising the preparation of the drafts (paragraph 5); provisions of the applicable law on the interpretation of contracts and presumptions on the meaning of certain expressions (paragraph 6); mandatory provisions (paragraph 7); introductory recitals (paragraph 8); use of standard forms, general conditions, standard clauses and previously concluded contracts (paragraph 9); use of one or more than one language for the contractual documents (paragraphs 10 to 12); identification and description of the parties in a principal document designed to come first in logical sequence amongst various documents (paragraph 13); the source of the legal status of parties that are legal persons, and any particular considerations when a party is a governmental agency (e.g., authorization for the conclusion of a contract or an arbitration agreement) (paragraph 14); the name, address, status and authority of any agents (paragraph 15).

It is desirable for the parties to consider the form that notifications under the countertrade transaction are to take and the means of transmittal (paragraph 16 and 17), the point of time when notifications are to be deemed effective (paragraph 18), addressees of notifications (paragraph 19), and the consequences of a failure to notify and of a failure to respond to a notification (paragraph 20).

It is advisable to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contracts (paragraphs 21 to 24).

## VI. Type, quality and quantity of goods

The discussion concerning "goods" in the Legal Guide is broadly applicable also to services and technology (paragraph 1).

The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known (paragraph 2).

Various commercial considerations enter into the selection of the type of goods to be supplied under the countertrade transaction. The freedom of the parties to agree on the type of goods may be affected by government regulations (paragraphs 3 to 6).

When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of goods the purchase of which would count towards fulfilment of the countertrade commitment. If such a list is used, the parties may settle questions such as the availability of goods on the list, purchaser's duty to provide specifications and requirements, "additionality" and procedure for deciding on the type of goods (paragraphs 7 to 14). Services and technology as subject-matters of countertrade are discussed in paragraphs 15 to 23.

The question of quality of countertrade goods raises two main issues that the parties may address in the countertrade agreement: expressing the level of quality that the goods offered for purchase must possess (paragraphs 24 to 28), and the establishment of procedures to ascertain, before the conclusion of a supply contract, whether goods being offered meet the specified level of quality (paragraphs 29 to 32).

The quantity of goods to be purchased may be specified in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts. The quantity may be expressed as a monetary amount or as a number of units to be purchased, or the quantity may be left to be determined on the basis of the purchaser's requirements or the supplier's output (paragraphs 33 to 39).

Particularly in long-term transactions, it may be provided that, at regular intervals or in response to specified changes of circumstances, the parties will review the provisions in the countertrade agreement on the type, quality or quantity of goods. The parties may wish to stipulate in the countertrade agreement that under certain conditions fulfilment credit would be earned by the purchase of goods other than those stipulated in the countertrade agreement (paragraph 40 and 41).

## VII. Pricing of goods

The chapter deals with methods for determining the price of goods that will be the subject-matter of the supply contract to be concluded pursuant to the countertrade commitment. It also deals with certain pricing questions encountered in the specific contexts of supplying services and the transfer of technology. In addition, it discusses the currency in which a price is expressed and the revision of a price.

It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future supply contract. When the parties are not able to do so, it is advisable to provide in the countertrade agreement a method for determining the price at the time the supply contract is to be concluded (paragraphs 1 to 6).

The currency in which the price is to be paid may involve risks arising from the fluctuation in exchange rates between that currency and other currencies. In stipulating the currency, the parties should take into consideration foreign exchange regulations. The parties may wish to denominate the price in a stable currency or in a unit of account (paragraphs 7 to 10).

The countertrade agreement may provide for a determination of the price through the use of a standard, a method that provides a price at the time of the conclusion of a

supply contract in a manner not influenced by the will of the parties. Possible price standards include: a reported market price for goods or services of standard quality; production cost of the goods; competitor's price; most-favoured-customer price (paragraphs 11 to 20).

The parties may stipulate in the countertrade agreement that the price to be paid under a future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement. It is advisable that, to the degree possible, the parties agree on guidelines for the negotiation of the price (paragraphs 21 to 24).

Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question) (paragraphs 25 and 26). Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement, a method with respect to which utmost caution is advisable (paragraph 27).

Prices for services may be set as rates for units of work processes or as a lump sum, or they may be set on a cost-reimbursable basis (paragraphs 28 to 31).

For setting the price for a technology transfer, the two principal forms are the lump-sum payment and payment of royalties (paragraphs 32 to 38).

When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. A revision may take place at specified points of time or in response to specified changes in the economic conditions (paragraphs 39 to 43). Possible methods of price revision include the reapplication of the method used to determine the original price (paragraph 44); an index clause, a method by which the price of the countertrade goods is made to depend on the levels of the prices of specified goods or services (paragraphs 45 to 47); a currency clause or a unit-of-account clause, whereby the price is linked to an exchange rate between the currency in which the price is to be paid and a stipulated other currency (paragraphs 48 to 52).

### VIII. Participation of third parties

The chapter deals with cases in which a party committed to purchase or committed to supply goods, instead of itself purchasing or supplying goods, engages a third party to do so (sections B and C). Section D deals with "multi-party" transactions that are distinct from the cases discussed in sections B and C.

A party committed under a countertrade agreement to purchase goods (party "originally" committed to purchase goods) often engages a third party ("third-party purchaser") to make those purchases (paragraphs 4 to 7). When such participation of a third-party purchaser is envisaged, it is advisable to address in the countertrade agreement the question of the selection of the third-party purchaser and the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment (paragraphs 9 to 20). In addition, the party originally committed to purchase goods and the third-party purchaser should conclude a contract to deal with questions such as the nature of the commitment of the third party (a "firm" commitment or a "best-efforts" commitment, paragraph 22); fee payable to the third party (paragraphs 30 to 36); "hold-harmless" clause (paragraph 37); and the question whether the third

party should have an exclusive or non-exclusive mandate to purchase and resell the goods (paragraphs 38 to 40).

Sometimes, the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser or a third party may assume in the future (paragraph 8).

The party committed to supply goods (party "originally" committed to supply) sometimes designates a third party ("third-party supplier") to supply the goods (paragraphs 41 to 44). When the participation of a third-party supplier is envisaged, it is advisable for the countertrade agreement to address the selection of the third party and the consequences of the failure by the third party to make the agreed goods available. In some transactions, the selection of the third-party supplier is left to the party committed to purchase goods (paragraphs 45 and 46). In other transactions, the selection is left to the party originally committed to supply goods (paragraphs 47 to 52).

As to "multi-party" countertrade transactions, three types are described in the chapter: (a) tripartite transaction that involves the exporter (who does not at any stage of the transaction assume a commitment to counter-import), the importer and the third-party counter-importer; (b) tripartite transaction that involves the exporter, the importer (who does not at any stage of the transaction assume a commitment to counter-export) and a third-party counter-exporter; and (c) four-party transaction in which the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties (paragraphs 53 to 58).

### IX. Payment

Parties to a countertrade transaction may decide to link payments for the supply contracts in the two directions in such a way that the proceeds generated by the supply contract in one direction are to be used to pay for the supply contract in the other direction. This allows the transfer of funds between the parties to be avoided or reduced (paragraphs 1 to 8).

Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract) in order to generate funds to pay for the counter-export. In such a case, sometimes referred to as "advance purchase", it may be agreed that the proceeds of the export contract are to be retained by the importer until payment under the subsequent counter-export contract becomes due (paragraphs 9 to 13). When in an advance-purchase situation the proceeds generated by the export contract are not to be left under the control of the importer, the parties may agree on the use of a "blocked account" or of "crossed letters of credit" (paragraphs 14 to 18). Under a blocked-account method, the proceeds generated by the export contract are deposited in an account at an agreed bank, and the release of the money, intended as payment for the counter-export goods, is subject to agreed conditions (paragraphs 19 to 30). When crossed letters of credit are to be used, the funds payable under a letter of credit opened by the importer in favour of the exporter ("export letter of credit") are blocked in order

to be used to cover the letter of credit opened by the counter-importer in favour of the counter-exporter ("counter-export letter of credit") (paragraphs 31 to 37).

The parties may agree that their payment claims arising from the shipments made in the two directions would be set off. If an imbalance arises in the values of the deliveries, it can be settled by delivery of additional goods or by payment of money. In order to facilitate the setoff of claims, in particular in the case of multiple shipments, the parties may wish to use a record-keeping mechanism, which is referred to in the Guide as a "setoff account". A setoff account may be administered by the parties themselves or by a bank or banks (paragraphs 38 to 57).

Certain issues common to linked payment mechanisms (currency, designation of banks, interbank agreements, unused or excess funds, supplementary payments or deliveries, and bank charges) are discussed in paragraphs 58 to 65.

In the case of a "multi-party" countertrade transaction (i.e., "tripartite" or "four-party" countertrade; see chapter VIII), it might be agreed that the proceeds of the supply contract between one pair of parties will be used to pay for the supply contract between a different pair of parties. In a tripartite transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer; the counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a tripartite transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer, and the counter-importer (exporter) agrees that the payment claim under the export contract is discharged up to the value of the goods delivered to the counter-importer. In a four-party transaction, the exporter ships goods to the importer, and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter (paragraphs 66 to 73).

As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade (paragraphs 74 to 77).

## X. Restrictions on resale of countertrade goods

Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of goods purchased pursuant to the countertrade commitment (paragraphs 1 and 2).

The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competi-

tion and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices (e.g., against agreements setting a minimum price) (paragraph 3).

When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction (paragraphs 4 to 7).

Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction (paragraph 8).

The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods (paragraphs 9 and 10).

Parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods may resell those goods (paragraphs 11 to 16).

Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. It should be noted that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is generally prohibited or permitted only in limited circumstances (paragraphs 17 to 20).

The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. The parties should ensure that any packaging or marking requirements do not conflict with mandatory provisions at the place where the goods are to be resold (paragraphs 21 and 22).

When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in the observation by the third party of resale restrictions stipulated in the countertrade agreement (paragraphs 23 and 24).

Changes in the underlying commercial circumstances may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions (paragraph 25 and 26).

## XI. Liquidated-damages and penalty clauses

Liquidated-damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation, or a failure to perform it on time, entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties established their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or to do both (paragraph 1).

The chapter focuses on liquidated-damages and penalty clauses covering a failure to fulfil the countertrade commitment (paragraph 2). Such a failure may take the form of non-fulfilment or delayed fulfilment of the commitment (paragraphs 3 and 4). The clause may cover the purchaser's commitment to purchase goods or the supplier's commitment to make goods available (paragraphs 5 and 6).

Many national laws have provisions on liquidated-damages and penalty clauses. Those provisions include: a

mandatory restriction in some legal systems that clauses fixing an agreed sum to stimulate performance are invalid and that the party subject to such a clause is liable for a failure to perform only for the damages recoverable under the general law (paragraph 7); rules giving a power to the courts to reduce the amount of the agreed sum, or to award additional damages when the actual damage exceeds the agreed sum (paragraph 7); the rule that the agreed sum is not due if the party who failed to perform the obligation in question is not responsible for the failure (paragraph 8); other rules on the relationship between the recovery of the agreed sum and the recovery of damages (paragraph 12).

Liquidated-damages or penalty clauses should be distinguished from clauses limiting the amount recoverable as damages, clauses providing alternative obligations and clauses establishing an obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing payment claims are to be set off (paragraphs 9 and 10).

Where a party originally committed to purchase or to supply goods engages a third party to fulfil that commitment, it may be agreed that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods (paragraph 11).

An important question to consider is whether, by claiming the agreed sum, the beneficiary of the clause should be deemed to have forsaken fulfilment of the underlying obligation. Often the intention of the parties to countertrade transactions is that the beneficiary who chooses to claim the agreed sum is precluded from also claiming the fulfilment of the countertrade commitment. Sometimes, the parties intend that the agreed sum is to be payable for delay in fulfilment of the commitment, in which case the countertrade commitment remains outstanding despite payment of the agreed sum. It is advisable that the parties specify the effect of payment in the countertrade agreement (paragraphs 13 to 16).

The amount of liquidated damages or a penalty may be expressed as an absolute amount or as a percentage of the value of the outstanding countertrade commitment (paragraph 17). When the clause covers delay, an agreed sum is often fixed by way of increments, a specified amount being due for a specified time unit of delay (paragraph 18). Considerations relating to determining the appropriate amount of the agreed sum are discussed in paragraphs 19 to 23.

Issues related to obtaining the agreed sum that may be dealt with in the countertrade agreement include the following: a cut-off time for claiming the agreed sum (paragraph 24); payment of the agreed sum when the period for the fulfilment of the countertrade commitment is divided into subperiods (paragraph 25); a beneficiary's right to deduct the agreed sum from funds held by the beneficiary or a beneficiary's right to set off the claim to the agreed sum against a countervailing claim (paragraph 26); an independent guarantee to cover the obligation to pay the agreed sum (paragraph 27). The countertrade agreement may also address the possibility to terminate the countertrade commitment when the liquidated-damages or penalty clause covers delay (paragraph 28), and the effect of the termination of the countertrade commitment on the obligation to pay the agreed sum (paragraph 29).

## XII. Security for performance

The parties to a countertrade transaction may agree to use a guarantee to cover the fulfilment of the countertrade commitment. A guarantee may be used for the obligation to purchase goods, the obligation to supply goods, or both those obligations (paragraph 1).

A guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor is obligated to pay when the beneficiary of the guarantee presents to the guarantor a demand for payment and any additional document required under the terms of the guarantee; such a document may be, for example, the beneficiary's statement that the party who procured the guarantee (the "principal") has breached the underlying obligation, the beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person stating that the breach of the underlying obligation has occurred. The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and the supporting documents conform to the requirements specified in the guarantee. Despite the independence of the guarantee from the underlying obligation, payment under the guarantee may exceptionally be refused, in particular when the payment claim is fraudulent (paragraph 3).

Under an accessory guarantee, the guarantor must, before paying a claim, ascertain whether the underlying obligation was breached, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary (paragraph 4).

The discussion in the chapter is limited to independent guarantees, without thereby implying a preference for this type of guarantee. The discussion in the chapter applies not only to securities in the form of guarantees but also to securities in the form of stand-by letters of credit, which are the functional equivalent of independent guarantees (paragraphs 5 and 6).

When a guarantee is to be used, the parties should include in the countertrade agreement provisions on questions such as: who is to procure the guarantee (paragraph 8); whether payment under the guarantee releases the principal from the countertrade commitment (paragraph 9); the identity of the guarantor or how a guarantor is to be chosen (paragraphs 10 to 16); the documents that the beneficiary would have to present for the guarantor to be obligated to pay (paragraphs 17 to 22); the amount of the guarantee and possibly a mechanism to reduce that amount as fulfilment of the countertrade commitment progresses (paragraphs 23 to 26); time when the guarantee is to be issued (paragraphs 27 to 30); expiry of the guarantee (paragraphs 31 to 33); return of the guarantee instrument (paragraph 34); obligation to procure an extension of the guarantee as a result of an extension of the period for the fulfilment of the countertrade commitment (paragraphs 35 and 36); modification of the underlying commitment and modification of the guarantee (paragraphs 37 to 39).

In transactions in which goods shipped in the two directions are not to be paid in money, guarantees may be used to secure the liquidation through cash payment of a possible imbalance in the flow of trade (paragraphs 40 to 48).

### XIII. Failure to complete countertrade transaction

This chapter discusses remedies for non-fulfilment of the countertrade commitment (section B) and circumstances in which a party is exonerated from liability for a failure to fulfil the countertrade commitment (section C). Also discussed is the effect of a failure to conclude or perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section D). The discussion is set in the context of "firm" countertrade commitments (paragraphs 1 to 3).

It is advisable that countertrade agreements stipulate the remedies for a failure to fulfil the countertrade commitment since national laws generally do not contain rules specifically tailored to countertrade (paragraphs 4 and 5). Remedies to be considered are the release of a party from the countertrade commitment (paragraphs 6 to 10) or a monetary compensation, in particular in the form of liquidated damages or a penalty (paragraphs 11 and 12).

During the period for the fulfilment of the countertrade commitment, events of a legal or physical nature may occur that impede, permanently or temporarily, a committed party from concluding an envisaged supply contract. The party who fails to fulfil its commitment due to such an impediment may, according to the applicable law or according to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or may be released altogether from the commitment. Impediments that give rise to such an exemption are referred to as "exempting impediments" (paragraph 13).

Many national laws contain provisions concerning exempting impediments. However, since those provisions may lead to results that are incompatible with the needs of a given transaction, the parties may wish to include in the countertrade agreement a clause specifying the legal consequences of an exempting impediment (paragraphs 14 to 18) and a clause defining exempting impediments (paragraphs 19 to 34). The countertrade agreement may also contain a requirement that the party invoking an exempting impediment must give written notice of the impediment to the other party (paragraphs 35 and 36).

Since in a countertrade transaction the conclusion of a supply contract in one direction is conditioned upon the conclusion of a supply contract in the other direction, the question may arise whether a failure to conclude or perform a contract in one direction should have an effect on the obligation to conclude or perform a contract in the other direction. National laws normally do not provide a specific answer to the question of such interdependence of obligations in countertrade transactions. Therefore, in order to avoid uncertainty or disagreement, the parties may wish to include in the countertrade agreement clauses indicating the extent of the interdependence of obligations (paragraphs 37 to 42). Such clauses may address in particular the following problems in the completion of countertrade transactions: failure to conclude a supply contract as stipulated in the countertrade agreement (paragraphs 43 to 48), termination of a supply contract (paragraphs 49 to 55), failure to meet a payment obligation under a supply contract (paragraphs 56 to 60), failure to deliver goods under a supply contract (paragraph 61).

### XIV. Choice of law

The chapter focuses on the choice by the parties to a countertrade transaction of the law applicable to the countertrade agreement, the supply contracts in the two directions, and the contract by which a party committed to fulfil a countertrade commitment engages a third party to fulfil that commitment. The chapter considers also the question whether the countertrade agreement and the contracts forming part of the transaction should be made subject to a single national law or to different national laws (paragraph 1).

Under the rules of "private international law" (or "conflict-of-laws" rules) of many States, parties are permitted to choose by agreement the applicable law, though under some of those laws there are restrictions on that choice. If the parties do not choose the applicable law, the applicable law is determined by the application of rules of private international law (paragraph 2). By choosing the applicable law, the parties do not make a choice as to jurisdiction (paragraph 3). Whatever the chosen law, particular aspects of the countertrade transaction may be affected by mandatory rules (paragraphs 4 and 30 to 33). The extent to which the parties may designate issues to be governed by the chosen law may be limited (paragraph 5). The relevance of the United Nations Sales Convention for a countertrade transaction is discussed in paragraph 6.

In order to avoid uncertainty as to what law applies, it is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts (paragraphs 8 to 11). The extent to which the parties are allowed to choose the applicable law is determined by the rules of private international law. Under some systems of private international law, the autonomy of parties is limited, and they are permitted to choose only a national law that has some connection with the contract (the "nexus" rule). Under most systems of private international law, parties are permitted to choose the applicable law without those restrictions (paragraph 12).

When choosing the applicable law, it is in general advisable to choose the law of a particular country (paragraphs 13 to 18). Parties may wish to take the following factors into consideration in choosing the applicable law: the parties' knowledge of, or possibility of gaining knowledge of, the law; the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship; the extent to which the law contains mandatory rules that would prevent the parties from settling by agreement questions that arise in their contractual relationship (paragraph 19). Further issues the parties may wish to bear in mind are: possible changes legislated in the law chosen by the parties (paragraph 20); approach to the drafting of the choice-of-law clause (paragraph 21); separateness of the choice-of-law clause from the rest of the contract (paragraph 22); applicability of the chosen law to the prescription of rights (limitations of actions) (paragraph 23); advisability of designating the applicable law not only for the countertrade agreement but also for the future supply contracts (paragraph 24).

In choosing the applicable law, the parties may wish to consider whether the countertrade agreement and the supply contracts should be made subject to a single national law or to different national laws (paragraphs 25 to 29).

## XV. Settlement of disputes

It is advisable that the parties agree on the method by which future disputes arising out of the countertrade agreement and the related supply contracts would be settled. Dispute-settlement methods include negotiation, conciliation, arbitration and judicial proceedings (paragraphs 1 to 6). In some States, restrictions exist as to the freedom of a State agency to conclude an arbitration agreement or to agree to the jurisdiction of a court of a foreign State (paragraph 7).

Usually, the most satisfactory method of settling a dispute is through amicable settlement by negotiation between the parties (paragraphs 8 to 11).

If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceedings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator. If the parties provide for conciliation, they may settle relevant procedural issues by agreeing on a set of conciliation rules such as the UNCITRAL Conciliation Rules (paragraphs 12 to 15).

There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions (paragraphs 16 and 17). In general, arbitral proceedings may be conducted only if the parties agree thereto. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction (paragraphs 18 and 23). The parties are able to select the type of arbitration that best suits their needs (paragraphs 24 to 26).

The arbitral proceedings will normally be governed by the procedural law of the State where the proceedings take

place. It is advisable for the parties to agree on a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution (paragraphs 27 to 29). Some arbitration rules contain a model arbitration clause that invite the parties to settle in the arbitration clause matters such as the involvement of an appointing authority and the number of arbitrators (paragraphs 30 to 34), the place of arbitration (paragraphs 35 to 39) and the language or languages to be used in the arbitral proceedings (paragraphs 40 and 41).

Disputes that are not settled through negotiation or conciliation can be settled, if the parties do not opt for arbitration, in judicial proceedings. Courts of two or more States may be competent to decide a given dispute. Parties may agree on a jurisdiction clause under which the parties are obligated to submit disputes to a specified court (paragraphs 42 to 45).

Countertrade transactions often involve several contracts, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court (paragraphs 46 to 49).

Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods. In such multi-party disputes, it may be desirable to settle all related issues in the same dispute settlement proceedings (paragraphs 50 to 53).

### III. PROCUREMENT

#### A. Report of the Working Group on the New International Economic Order on the work of its thirteenth session

(New York, 15-26 July 1991) (A/CN.9/356) [Original: English]

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#### 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.<sup>1</sup> The Working Group commenced its work on this topic at its

tenth session (17 to 25 October 1988), by considering a study of procurement prepared by the Secretariat.<sup>2</sup> 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 discussion and decisions at the session.<sup>3</sup>

<sup>1</sup>Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17), para. 243.

<sup>2</sup>A/CN.9/WG.V/WP.22.

<sup>3</sup>A/CN.9/315, para. 125.

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 that 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.<sup>4</sup>

3. At the twelfth session (8 to 19 October 1990), the Working Group had before it the second draft of articles 1 to 35 (A/CN.9/WG.V/WP.28), as well as draft provisions on review of acts and decisions of, and procedures followed by, the procuring entity (draft articles 36 to 42, contained in A/CN.9/WG.V/WP.27). At that session, the Working Group reviewed the second draft of articles 1 to 27. It did not have sufficient time to review draft articles 28 to 35, or the draft articles on review of acts and decisions of, and procedures followed by, the procuring entity and decided to consider those articles at its thirteenth session. The Working Group requested the Secretariat to revise articles 1 to 27 to take into account the discussion and decisions concerning those articles at the twelfth session.<sup>5</sup> The Secretariat was also requested to report to the thirteenth session of the Working Group on the treatment in national procurement laws of competitive negotiation, one of the methods of procurement other than tendering that the Working Group had agreed the Model Law should allow under certain conditions.

4. The Working Group, which was composed of all States members of the Commission, held its thirteenth session in New York from 15 to 26 July 1991. The session was attended by representatives of the following States members of the Working Group: Bulgaria, Canada, Chile, China, Cuba, Cyprus, Egypt, France, Germany, India, Iran (Islamic Republic of), Iraq, Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Nigeria, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay and Yugoslavia.

5. The session was attended by observers from the following States: Brazil, Burkina Faso, Cape Verde, Colombia, Ecuador, Haiti, Honduras, Indonesia, Lebanon, Pakistan, Peru, Philippines, Republic of Korea, Sweden, Switzerland, Thailand, Turkey, Uganda, United Republic of Tanzania, Vanuatu, Venezuela, Viet Nam and Yemen.

6. The session was also attended by observers from the following international organizations:

(a) *United Nations organizations*: International Bank for Reconstruction and Development, United Nations Industrial Development Organization, Inter-Agency Procurement Services Unit;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Committee;

(c) *International non-governmental organizations*: International Bar Association, International Chamber of Commerce.

7. The Working Group elected the following officers:

*Chairman*: Mr. Robert Hunja (Kenya)

*Rapporteur*: Mr. Hussein Ghazizadeh (Islamic Republic of Iran).

8. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.V/WP.29);

(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: draft articles 1 to 35 of Model Law on Procurement (A/CN.9/WG.V/WP.30);

(d) Procurement: competitive negotiation; note by the Secretariat (A/CN.9/WG.V/WP.31).

9. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Procurement.
4. Other business.
5. Adoption of the report.

10. With respect to its consideration of agenda item 3, the Working Group decided to turn its attention first to draft articles 28 to 35 of the Model Law on Procurement (A/CN.9/WG.V/WP.30). It was decided to consider the report on competitive negotiation (A/CN.9/WG.V/WP.31) at the time of the consideration of the articles in the Model Law dealing with competitive negotiation.

11. The deliberations and decisions of the Working Group with respect to its consideration of draft articles 28 to 35 of the Model Law on Procurement and the report on competitive negotiations are contained in chapter I of the present report.

12. After the completion of consideration of draft articles 28 to 35 of the Model Law and of the report on competitive negotiation, the Working Group considered the review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law (A/CN.9/WG.V/WP.27).

13. The deliberations and decisions of the Working Group with respect to its consideration of draft articles 36 to 42 on the review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law are contained in chapter II of the report.

<sup>4</sup>A/CN.9/331, para. 222.

<sup>5</sup>A/CN.9/343, para. 229.

## DELIBERATIONS AND DECISIONS

### I. Discussion of draft articles 28 to 35 of the Model Law on Procurement

(A/CN.9/WG.V/WP.30)

#### Article 28

##### *Examination, evaluation and comparison of tenders*

##### *Paragraph (1)*

14. As regards subparagraph (a), the Working Group decided to retain the third sentence which allowed requests for clarifications of tenders, and responses to those requests, to be communicated by telephone subject to written confirmation, in view of the fact that such telephone communication was widely used. The Working Group noted that similar provisions on telephone communication had been added in a number of places in the Model Law and requested the Secretariat to consider consolidation of those provisions into a single provision.

15. It was proposed that the last sentence should be limited to restricting changes in the tender price, rather than also containing a prohibition against changes in other matters of substance. In support of that proposal, it was stated that the restriction on changes of substance other than price raised issues relating to the responsiveness of a tender, which was dealt with in other provisions of the Model Law, including articles 2(j), 28(2)(c) and 28(4). The Working Group requested the Secretariat to redraft the last sentence with a view to taking into account the aspect of responsiveness, including the permissibility of minor deviations pursuant to paragraph (4), and to allowing within that scope discussion for clarification of issues other than price.

16. As regards subparagraph (b), a view was expressed that the term "purely arithmetical errors apparent on the face of a tender" might raise difficulties in some legal systems. The Working Group decided to defer a decision on the subparagraph pending its consideration of other articles of the Model Law.

##### *Paragraph (2)*

17. A question was raised whether the present formulation, which obligated the procuring entity to "reject" a tender under the specified circumstances, implied a duty on the part of the procuring entity to take some formal action of rejection, beyond mere passive non-acceptance. Such a formal action might involve, for example, providing a contractor or supplier whose tender had been rejected with the reasons for the rejection. A view was expressed that the imposition of such a duty to give reasons for rejection of tender would be more appropriate in paragraph (2) than in article 29. It was suggested, however, that, if the intent of the provision was not to impose a duty to take a formal action and that mere non-action would suffice, words such as "shall not accept a tender" might be more appropriate in the *chapeau* than the words "shall reject a tender". At the same time, it was recognized that the question of whether to require a formal act of rejection was of particular significance to the rights and remedies of aggrieved contractors

and suppliers and that, therefore, the question should be considered in the context of the discussion of the draft articles on review.

18. A proposal was made to delete subparagraph (d), which provided for rejection of a tender received by the procuring entity after the deadline for submission of tenders, in view of the requirement in article 24(3) that late tenders be returned unopened. While it was suggested that the laws of some States required governmental entities to respond to submissions of documentation, the Working Group was agreed that subparagraph (d) could be deleted in view of the provision of article 24(3), to which reference might be made in the commentary to paragraph (2).

##### *Paragraph (3)*

19. The Working Group decided to replace the words "the procuring entity may reject a tender" in the first sentence by the words "the procuring entity shall reject a tender" so as to make the rejection of a tender mandatory rather than merely discretionary when a contractor or supplier attempted to improperly influence the procuring entity's decision. It was felt that such an approach was more apt to further the objectives of the Model Law.

##### *Paragraph (4)*

20. A view was expressed that, since paragraph (4), which permitted tenders with minor deviations from the required specifications to be considered responsive, and article 2(j), which defined the term "responsive tender", both dealt with the responsiveness of tenders, it was necessary either to delete the definition in article 2(j) or to ensure consistency in the language of the two provisions. The Working Group noted that a cross-reference to paragraph (4) had been added to article 2(j) with a view to establishing consistency between the two provisions.

21. It was observed that not all types of permitted deviations could be quantified as required by the second sentence. In the light of that observation, the Working Group decided to add the words "to the extent possible" after the words "shall be quantified".

##### *Paragraph (7)*

22. Concern was expressed as to the suitability of the term "most economic tender", which appeared in subparagraphs (a) and (c), on the ground that that term did not appear to take sufficient account of the use by the procuring entity of criteria other than price to select a tender. It was stated that the term, while appropriate in subparagraph (c)(i), which dealt with selection of the tender with the lowest price, was less appropriate in the context of subparagraphs (c)(ii) and (d), which referred to selection of a tender on the basis of criteria other than price. A similar concern was expressed with regard to the term "lowest evaluated tender" used in subparagraph (c)(ii). Similar misgivings were expressed with respect to the term "most advantageous tender" that had been used in the earlier draft. It was widely felt that a more neutral term, such as "successful" tender, should be used.

23. The view was expressed that it was not clear when the various criteria for the selection of a tender mentioned in subparagraphs (c)(i), (c)(ii) and (d) were applicable. It was generally agreed that in order to alleviate that lack of clarity it was necessary for paragraph (7) to make it clear that the procuring entity must indicate the selection criteria in the solicitation documents.

24. It was proposed that paragraph (7) might be simplified by deleting subparagraph (d). In support of that proposal it was suggested that the criteria referred to in subparagraph (d) could be viewed as encompassed within the criteria referred to in subparagraph (c)(ii). That proposal did not attract support as it was generally recognized that the socio-economic criteria in subparagraph (d) were distinct from the criteria in subparagraph (c)(ii), which referred to operational and functional characteristics of the goods or construction that tended to be quantifiable. It was suggested that, as an alternative to the deletion of subparagraph (d), the Model Law might limit the socio-economic criteria that a procuring entity would be permitted to consider to those set forth in the procurement regulations. However, it was generally felt that the identification of permissible socio-economic criteria was a basic element of the Model Law that should be retained. That view was reinforced by the fact that article 4 made the promulgation of procurement regulations discretionary. A proposal was made that subparagraph (d) should be expanded to include national defence and national security considerations.

25. Another proposal for simplifying paragraph (7) was to combine subparagraphs (d) and (e). In response, it was pointed out that the two provisions were conceptually different, as subparagraph (d) dealt with socio-economic criteria, while subparagraph (e) involved the application of a margin of preference in the form of a mathematical formula. However, the Working Group did accept a proposal to delete the second sentence of subparagraph (e), which dealt with detailed aspects of the application of a margin of preference. It was agreed that such detailed provisions were more appropriately dealt with in the procurement regulations. Yet another proposal was that additional clarity might be achieved by listing all the permissible criteria, presently contained in subparagraphs (c) and (d), in a single subparagraph.

26. The Working Group then considered the following proposed reformulation of subparagraphs (c), (d) and (e):

“(c) The successful tender shall be:

- (i) the tender with the lowest tender price, subject to any margin of preference applied pursuant to subparagraph (e); or
- (ii) if the procuring entity has so stipulated in the solicitation documents, the lowest evaluated tender ascertained on the basis of criteria specified in the solicitation documents, which criteria shall be objective and quantifiable to the extent possible.

“(d) In determining the lowest evaluated tender in accordance with subparagraph (c)(iii), the procuring entity may consider only the following:

- (i) the tender price, subject to any margin of preference applied pursuant to subparagraph (e);
- (ii) the cost of operating, maintaining and repairing the goods or construction, the time for delivery of the goods or completion of construction, the functional characteristics of the goods or construction, the terms of payment and of guarantees;
- (iii) socio-economic criteria including the balance of payments position or foreign exchange reserves of [this State], industrial off-sets, local content including manufacture, labour and materials, regional economic development, encouragement of domestic investment or activity, encouragement of employment equity, limitation of certain production to domestic suppliers, transfer of technology and the development of managerial, scientific and operational skills; and
- (iv) national defence and security considerations.

“(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 calculated in accordance with the procurement regulations.”

27. The Working Group noted that the term “successful tender” was being used provisionally pending the determination of a more suitable expression. Subparagraph (c)(i) was found to be satisfactory.

28. It was observed that the proposed reformulation of subparagraph (c)(ii) did not indicate the manner in which the quantification of the non-price criteria would be carried out. It was therefore proposed that the subparagraph provide that such criteria must be expressed in monetary terms or given a relative weight. That proposal gave rise to a discussion of whether the subparagraph should require both the assignment of a relative weight to non-price criteria and the expression of those criteria in monetary terms. In support of requiring both assignment of relative weight and expression in monetary terms, it was stated that leaving the procuring entity with a choice might be interpreted as giving the procuring entity the right to determine the manner of quantifying non-price criteria after tenders had been received, rather than requiring a decision upon a method of quantification at the outset and an indication of the manner of quantification in the solicitation documents. While the Working Group agreed with the need to make known the method of quantification of non-price factors in the solicitation documents, the prevailing view was that it was not advisable to require both the assignment of relative weight and expression in monetary terms. It was felt that such an approach would encounter difficulties because there were some types of such criteria that were difficult if not impossible to quantify.

29. A similar exchange of views took place with respect to the words "to the extent possible" in the proposed reformulation of subparagraph (c)(ii). The view was expressed that those words should be deleted because they might permit the procuring entity to avoid the obligation to quantify non-price criteria, thereby diminishing objectivity and transparency in the tendering proceedings. The prevailing view, however, was that the words "to the extent possible" should be retained with respect to the obligation to express non-price criteria in monetary terms.

30. A view was expressed that in the proposed reformulation of subparagraph (c)(ii), in particular because of the use of the term "criteria", it was not clear whether reference was being made to the situations in which a procuring entity might wish to consider non-price considerations rather than to the particular formulas to be applied in using non-price considerations in evaluating and comparing tenders.

31. In view of the foregoing deliberations and decisions, the Working Group agreed to the formulation of subparagraph (c)(ii) along the following lines, subject to the proviso that the procuring entity make clear in the solicitation documents the manner in which non-price criteria would be quantified:

- "(ii) if the procuring entity has so stipulated in the solicitation documents, the lowest evaluated tender ascertained on the basis of factors specified in the solicitation documents, which factors shall, to the extent practicable, be objective and quantifiable, and shall be given a relative weight in the evaluation procedure or be expressed in monetary terms wherever practicable."

32. The Working Group found subparagraphs (d)(i) and (ii) to be satisfactory.

33. It was generally agreed that the procuring entity should not have absolute discretion in the selection of non-price criteria to be used in evaluating and comparing tenders, as would be the case if no provisions were included in either the Model Law or the procurement regulations concerning the types of permitted non-price criteria. On that basis, the Working Group considered whether the Model Law should list permitted non-price criteria and whether such a listing in the Model Law should be exhaustive or illustrative, or whether it would suffice to provide that the procuring entity would be limited to using only those criteria set forth in the procurement regulations. It was recognized that listing such criteria in the procurement regulations rather than in the Model Law would have the advantage of flexibility since an enacting State that wished to alter the list of permitted criteria could do so more readily if the list were included in regulations rather than legislation. At the same time, any alteration of a listing in the procurement regulation would in all likelihood be subject to public scrutiny. Despite these advantages, the Working Group refrained from opting for a listing in the procurement regulations since article 4 provided that the promulgation of procurement regulations was optional and reliance on regulations would therefore

risk the possibility that a basic element of the procedures promulgated by the Model Law would not be adopted by some enacting States.

34. The decision to list permitted non-price criteria in the Model Law gave rise to the question whether the listing in the Model Law should be exhaustive or whether enacting States should be given the option of expanding the list set forth in subparagraph (d)(iii) in order to adapt tendering proceedings to their particular needs and circumstances. It was generally agreed that such flexibility was desirable and could be achieved by indicating in square brackets at the end of the subparagraph that enacting States could expand the list. The Working Group also agreed that the words "socio-economic criteria including" found at the beginning of the proposed subparagraph (d)(iii) should be replaced because the term "socio-economic" was not considered an appropriate description of the criteria set forth in the subparagraph and because the word "including" left it unclear whether the list of criteria in the subparagraph was intended to be exhaustive or merely illustrative. It was decided to use the words "other factors, namely," instead. It was further agreed to accept the addition in subparagraph (d)(iv) of national defence and security as an additional non-price criterion.

35. The Working Group agreed to the proposed reformulation of subparagraph (e).

#### *Paragraph (8)*

36. A question was raised as to whether paragraph (8) should specify the point of time and rate of exchange at which tender prices expressed in different currencies would be converted into a single currency for the purpose of evaluating and comparing tenders. The Working Group agreed that such a modification was unnecessary because the point of time and rate of exchange were specified in article 17(2)(g) and decided that inclusion of a cross-reference to that provision was unnecessary. The Working Group further decided to retain the words "of all tenders" and "the same" that had been added to it to make clear that all tender prices were to be converted to the same currency.

#### *Paragraph (8 bis)*

37. A view was expressed that the nature of the reconfirmation of the qualifications of the successful contractor or supplier referred to in the paragraph was not clear in the light of the practice in some States according to which the initial qualification or the prequalification of contractors and suppliers was merely a preliminary examination of qualifications for the purpose of determining whether to permit contractors and suppliers to submit tenders. Under such an approach, at a later stage the contractor or supplier submitting the successful tender was subject to an in-depth examination of its qualifications. It was suggested that the Model Law should accommodate a two-stage approach of that type. The prevailing view, however, was that in the interest of fairness the reconfirmation of qualifications should be limited to verifying whether the data submitted at the initial or prequalification stage had changed. Accordingly, the Working Group affirmed that the Model Law should make it clear that the criteria used in reconfirming qualifications should be the same as those

used in prequalification. Furthermore, in order to minimize uncertainty as to the nature of reconfirmation, the Working Group agreed that the use of the word "re-evaluating" in article 8 *bis* (6) needed to be reviewed.

38. The Working Group next considered whether, as in the existing draft, reconfirmation should be mandatory when the procuring entity had engaged in prequalification, and discretionary when no prequalification proceedings had been engaged in. It was noted that article 8 *bis* (6) left reconfirmation discretionary, without requiring reconfirmation in either type of situation. The Working Group agreed that the need for reconfirmation depended on the particular circumstances of tendering proceedings and that it was inappropriate for the Model Law to establish a general requirement of reconfirmation for tendering proceedings in which the procuring entity had engaged in prequalification. Accordingly, it was decided to align paragraph (8 *bis*) with the discretionary approach taken in article 8 *bis* (6).

39. The Working Group noted that, in accordance with articles 28(2)(a) and 32(1), the procuring entity was obligated to reject the selected tender if the contractor or supplier in question failed to reconfirm its qualifications. However, the question remained whether the Model Law should indicate how the procuring entity should proceed in such a case. According to one view, the Model Law, in the interest of fairness to the remaining contractors and suppliers, should obligate the procuring entity to select the next most economic tender. The prevailing view, however, was that such an obligation was overly restrictive since the possibility existed that, for a variety of reasons, none of the remaining tenders would be acceptable. It was considered to be more appropriate to obligate the procuring entity to select the next most economic tender, subject to the right to reject all tenders under article 29. The Working Group noted that such an approach would be in line with the discretionary approach taken in article 32(4) for the case in which the contractor or supplier whose tender had been accepted failed to sign a required procurement contract or to provide a required performance security.

40. In the discussion of paragraph (8 *bis*), it was suggested that in the case of a failure by the selected contractor or supplier to reconfirm its qualifications the procuring entity would have to resort to competitive negotiation, if rejection of all tenders pursuant to article 28(2) or (3), or article 29, were to be retained in the Model Law as a condition for use of that method of procurement (see article 34 (new 1) (e)). It was pointed out, however, that article 29, as presently formulated, referred to the rejection of all tenders, and could be interpreted as not covering the case in which a selected contractor or supplier failed to reconfirm its qualifications and the procuring entity then wished to reject all the remaining tenders. It was agreed that article 29 should clearly permit a procuring entity to reject all tenders remaining after a selected contractor or supplier failed to reconfirm its qualifications.

#### *Paragraph (9)*

41. A concern was expressed that paragraph (9), which restricted the disclosure of information concerning examination, clarification, evaluation and comparison of tenders,

was apparently inconsistent with the provision in article 33(2) concerning public disclosure of the record of the procurement proceedings. It was suggested that, in order to minimize that apparent inconsistency, it was necessary to restrict the availability of the record of the tendering proceedings to contractors and suppliers that had participated in the tendering proceedings. In response to that concern, it was pointed out that the two provisions were intended to deal with different issues, at different points of time with respect to the tendering proceedings. Whereas article 33(2) provided for public availability of the record of the tendering proceedings following the entry into force of the procurement contract, paragraph (9) appropriately prohibited disclosure of information prior to that point of time in order to protect the integrity of the tendering proceedings. The Working Group noted that the apparent inconsistency might be alleviated by deletion of the reference to article 33(2) and decided to defer a final decision on paragraph (9) until its consideration of article 33(2).

### *Article 29*

#### *Rejection of all tenders*

##### *Paragraph (1)*

42. The Working Group was generally agreed that, subject to any possibly required approval, a procuring entity should have a right to reject all tenders and that this right should be reserved in the solicitation documents. It was observed that it was in the public interest to allow such flexibility to a procuring entity. The Working Group noted that it had been decided, in connection with its consideration of article 28(8 *bis*), to make it clear in article 29 that the right to reject all tenders encompassed the situation in which the selected contractor or supplier failed to reaffirm its qualifications and the procuring entity then wished to reject all remaining tenders.

43. A proposal was made that a procuring entity should be allowed to reject "any or all" tenders. In support of that proposal, it was stated that the terminology suggested was in use in some countries and that it would allow a procuring entity to reject, for example, a contractor or supplier who had prequalified but was unacceptable to the procuring entity in the light of past experience. In opposition to the proposal, it was stated that the problem of an unsuitable contractor or supplier could best be dealt with at the stage of prequalification and that the addition of the proposed language might suggest that a procuring entity was entitled to exclude a contractor or supplier who had prequalified from being selected on grounds other than those specified in the solicitation documents. Such a result would be unfair and would undermine the integrity of the tendering process. The proposal was not accepted.

44. It was proposed that the words "for any reason other than for the sole purpose of engaging in competitive negotiation proceedings and other than any fraudulent purpose" should be deleted from paragraph (1). It was stated in support of that proposal that the principle embodied in those words could be dealt with in the provisions dealing with the conditions for use of competitive negotiation and single

source procurement. Moreover, the inclusion of the language in question in paragraph (1) might lead to the erroneous conclusion that the rejection by a State of all tenders for the purpose of entering into competitive-negotiation proceedings or single source procurement might give rise to remedies against the procuring entity. Finally, it was pointed out that the possibility that all tenders might be rejected was a normal commercial risk which contractors and suppliers took into account when they participated in procurement proceedings. In opposition to the proposal, it was stated that the words in question stated a particularly important principle, namely that rejection of all tenders should not be for the sole purpose of enabling the State to engage in other methods of procurement such as competitive negotiation and single source procurement. Such a rejection, it was observed, would be contrary to the preference accorded in article 7 to tendering proceedings and would be unfair to contractors and suppliers since participation in tendering proceedings entailed expenses on the part of contractors and suppliers. In addition, the words "any fraudulent purpose" should be retained as they were designed to check corruption in the exercise of the right to reject all tenders and might be useful in the interpretation of the Model Law. It was stated in reply that the question of fraud or corruption was adequately handled by other branches of the law such as criminal or administrative law.

45. After deliberation, the Working Group decided to delete the words "for any reason other than for the sole purpose of engaging in competitive negotiation proceedings and other than any fraudulent purpose".

#### *Paragraph (1 bis)*

46. It was suggested that paragraph (1 bis) should be expanded to cover additional reasons other than the one of price specified in the current text. In support of that proposal it was stated that there were several other reasons, such as a change in the nature of the procurement need, for which the procuring entity might wish to reject all tenders and thereafter engage in competitive-negotiation proceedings. The prevailing view, however, was that paragraph (1 bis) was unnecessary and could be deleted in view of the fact that paragraph (1), in providing for the rejection of all tenders for any reason, was sufficiently broad to cover the circumstances referred to in paragraph (1 bis), and in view of the fact that the conditions for use of methods of procurement other than tendering were set forth in the articles of the Model Law dealing with those other methods. After deliberation, the Working Group decided to delete paragraph (1 bis).

#### *Paragraph (2)*

47. A view was expressed that the words "but shall not be required to justify those grounds" required further consideration and should therefore be placed between square brackets. Those words might present difficulties in jurisdictions where courts had inherent power to review administrative decisions and to go behind the reasons advanced for administrative actions. Moreover, there might be cases where it would be appropriate to require a procuring entity to justify the grounds for the rejection of tenders. It was further suggested that the approach taken in paragraph (2) could affect the ability of aggrieved parties to

exercise remedies and might therefore be reconsidered when the Working Group discussed the provisions on remedies.

48. The prevailing view, however, was that the words should be retained and should not be placed in square brackets. In support of that view, it was stated that a procuring entity should not be required to justify the grounds for its rejection of all tenders. A procuring entity should be free not to proceed with a procurement on economic, social or political grounds which it need not justify. It was sufficient that it gave the reasons, and there should be no remedy against the procuring entity for the rejection of all tenders, particularly in view of the fact that the procuring entity would, pursuant to article 17(x), reserve the right to reject all tenders in the solicitation documents.

49. After deliberation, the Working Group decided to adopt paragraph (2) as drafted at present.

#### *Paragraph (3)*

50. The Working Group adopted paragraph (3) as drafted at present. The Secretariat was requested to consider placing the reference to telephone communication in an omnibus provision.

### *Article 30*

#### *Negotiations with contractors and suppliers*

51. A view was expressed that article 30 was unnecessary and should be deleted since the procedures set forth in the Model Law for tendering proceedings, in particular article 28(1), clearly ruled out negotiations and since the Model Law provided for the use under specified conditions of methods of procurement involving negotiation. The prevailing view, however, was that it was important to state the principle that no negotiations shall take place between the procuring entity and a contractor or supplier over a tender, particularly in the light of the fact that procuring entities and contractors and suppliers were often under the impression that they could negotiate even where tendering had been chosen as the method of procurement.

52. It was noted that the reference to article 29 (1 bis) would have to be deleted in view of the earlier decision of the Working Group to delete that provision from the Model Law (see above, paragraph 5), and that the reference to article 31(4) was of diminished relevance in view of the fact that the Working Group had decided to treat two-stage tendering as a separate method of procurement.

### *Article 31*

#### *Two-stage-tendering proceedings*

#### *Paragraph (1)*

53. It was proposed that in paragraph (1) and other paragraphs of this article the term "performance specifications" should be added as one of the possible indications of the goals of a given project.

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

54. The Working Group adopted the text of paragraphs (2), (3) and (4) unchanged.

*Paragraph (5)*

55. The Working Group found paragraph (5) to be generally satisfactory and decided to retain the reference in square brackets to the right of the procuring entity to delete or modify any evaluation criterion set forth in the solicitation documents. It requested the Secretariat to reformulate the reference to forfeiture of the tender security so as to reflect the fact that this reference was only applicable where provision of a tender security in the first stage of a two-stage-tendering proceeding was required by the procuring entity.

*Paragraph (6)*

56. It was proposed that the requirement that a procuring entity should specify in the record of the procurement proceedings the relevant facts on which it relied in invoking article 31(1) should be deleted. In support of that view, it was stated that the procuring entity should not be required to disclose facts that might violate the rights of privacy of contractors and suppliers or facts that might damage the commercial interests of contractors and suppliers. It was observed that it was sufficient to require the procuring entity to disclose the circumstances on which the procuring entity relied in invoking paragraph 31(1). Another proposal was that paragraph (6) should be deleted altogether as the requirement of inclusion in the record of the procurement proceedings of a statement of the grounds on which the procuring entity relied to select a method of procurement other than tendering was sufficiently dealt with in article 7(5); if that requirement were to be retained in article 31, it would have to be repeated elsewhere in provisions dealing with all the methods of procurement other than tendering.

57. The prevailing view, however, was that paragraph (6) should be retained. In support of this view it was stated that the problems of the invasion of privacy and breach of commercial interests of contractors and suppliers were unlikely to arise with respect to the information referred to in paragraph (6) since it concerned a decision on the method of procurement to be used that was taken before the selection of contractors and suppliers. The provision was important as it would serve as a mechanism of control by requiring a procuring entity that decided to use two-stage tendering to record the facts on which it based its decision. The record could also be usefully referred to in other cases where a procuring entity was considering the appropriateness of two-stage tendering.

58. However, in view of the concern that had been raised, the Working Group decided to delete the words "specifying the relevant facts" and to reformulate paragraph (6) so as to require the inclusion in the record of a statement of the "grounds and circumstances" on which the procuring entity relied in invoking paragraph 31(1). It was agreed that at a later stage consideration might be given to consolidating into a single omnibus provision all the provisions in the Model Law currently dealing with records of proceedings

involving various methods of procurement, in which event there might be no need for the provision in paragraph (6).

59. The Secretariat was requested to consider the restructuring of article 31, as well as of other articles dealing with methods of procurement other than tendering, with a view to setting forth in separate articles the conditions for the use of the methods and the provisions dealing with the procedures to be followed for those methods.

*Article 32*

*Acceptance of tender and entry into force of procurement contract*

*Paragraphs (1), (2) and (3)*

60. A question was raised as to whether paragraph (1), which provided that the most economic tender was to be selected, was consistent with article 29(1), which authorized the procuring entity to reject all tenders. It was agreed that that apparent inconsistency should be rectified by adding the words "subject to article 29" to the beginning of paragraph (1).

61. The Working Group noted that the second sentence of paragraph (1) raised the same question that had been raised in the context of articles 28 (8 *bis*) and 29 (1), namely, whether the Model Law should indicate what the procuring entity should do in the event the selected contractor or supplier failed to reconfirm its qualifications. It was agreed that paragraph (1) should reflect the approach decided upon earlier according to which the procuring entity, subject to the right to reject all remaining tenders pursuant to article 29, was required to select the next most economic tender.

62. It was noted that some States followed the rule reflected in paragraph (2), according to which a procurement contract entered into force upon dispatch of the notice of acceptance of the tender, while other States followed the rule embodied in paragraph (3), according to which the procurement contract entered into force upon the actual signature of the contract following notification of acceptance. It was generally agreed that the Model Law should provide for both methods and that the approach taken in paragraphs (2) and (3) was therefore basically acceptable.

63. Differing views were expressed as to the reference in the second sentence of paragraph (3)(a) to the applicable law as a source of the requirement of a signed, written procurement contract. According to one view, the general reference to applicable law was satisfactory because it called attention to the relevance of a law other than the Model Law in determining the formal validity of the procurement contract. According to another view, a general reference to applicable law, in the absence of an identification of the applicable law, would result in uncertainty for the procuring entity as to which law would govern the validity of the procurement contract. Such uncertainty would make it particularly difficult to prepare the solicitation documents. It was suggested that to preclude such uncertainty the general reference to applicable law should be replaced by a rule that the validity of the pro-

urement contract would be governed by the law of the procuring entity's State. It was also suggested that, if the Model Law did not indicate the law applicable to the validity of the procurement contract, it would be necessary for the Model Law to determine whether a signed contract was required for the entry into force of the procurement contract.

64. Opposition was expressed to the identification in the Model Law of the law applicable to the validity of the procurement contract on the ground that the question of the law applicable to the validity of contracts involved generally recognized rules of private international law, which had been made the subject of multilateral treaties. It was also suggested that a rule in the Model Law that the validity of the procurement contract was to be subject to the law of the procuring entity's State might not be sufficient to ensure the applicability of that law in any given case and that such a rule would not be compatible with the principle of free choice of law. It was pointed out that a prudent procuring entity would not permit the validity of a public contract to be governed by any other law than its own. If the procuring entity wished to ensure that the law of its State would govern the validity of the procurement contract, it should so indicate in the solicitation documents, thereby binding the selected contractor or supplier, who had, by participating in the tendering proceedings, agreed to the terms and conditions set forth in the solicitation documents. Such an approach would be in line with the generally recognized principle of freedom of contract.

65. In view of the foregoing considerations, it was agreed that the need to refer to applicable law as a possible source of the requirement of a signed procurement contract could be obviated by reformulating paragraphs (2) and (3) so as to provide that a procurement contract would enter into force upon dispatch of the notice of acceptance, unless the solicitation documents stipulated that the signature of a procurement contract was necessary. Such a stipulation in the solicitation documents might stem from mandatory provisions of the law applicable to the procuring entity, or merely from the established practice of the procuring entity. It was further agreed that the commentary should advise procuring entities to consider indicating in the solicitation documents the law applicable to the validity of the procurement contract.

66. A view was expressed that the Model Law should accommodate the practice in some States which required the procuring entity, after notifying acceptance of a tender or signing a procurement contract, to obtain a final approval of the procurement contract as a precondition for entry into force of that contract. An opposing view was that such approval requirements, at least to the degree they were applicable following acceptance of a tender or entry into force of a procurement contract, were undesirable and should not be encouraged by the Model Law. Such requirements were said to cause uncertainty on the part of contractors and suppliers as to when, if ever, the procurement contract would in fact receive the final approval and performance could begin. The risk to contractors and suppliers was aggravated when the solicitation documents required the selected contractor to provide a performance bond upon notice of acceptance or signature of a procurement contract

and before the issuance of the final approval. Faced with such uncertainty as to the actual length of time their tender price would have to be valid and with other risks, contractors and suppliers would be discouraged from participating in the tendering proceedings or would be forced to increase their tender prices. It was also suggested that permitting States to impose such final approval requirements would limit the degree of uniformity of law achieved by the Model Law on a significant issue.

67. Another view was that the Model Law should allow for the imposition of an approval requirement at the final stages of the selection process, but that the approval should be obtained at an earlier point, prior to the dispatch of the notice of acceptance. It was said that such an approach would have the advantage of avoiding the delays and increased risks and costs that might otherwise result from a final approval requirement. It would also take account of the fact that, pursuant to paragraphs (2) and (3), a procurement contract could enter into force by virtue of the dispatch of a notice of acceptance or through the signature of a procurement contract.

68. The prevailing view was that the Model Law had to recognize the right of a State to condition entry into force of the procurement contract upon a final approval that would be issued following the acceptance of a tender. A number of States regarded it as essential that entry into force of the procurement contract be subject to a final approval. This was said to be the case, in particular, when a procurement contract was to be signed, since an approving authority could not be expected to issue an approval on the basis of a preliminary or incomplete version of the procurement contract. One approach to reflecting that decision was to indicate in the commentary that States, in implementing the Model Law, were free to incorporate approval requirements not set forth in the Model Law. Another proposal was to provide that the approval would be deemed given if no decision was announced within a specified period of time, with the possibility for the procuring entity to obtain an extension. Yet another proposal was to add a subparagraph (*a bis*) along the following lines that would take into account concerns about delay, as well as the two possible ways in which a procurement contract could enter into force:

"Where the procurement contract is required to be approved by a higher authority or the Government, the approval shall be given within a reasonable time after the notice is dispatched to the contractor or supplier. The procurement contract shall not enter into force or, as the case may be, be executed before the approval is given."

69. The proposed subparagraph was found to be generally acceptable. In order to limit delays, a proposal was made to fix a specific period of time within which the approval must be issued rather than to use the words "within a reasonable time". That proposal was not accepted as it was generally felt to be preferable to take account of the fact that the amount of time required for approval would vary from case to case, depending on the circumstances such as the amount and nature of the procurement contract and the level of government from which the approval would have to emanate. The Working Group did agree, however, that,

in order to mitigate the risk of delay, the Model Law should, perhaps in article 17(2)(y) or as a new paragraph (3)(b)(iv) or (3)(c) of article 32, require of the procuring entity to specify in the solicitation documents the amount of time that would be required to obtain the necessary approvals and to link the validity period of tenders and of any required tender security to that period of time. Such an approach would institute more balance between the rights and obligations of contractors or suppliers and of the procuring entity by excluding the possibility that a selected contractor or supplier would remain committed to the procuring entity for a potentially indefinite period of time with no assurance of the eventual entry into force of the procurement contract. The Working Group noted that the addition of subparagraph (3) (a *bis*) might require consequential changes in subparagraph (3)(b) and article 17(2)(y).

70. The view was expressed that, for the purpose of clearly differentiating between issues dealing with acceptance of a tender and issues related to entry into force of a procurement contract, consideration should be given to treating those two categories of issues, which were now grouped together in article 32, in separate articles.

71. A question was raised as to the usefulness of the formulation of paragraph (3)(b)(i), (ii) and (iii), which set forth rules governing the conduct of the procuring entity and the contractor or supplier in the period of time between the dispatch of a notice of acceptance and the signature of a procurement contract. It was suggested that the import of those provisions, which appeared to be based on the principles of international law governing the conduct of signatories to a treaty prior to ratification and entry into force, was unclear in the context of procurement proceedings. In particular, it was questioned to what extent those rules, as opposed to rules in some other law of the enacting State, would be applicable to a contractor or supplier that refused to sign a procurement contract. The meaning of the words "object or purpose" in paragraph (3)(b)(i) was also questioned.

72. After deliberation, the Working Group decided to revert to the more general statement of principle set forth in the earlier draft (contained in document A/CN.9/WG.V/WP.24), thereby necessitating the deletion of paragraph (3)(b)(i), (ii) and (iii). It was further agreed that it should be made clear that paragraph (3)(b) was subject to the possibility that the entry into force of the procurement contract would be contingent upon a final approval.

#### *Paragraph (4)*

73. The Working Group noted that paragraph (4) would have to be redrafted in line with the decision of the Working Group that, in the event the selected contractor or supplier failed to reconfirm its qualifications, the procuring entity would be obligated to select the next most successful tender, subject to its right to reject all remaining tenders (see paragraph 2 above). It was further noted that the words "may be accepted" in the first sentence were not consistent with the words "shall be given" in the second sentence and that they should be replaced by the words "shall be accepted". The Working Group found paragraph (4) to be otherwise acceptable.

#### *Paragraph (5)*

74. The Working Group adopted the text of paragraph (5) unchanged.

#### *Paragraph (6)*

75. A proposal was made that the definition of the term "dispatched" in subparagraph (b) should be qualified by the proviso that contractors and suppliers had the right to prove that receipt of a notice had not taken place. Misgivings were expressed with regard to the proposal because of the questionable nature of the evidence that might be adduced to prove lack of receipt, unless the procuring entity was obligated to use a method of communication providing for acknowledgement of receipt.

76. Another proposal was that subparagraph (b) should be deleted and the definition of "dispatch" dealt with in the commentary. It was pointed out that the notion of dispatch was well developed in many legal systems and that the term as used in the Model Law would be interpreted accordingly. While accepting the proposal to delete subparagraph (b), the Working Group noted that the possibility of the inclusion in the Model Law of an omnibus provision on communications might present an opportunity to define the term "dispatch".

### *Article 33*

#### *Record of tendering proceedings*

77. The Working Group considered in particular the question of the content and purpose of the record of the tendering proceedings required to be maintained by the procuring entity and noted that the content and purpose of the record was closely linked to the question of the extent to which the record should be disclosed. It was also noted that the question of the purpose or use of the record was closely related to issues dealt with in the provisions of the Model Law dealing with review. The Working Group therefore continued and completed its discussion of the record requirement after having reviewed articles 36 to 42. In view of the fact that record requirements were found in a number of provisions of the Model Law dealing with various methods of procurement, the Working Group decided that it would be desirable to consolidate those provisions into a single provision dealing with the contents, and extent of disclosure, of records for all methods of procurement.

78. It was noted that a distinction had to be drawn between the question of the potential use of information contained in the record for the purpose of exercising remedies available under the Model Law and the question of any remedies that might be available for a failure by the procuring entity to prepare a record or for gaps or incorrect information in the record. In regard to remedies of the latter type, a further distinction had to be drawn between remedies that might be available to private parties and corrective measures that might be required in order to ensure transparency. As regards remedies available to private parties, it was agreed that such parties should be entitled to compel the procuring entity to establish a record, but not to receive damages in the event of a breach of the procuring entity's obligations with respect to records. It was also agreed that consideration

should be given to providing an exception to time limitations for seeking review under the Model Law to the extent that an aggrieved contractor or supplier was prevented from exercising its right to seek review as a result of a breach by the procuring entity of the record requirement.

79. It was noted that the record of the procurement proceedings would be of interest to three categories of users and that the information of interest to those different categories varied according to the purpose to which information contained in the record would be put. Those categories included the general public, contractors and suppliers that participated in some way in the procurement proceedings, and governmental bodies exercising an audit or control function over the procuring entity. Accordingly, it was agreed that the Model Law should draw a distinction between those parts of a record that should be available to any person, those that should be available to aggrieved contractors and suppliers and yet other parts that would be kept exclusively in the public interest for auditors.

80. As to the general public, it was agreed that it would be sufficient for the record to contain a brief description of the goods or construction to be procured, the names and addresses of contractors and suppliers that submitted tenders or other types of proposals and an indication of which contractor or supplier was selected. It was agreed that the record to be disclosed to contractors and suppliers should include additional information relative to issues such as the qualifications, or lack thereof, of contractors and suppliers, the price and a summary of each tender or proposal and of the procurement contract, a summary of the evaluation and comparison of tenders or proposals and information concerning rejection of tenders or proposals. It was agreed that the restrictions on disclosure of information imposed by paragraphs (2)(a) and (b) should remain in place, but that the Model Law should indicate that disclosure may be made subject to the order of a competent court. Such an exception would permit the exceptional use of the restricted information when deemed necessary by a court, for example in the case of review proceedings. Information included in the record for the third category of users would include, for example, the statement required in article 7(5) of the grounds on which the procuring entity relied to select a particular method of procurement.

81. The Working Group agreed that the record should be made available to the various categories of users upon completion of the procurement proceedings as provided in paragraph (2) and, pending further revision of the provision, to retain both alternatives contained in square brackets. It was further agreed that the issue of access to information contained in the record prior to that point of time would not be addressed in the Model Law but would be left to other branches of law such as access to information legislation and the law of evidence.

#### *Articles 33 ter to 33 sexies*

##### *Request-for-proposals proceedings*

82. The Working Group considered the following proposal for a streamlined version of the provisions contained in articles 33 *ter* to 33 *sexies* concerning the conditions for

use and procedures for use of request-for-proposals proceedings:

#### *"Article 33 ter*

##### *"Request for proposals*

"(1) (Subject to approval by ...) a procuring entity may engage in procurement by means of requests for proposals addressed to as many contractors or suppliers as practicable, provided that the following conditions are satisfied:

(a) the procuring entity has not decided upon the particular nature or specifications of the goods or construction to be procured and seeks proposals as to various possible means of meeting its needs;

(b) the selection of the successful contractor or supplier is to be based on both the effectiveness of the means proposed and on the price of the proposal; and

(c) the procuring entity has established the factors for evaluating the proposals and has determined the relative weight to be accorded to each such factor and the manner in which they are to be applied in the evaluation of the proposals.

"(2) The factors referred to in paragraph (1)(c) shall measure:

(a) the competence of the contractor or supplier;

(b) the effectiveness of the proposal submitted by the contractor or supplier; and

(c) the price submitted by the contractor or supplier for carrying out its proposal and the life cycle costs associated therewith.

"(3) A request for proposals issued by a procuring entity shall include at least the following information:

(a) the name and address of the procuring entity;

(b) a description of the procurement need including any technical specifications and other parameters to which the proposal must conform, as well as the location of any construction to be effected;

(c) the factors for evaluating the proposal, the relative weight to be given to each such factor, expressed in monetary terms to the extent practicable, and the manner in which they shall be applied in the evaluation of the proposal; and

(d) the desired format and any instructions, including any relevant time-frames, applicable in respect of the proposal.

"(4) The procuring entity shall open all proposals in such a manner as to avoid the disclosure of their contents to competing contractors and suppliers.

"(5) The procuring entity may conduct negotiations with contractors or suppliers with respect to their proposals and may seek or permit revisions of such proposals provided that the following conditions are satisfied:

(a) any negotiations between the procuring entity and a contractor or supplier shall be confidential; and

(b) subject to paragraph (8), one party to the negotiations shall not reveal to any other person any technical, price or other market information relating to such negotiations without the consent of the other party.

"(6) Following completion of negotiations, the procuring entity may request contractors or suppliers to submit, by a specified date, a best and final offer with respect to their proposals.

"(7) The procuring entity shall employ the following procedures in the evaluation of proposals:

(a) only the factors referred to in paragraph (2) and set forth in the request for proposals shall be considered;

(b) the effectiveness of a proposal in meeting the needs of the procuring entity shall be evaluated separately from the price; and

(c) the price of a proposal shall only be considered by the procuring entity after completion of the technical evaluation.

"(8) [provision on record of request for proposals]."

83. The view was expressed that the version contained in the proposal left certain gaps, in particular because it did not retain the provision in article 33 *ter* (2) incorporating by reference provisions contained in the article governing tendering proceedings. For example, since the proposal contained no provisions on the acceptance of a proposal or the entry into force of the procurement contract, and since there was no incorporation by reference of article 32, the Model Law would not indicate the time when the procurement contract entered into force in the context of request-for-proposals proceedings. It was pointed out in reply that the Model Law did not contain provisions of that type for other methods of procurement such as single source procurement, competitive negotiation and request for quotations.

84. It was agreed that request-for-proposals proceedings under the Model Law should be regarded as a method of procurement completely distinct from tendering and that it was therefore inappropriate to incorporate provisions dealing with tendering. The question of entry into force of the procurement contract in such proceedings could be left to the applicable law.

#### Paragraph (1)

85. A proposal was made that the *chapeau* should be modified so that, in addition to requiring that the request for proposals be addressed to as many contractors as practicable, it would require the request for proposals to be given to at least three contractors or suppliers, if possible. A view was expressed that such a modification was unnecessary because in the type of large project that was typically involved in request-for-proposals proceedings the procuring entity, acting out of its own self-interest, would solicit as many proposals as it could. The prevailing view, however, was that the proposed modification was desirable because simply requiring the sending of the proposal to as many contractors and suppliers as "practicable" did not ensure that in every case the procuring entity solicited proposals from a sufficient number of contractors and suppliers to establish a minimum degree of competition.

86. Another proposal, aimed at enhancing competition in request-for-proposals proceedings, was that the procuring entity should be required to publish a notice concerning the request-for-proposals proceedings. Objections were expressed to such a publication requirement on the grounds that it would blur the distinction between request-for-proposals proceedings and tendering proceedings by placing the procuring entity in a position of having to evaluate proposals from contractors and suppliers whose proposals it did not necessarily wish to consider. Moreover, the concern was expressed that the amount of time spent by the procuring entity in evaluating proposals would be increased greatly. The prevailing view, however, was that it was desirable for the procuring entity to be generally required to publicize the request-for-proposals proceedings so as to enhance competitiveness, but that that requirement should be subject to some limitations. One proposal for doing so to a relatively limited extent was merely to require that the procuring entity contact the most significant contractors and suppliers in a particular sector. That proposal was regarded as unworkable because it involved a high degree of subjectivity. Another proposal was to provide for notice, but on a discretionary basis. It was pointed out that such an approach was of limited value because the proposed text did not preclude a procuring entity from publishing a notice if it so desired. Yet another proposal was that the procuring entity should be required to contact the professional associations of contractors and suppliers operating in the sectors involved in the project in question.

87. In view of the foregoing considerations and deliberations, the Working Group agreed to add a provision to paragraph (1) along the following lines:

"The procuring entity shall publish in a widely circulated trade journal a notice seeking expression of interest in submitting a proposal, unless for reasons of economy or efficiency the procuring entity considers it inappropriate to do so."

88. The Working Group expressed its understanding that the publication of the notice would not bestow any rights on contractors or suppliers, including any right to have a proposal evaluated.

89. It was agreed to replace the words "has not decided" by the words "has been unable to fully decide". It was felt that the new language would avoid suggesting that a procuring entity could procure through requests for proposals when it had been in a position to decide, but merely failed to take the necessary steps to decide, on the types of goods to purchase. The word "fully" was added so as not to preclude the use of requests for proposals when the procuring entity was in a position to decide only partially upon the particular nature or specifications of the goods or construction to be procured.

90. A question was raised as to the appropriateness of retaining subparagraphs (b) and (c) in paragraph (1). It was suggested that the current position of the subparagraphs, which concerned procedures for use of request for proposals, might cause confusion since paragraph (1) concerned the conditions for use of requests for proposals and the procedures for use were referred to elsewhere in the pro-

posed text. In support of the structure in the proposed text, it was stated that the inclusion of subparagraphs (b) and (c), while not strictly necessary, was intended to make clear from the outset those essential features of a request-for-proposals proceedings. A question was also raised as to the necessity of retaining subparagraph (a), on the ground that it was of such a general nature that it might also be an apt description of the criteria used to select a contractor or supplier in proceedings involving other methods of procurement. The Working Group decided to retain subparagraph (a) and, pending further consideration, to retain subparagraphs (b) and (c) in their current position. It was also agreed that the reference in subparagraph (b) to the "effectiveness of the means proposed" needed to be aligned with the reference in paragraph (2)(b) to the "effectiveness of the proposal".

91. A concern was expressed that the meaning of the words "factors for evaluating the proposals" in subparagraph (c) was not clear. In order to address that concern, it was proposed that a provision should be added along the following lines containing a non-exhaustive list of the type of factors being referred to:

"The factors referred to in paragraph (1)(c) may include the proposed work structure, identification of key technical problems and outlines of solutions, proposed schedule of milestones, and quality and time control systems to be employed."

92. The inclusion of such a provision was objected to on the ground that such a list, although intended to be non-exhaustive, might be interpreted in some jurisdictions as limiting the procuring entity to the use only of factors similar to those included in the list. In view of that possibility, the Working Group decided that it would be preferable not to include the proposed provision, but instead to include in the commentary an explanation of the reference to factors.

#### Paragraph (2)

93. It was agreed to replace the words "shall measure" in the *chapeau* with words such as "shall concern" in view of the fact that subparagraph (c) referred to price and in order to make it clear that price itself could be a factor.

94. It was proposed that the competence of the contractor or supplier referred to in subparagraph (a) as one of the weighted factors to be used in evaluating a proposal be removed from paragraph (2). In support of that proposal, it was stated that the competence of a contractor or supplier was not quantifiable and should be treated as a separate threshold requirement, to be used merely in determining whether to admit a contractor or supplier into the request-for-proposals proceedings. According to that view, the use of competence as a factor in evaluating and comparing proposals entailed a high degree of subjectivity and increased the risk of corruption. The proposal was objected to on the ground that it would be legitimate for the procuring entity to use competence as an evaluation factor because the procuring entity might be less confident in the ability of one particular contractor or supplier rather than in the ability of another to implement the proposal. The Working Group agreed that competence should be retained as an evaluation factor in view of the safeguards against

abusive practices contained in the Model Law. At the same time, it was agreed that the Model Law should authorize the procuring entity to exclude contractors or suppliers deemed unreliable or incompetent from participation in the request-for-proposals proceedings. Such a result might be achieved by providing that the procuring entity had the right to pursue only those proposals that it wished. In order to distinguish competence as an evaluation factor from such a provision, it was agreed that subparagraph (a) should be modified to refer to the relative technical and managerial competence of contractors and suppliers.

95. The Working Group adopted subparagraphs (b) and (c) unchanged.

#### Paragraph (3)

96. The Working Group adopted subparagraph (a) unchanged.

97. It was agreed to delete the words "specifications" in subparagraph (b) in order to avoid inconsistency with paragraph (1)(a), in which it was provided that the procuring entity was entitled to engage in request-for-proposals proceedings when it had been unable to decide fully upon the specifications of the goods or construction to be procured.

98. While it was recalled that the Working Group had decided in connection with its discussion of article 28 that the expression of evaluation factors in monetary terms was a particularly appropriate method of evaluating and comparing tenders, questions were raised as to the practicability of the requirement in subparagraph (c) that evaluation factors in request-for-proposals proceedings should, to the extent practicable, be expressed in monetary terms. In particular, it was questioned how proposals would be evaluated and compared when only some of the evaluation factors could be expressed in monetary terms. It was pointed out that in cases in which all evaluation factors could not be expressed in monetary terms all factors would have to be converted to the "merit-point" system. The view was expressed that expression of evaluation factors in monetary terms lent itself to a greater degree of objectivity in the evaluation and comparison of tenders. The Working Group agreed that the approach used in the proposed text was acceptable, in that it recommended the expression of evaluation factors in monetary terms, but permitted the procuring entity to avoid doing so when it was not practicable. At the same time, the Working Group noted the crucial nature of the requirement that contractors and suppliers be informed in the request for proposals of the evaluation factors and the manner of application of those factors. It was further agreed that the reference to expression in monetary terms should be placed immediately after the words "the factors for evaluating the proposal", in order to avoid suggesting that the relative weight of the factors could be expressed in monetary terms.

99. The Working Group adopted subparagraph (d) unchanged.

#### Paragraph (4)

100. The Working Group adopted paragraph (4) unchanged.

*Paragraph (5)*

101. The Working Group adopted subparagraphs (a) and (b) unchanged.

102. It was pointed out that situations might arise in which the procuring entity might wish to modify evaluation factors set forth in the request for proposals. In some cases the procuring entity might be prompted to make such modifications by information derived from proposals or from negotiations with contractors and suppliers. A question was raised as to the extent to which the Model Law should permit modification of evaluation factors, and as to whether such a modification might permit a contractor or supplier to surmise the content of a competing proposal. It was agreed that modifications of evaluation criteria set forth in the request for proposals should be permitted, on the condition that those modifications applied and were communicated to all participating contractors and suppliers. It was also agreed that such modification should be permitted even after commencement of negotiations, but that any modification should be carried out in a way that preserved the confidentiality of the negotiations. It was further agreed that a new subparagraph should be added to paragraph (5) setting forth the requirement that any modifications or clarifications of the request for proposals should be communicated to all participating contractors and suppliers.

103. It was proposed that the Model Law should require the procuring entity, if it wished to negotiate with a contractor or supplier concerning its proposal, to extend the opportunity to all contractors and suppliers that had submitted proposals and whose proposals had not been rejected. It was agreed to accept the proposal and to embody it in an additional subparagraph in paragraph (5).

*Paragraph (6)*

104. The Working Group agreed to the inclusion of a "best and final offer" procedure (BAFO) in the procedures for use of requests for proposals. However, it was agreed that the BAFO procedure should be made mandatory in order to promote competitiveness and transparency in the proceedings. Accordingly, it was decided to replace the words "may request" by the words "shall request". It was also agreed that the BAFO should be requested from all contractors and suppliers remaining in the proceedings and that it should be made clear that the BAFO referred to all aspects of an offer, and not just to price.

*Paragraph (7)*

105. It was suggested that subparagraph (a) should refer to paragraph (3)(c) in place of paragraph (2). It was also suggested that the subparagraph might allude to the manner of application of the factors and take into account the possibility of amendment of the factors set forth in the request for proposals.

*Article 34**Competitive-negotiation proceedings*

106. The Working Group recalled that, at the twelfth session, it had requested the Secretariat to report to the current session on provisions in national procurement laws

on the method of procurement referred to in the Model Law as competitive negotiation. It was noted that that report (A/CN.9/WG.V/WP.31) was before the Working Group.

107. The Working Group commenced its discussion of article 34 with an exchange of views as to the desirability of providing for competitive negotiation as one of the methods of procurement other than tendering. The view was expressed that the conditions for use of competitive negotiation were too broadly worded and allowed the procuring entity excessive discretion in deciding whether to forego the use of tendering proceedings. It was further stated that any need that a procurement entity might have to procure through negotiation was already adequately provided for by two other methods of procurement, namely, two-stage tendering and request for proposals, and that article 34 could therefore be deleted in its entirety. It was also stated that the Model Law in its current form would create confusion for procurement officials because there was overlap between the conditions for use of competitive negotiation as set forth in article 34 and the conditions for use of two-stage tendering and request for proposals. To attempt to address the problem of overlap, it was suggested that consideration should be given to treating those three methods of procurement as alternatives, any of which the procuring entity would be free to select.

108. As had been the case at previous sessions of the Working Group, the prevailing view was that the Model Law should provide for competitive negotiation. It was agreed that the mere fact that the application of the Model Law in a given case might reveal an overlap between the conditions of use of different methods of procurement did not mean that those methods could be generally treated as alternatives under the Model Law. It was also pointed out that article 7(3) dealt with the problem of overlap by establishing an order of preference that was meant to be followed in cases of overlap among various methods of procurement other than tendering. The Working Group did, however, express the view that the conditions for use of competitive negotiation needed to be refined further.

*Paragraph (new 1)*

109. In line with its decision at the twelfth session that the conditions for use of methods of procurement other than tendering should be set forth in the individual articles dealing with those other methods, the Working Group agreed to the inclusion of the conditions for use of competitive negotiation in paragraph (new 1).

110. There was general agreement with the thrust of subparagraph (a). However, it was felt that the provision was worded too broadly and could be interpreted to cover a range of procurement situations in which it would be more appropriate to use more competitive methods of procurement. It was agreed that the subparagraph needed to be reformulated in order to emphasize more clearly that the goods must be of a special nature or particularly technically complex in order to justify resort to competitive negotiation.

111. It was proposed that subparagraph (b) should be modified in order to make it clearer that urgency was a ground for using competitive negotiation only when engaging in tendering proceedings was impossible. In that vein, it was suggested that specific reference might be made to circumstances in which it was impossible to follow the solicitation procedures set forth in article 12. It was decided that such a modification was unnecessary as subparagraph (b) already implicitly referred to specific aspects of tendering such as the procedures in article 12. The Working Group did agree, however, that the subparagraph should limit the use of competitive negotiation on the ground of urgency to cases of urgency that were unforeseeable and did not result from the dilatory conduct of the procuring entity.

112. A question was raised as to the necessity of retaining the words "except where the contract includes the production of goods in quantities sufficient to establish their commercial viability or to recover research and development costs" at the end of paragraph (c). It was agreed that the words should be retained because they were meant to ensure that the contract to be entered into by the procuring entity was for genuine research and not for commercial purposes. The Working Group adopted the paragraph unchanged.

113. It was observed that subparagraph (d) as currently formulated limited resort to competitive negotiation in cases of procurement involving national defence or national security aspects only to those cases in which secrecy was required. It was suggested that such an approach was too narrow because there might be cases of procurement involving national defence or security considerations, but not necessitating secrecy, in which the procuring entity would regard competitive negotiation as the most appropriate method of procurement. Misgivings were expressed as to the proposed broadening of the scope of subparagraph (d) out of a concern that it could result in the inappropriate avoidance of tendering proceedings in cases in which national defence or security considerations were peripheral. After deliberation, the Working Group accepted the proposal to remove the reference to secrecy and to refer only to national defence and security. It was felt that such an approach would broaden the possibility of application of the Model Law.

114. A question was raised as to whether the inclusion of national defence and security considerations as a ground for the use of competitive negotiation was consistent with the provision in article 1(2) that excluded application of the Model Law to procurement involving national defence or security, except and to the extent indicated by the procuring entity. In particular, a concern was expressed that the juxtaposition of the two provisions might result in confusion as to whether the Model Law was generally applicable to national defence procurement. The Working Group noted that article 1(2), which dealt with the scope of application of the Model Law, permitted the procuring entity to apply the Model Law to procurement involving national defence or security. As such, the reference in subparagraph (d) to national defence or security did not relate to the scope of application of the Model Law, but rather permitted a procuring entity, once it had decided to apply the

Model Law, to use competitive negotiation. It was agreed that the formulation of subparagraph (d) should be reviewed in order to see whether it would be possible to make the relationship between subparagraph (d) and article 1(2) clearer, perhaps by adding to subparagraph (d) a cross-reference to article 1(2). It was further agreed that the commentary should indicate that national defence and security considerations had been added as a ground for competitive negotiation in order to encourage as broad an application of the Model Law to national defence and security procurement as possible.

115. A proposal was made to modify subparagraph (e) so as to provide that when competitive-negotiation proceedings were engaged in on the grounds of unsuccessful tendering proceedings, the resultant procurement contract should not be for a higher price than the price offered in the tendering proceedings and that the contractual terms of the procurement contract should remain the same. The proposal was not accepted as it was felt to unduly restrict the procuring entity. Moreover, questions were raised as to the practicability of such an approach, in particular because prices might rise during the period of time between the termination of the unsuccessful tendering proceedings and the commencement of the competitive-negotiation proceedings. The suggestion that an inflation factor could be added to address that possibility failed to attract support. It was agreed that subparagraph (e) should be retained along its current lines and that the reference to circumstances in which engaging in new tendering proceedings was unlikely to result in a procurement contract was a sufficient safeguard against abusive resort to competitive negotiation. The Secretariat was requested to examine subparagraph (e) in order to determine whether any changes would have to be made in view of the earlier decision of the Working Group concerning the right of the procuring entity to reject all tenders when a selected contractor or supplier failed to reconfirm its qualifications.

116. As in the discussion of other provisions of the Model Law containing references to the procurement regulations, the appropriateness and effect of the reference to the procurement regulations in subparagraph (f) was questioned in view of the discretion given to enacting States by article 4 as to whether to issue procurement regulations. The need for consideration of that question with respect to subparagraph (f) was obviated by the decision of the Working Group to delete the subparagraph on the ground that request-for-quotation proceedings were a more competitive and therefore more appropriate method of procurement for low-value procurement than the more complex and secret method of competitive negotiation.

#### *Paragraph (new 1 bis)*

117. It was agreed that, in view of the decision not to retain paragraph (new 1) (f), there was no need to retain paragraph (new 1 bis).

#### *Paragraph (1)*

118. It was brought to the attention of the Working Group that the procurement laws of some States provided that in negotiation proceedings the procuring entity should require that all participating contractors and suppliers should, by a

fixed date at the latter stages of the procurement proceedings, make what is their "best and final offer" (BAFO) and that the selection of a contractor or supplier should be based on those final offers. It was suggested that such a procedure would inject discipline and competition into the negotiation proceedings and that consideration should be given to including it in paragraph (1). Reservations were expressed, however, to including a general requirement of a BAFO procedure. While it was recognized that in some circumstances such a procedure might be helpful, there was a danger that it might in some cases unduly restrict the negotiating power of the procuring entity and limit its ability to obtain the best value. The concern was also expressed that a BAFO procedure might have the unintended effect of fostering collusion among contractors or suppliers. In view of the foregoing considerations, the Working Group agreed that the Model Law should provide for a BAFO procedure, but that its use should be left to the discretion of the procuring entity. The Working Group also expressed its understanding that the concept of a BAFO referred not just to price, but to technical and all other aspects of an offer as well. It was agreed that the commentary should discuss factors to be considered by a procuring entity in determining whether to use a BAFO procedure. The Working Group adopted the text of paragraph (1), subject to the addition of the BAFO procedure.

#### *Paragraph (2)*

119. The Working Group accepted a proposal to add the word "clarifications" to the list of elements of information referred to in paragraph (2). Subject to that change, the Working Group adopted the paragraph.

#### *Paragraph (3)*

120. A view was expressed that it was not clear whether paragraph (3), as currently formulated, in particular the reference to "any third person", only prohibited the disclosure of information by the procuring entity and by participating contractors and suppliers to persons not involved in the competitive negotiation proceedings. In particular, a concern was expressed that the paragraph might be interpreted as not prohibiting the sharing of information on the negotiations by participating contractors and suppliers. While it was recognized that the procuring entity might ordinarily be more tempted to share information with a particular contractor or supplier about its negotiations with another contractor or supplier than competing contractors and suppliers might be to share information among themselves, it was noted that the danger existed of collusion among participating contractors or suppliers. It was agreed that the restriction in paragraph (3) on disclosure of information by participants in the proceedings to any third person was intended to cover sharing of information among contractors or suppliers as well as disclosure by a procuring entity to a contractor or supplier of information concerning negotiations with another contractor or supplier. It was suggested that the intended meaning of the paragraph could be made clearer by referring to "any other person" or to "any other contractor or supplier or any third person", instead of merely referring to "any third person".

121. It was suggested that the restriction on disclosure of information was too broadly formulated and might therefore conflict with legislation found in some States concern-

ing access to information and that only the disclosure of "confidential" information should be restricted. In support of the existing formulation, it was stated that the need to protect confidentiality in competitive-negotiation proceedings meant that, in particular during the negotiations, no third party should have the right to information about the negotiations between the procuring entity and a contractor or supplier. It was pointed out that, in States with access-to-information legislation, such legislation would resolve any conflict with the Model Law. According to that view, the extent to which information should be made public was dealt with adequately in paragraph (4). The Working Group agreed with the basic thrust of the existing text, but at the same time recognized that it would be useful to attempt to restrict somewhat its scope to the type of information that was meant to be protected. That information concerned technical and price aspects of the negotiations and did not concern matters which might usefully be revealed without prejudicing the proceedings such as the identity of participating contractors and suppliers. As to the exact manner of reformulating paragraph (3), the proposal to add the word "confidential" did not gain support because there was a concern that it would raise complicated questions as to what information was confidential, particularly in view of the fact that paragraph (3) provided that the negotiation process as a whole was confidential. It was agreed that specific reference could be made to technical and price information, as well as to other market information. It was also suggested that additional clarity could be achieved by making it clear that paragraph (3) referred to the time prior to the termination of the competitive-negotiation proceedings, while paragraph (4) involved the disclosure of information following the termination of the competitive-negotiation proceedings.

122. The Secretariat was requested to revise paragraph (3) with a view to reflecting the deliberations and decisions of the Working Group.

#### *Paragraph (4)*

123. It was agreed to defer consideration of record requirements for competitive-negotiation proceedings until the consideration by the Working Group of an omnibus provision governing record requirements generally.

### *Article 34 bis*

#### *Request for quotations*

#### *Paragraph (1)*

124. It was proposed that the reference to the types of goods for which request for quotations might be appropriate should be modified to include a reference to goods which were readily identifiable or available at list prices in order to make it clear that reference was being made to goods for which there was a market. It was observed that the term "list price" was not sufficiently precise. The Working Group agreed with the thrust of the proposal and requested the Secretariat to examine the specific manner in which it might be implemented.

125. A view was expressed that the appropriateness and effect of setting in the procurement regulations the amount

below which request-for-quotations proceedings might be engaged in needed to be reconsidered in view of the fact that article 4 made issuance of procurement regulations discretionary. It was pointed out that, according to the approach taken in some legal systems, a failure on the part of the enacting State to issue procurement regulations would mean that procuring entities would not be able to engage in request-for-quotations proceedings. It was noted that the effect of a failure by an enacting State to promulgate procurement regulations was raised with respect to other provisions of the Model Law and that the Working Group had decided to consider the matter further in a general manner.

126. A suggestion was made that the commentary should indicate that procuring entities using this method of procurement should take the steps necessary to ensure that standardized goods being procured met the required quality standards.

#### *Paragraph (2)*

127. The Working Group adopted the text of paragraph (2) without change.

#### *Paragraph (3)*

128. The Working Group considered whether paragraph (3) should require the procuring entity to obtain quotations from a specified minimum number of contractors or suppliers. While the Working Group recognized that setting a minimum number, as was done in the draft under consideration, had the advantage of clarifying the obligations of the procuring entity, it was generally agreed that setting a rule for all cases would be unworkable. This was because there might be instances in which the procuring entity would not be able to obtain quotations from the minimum number, for example, when less than the minimum number of contractors or suppliers were available to meet the procuring entity's needs. In an attempt to find an approach that would be flexible, while still preserving some of the benefit of referring to a minimum number, it was agreed to require the procuring entity to obtain quotations from as many contractors as practicable, and from at least three if possible.

129. A question was raised as to the necessity of retaining in the final sentence the prohibition against negotiation. It was suggested that that sentence might be deleted because the use of negotiation in the context of request for quotations took place in practice. The prevailing view was that the prohibition against negotiation should remain in place because it was an important element of this method of procurement. It was also agreed that negotiation should be prohibited because the Model Law provided other methods of procurement that dealt sufficiently with the need that the procuring entity might have to use negotiation in procurement.

#### *Paragraph (4)*

130. It was proposed that the term "lowest priced responsive quotation" should be used instead of the term "lowest price" to ensure that the procuring entity was not obligated to accept the lowest quotation if that quotation was not

otherwise responsive. The need for such flexibility might arise, for example, where a contractor or supplier quoting the lowest price could not promise to deliver the goods within the required period of time. The Working Group accepted the proposal. It was also pointed out that the current formulation might have the unintended effect of suggesting that the procuring entity was obligated to accept the lowest quotation, even if that quotation was too high. It was suggested that this could be clarified by making it clear that the procuring entity was obligated to accept the lowest responsive quotation only if an award was in fact made.

131. The view was expressed that paragraph (4) in its current form would leave the procuring entity no choice but to accept the lowest quoted price, even if it was quoted by a contractor or supplier that the procuring entity knew to be unreliable. In order to avoid tying the hands of the procuring entity in such a manner, it was suggested that the word "responsible" be inserted before the words "contractor or supplier". The need for such an amendment was questioned on the ground that request-for-quotations proceedings allowed the procuring entity to verify the reliability of contractors and suppliers prior to requesting quotations from them. The Working Group recognized, however, that there might be circumstances in which a procuring entity only discovered the unreliability of a contractor or supplier after it had received the lowest quotation from that contractor or supplier. It was agreed that, in such a case, as well as when the procuring entity was limited to lists or rosters of contractors or suppliers, the procuring entity should be able to reject the lowest quotation if it came from an unreliable contractor or supplier. As to the precise drafting, the word "qualified" was suggested as an alternative to the word "responsible", but was objected to on the ground that it might tend to diminish the informality of request-for-quotations proceedings. Objections were also raised to a proposal to use the word "competent". The Secretariat was requested to find a formulation that would take into account the reliability of the contractor or supplier.

132. A question was raised whether the term "lowest price" included elements other than the cost of the goods themselves, such as transportation and insurance charges. It was suggested that the use of the term could be understood in the context of the evaluation of the quotations by the procuring entity to determine which quotation would have to be selected in order to enable the procuring entity to obtain the goods it was procuring at the lowest total cost and that the question raised was of a drafting nature. The Secretariat was requested to consider whether the question of which elements were to be included in the price was also relevant to other methods of procurement and, if so, whether there might be a need to include a definition of "price" in article 2. It was also suggested that, to the extent it did not raise matters of substance, the question of the components of price could be left to the commentary.

#### *Paragraph (5)*

133. It was agreed to defer consideration of record requirements for request-for-quotations proceedings until the consideration by the Working Group of an omnibus provision governing record requirements generally.

### Article 35

#### *Record of single source procurement*

##### *Paragraph (new 1)*

134. In line with its decision at the twelfth session that the conditions for use of methods of procurement other than tendering should be set forth in the individual articles dealing with those other methods, the Working Group agreed to the inclusion of the conditions for use of single source procurement in paragraph (new 1). Concomitantly, it was agreed that the title of the article would read "single source procurement".

135. A view was expressed that the reference to a large number of circumstances in which single source procurement would be available risked increasing the extent of overlap between the conditions for use of different methods of procurement and that some of the conditions for use of single source procurement were of doubtful utility and could therefore be deleted. In response, it was stated that article 7(3), which established an order of preference among methods of procurement other than tendering, dealt adequately with the possibility of overlap.

136. It was proposed that subparagraph (a) should be deleted on the ground that the low value of a procurement should not justify resort to single source procurement. It was pointed out that the provision failed to establish an obligation to seek an advantageous price and that the Model Law provided for a more competitive method that could be used for low-value procurement, namely, request for quotations, and that that method could be used with little additional effort. In view of the foregoing, it was agreed to delete subparagraph (a).

137. It was agreed to retain subparagraph (b) in its current form. However, a question was raised as to the relationship between the subparagraph and the practice in some States of requiring licences.

138. As regards subparagraph (c), the view was expressed that urgency should not be available as a ground for resort to single source procurement when the condition resulting in the urgency was foreseeable and could have been avoided, or was due to the dilatory conduct of the procuring entity. It was agreed that subparagraph (c) should be modified in accordance with that view. It was further agreed that, as currently formulated, subparagraph (c) was not sufficiently distinguishable from urgency as a ground for use of competitive negotiation pursuant to article 34 (new 1)(b). Accordingly, the Working Group decided to limit subparagraph (c) to catastrophic events. A view was expressed that subparagraph (c) could be further restricted by limiting the amount of a procurement that could be single-sourced to only what was needed until such time as a more competitive method of procurement could be employed.

139. A concern was expressed that subparagraph (d) might, in the name of standardization, have the effect of encouraging procuring entities, against their own interest, to continue to procure the same types of goods or construction. That would needlessly exclude the possibility of a competi-

tive procurement approach that might result in the procurement of more suitable goods and might reduce opportunities to develop local production. In view of this concern, the Working Group agreed that subparagraph (d) should be reformulated to make it clear that it applied only when there was no feasible alternative. The procuring entity should be required to consider factors including whether the original procurement was suitable, the size of the proposed procurement in relation to the original procurement, the reasonableness of the price and the suitability of alternatives to the goods in question. A view was expressed that there was an inconsistency between the words "must be procured" used in subparagraph (d) and the words "may procure" used in the opening words of paragraph (new 1).

140. The Working Group decided not to add proposed subparagraphs (d bis) and (d ter). The text of subparagraph (e) was adopted unchanged.

141. It was agreed to modify subparagraph (f) in line with the modification that had been agreed to with respect to article 34 (new 1)(d). It was suggested that the commentary should indicate that the purpose of including subparagraph (f) was to facilitate the application of the Model Law to procurement involving national security or national defence.

142. As regards subparagraph (g), a view was expressed that the availability of socio-economic factors as a ground for single source procurement would increase significantly the risk of abusive resort to single source procurement. According to that view, a State that wished to promote socio-economic policies could do so effectively through tendering proceedings, which were competitive and open to public scrutiny, and therefore more likely to result in an effective use of public funds. In response, it was stated that States generally would be reluctant to forego completely the right to use single source procurement for socio-economic reasons. Invariably Governments encountered special situations in which there were compelling socio-economic and political reasons for awarding a procurement contract without any type of competitive procedure. That might be the case, for example, when a production facility employing a very large proportion of the working population in a particular area was in danger of closing down.

143. In view of the foregoing considerations, the Working Group agreed that the Model Law should have a safety-valve provision along the lines of subparagraph (g) for exceptional situations, but that certain procedures had to be included to ensure transparency. It was noted that the Working Group had agreed to avoid the use of the term "socio-economic" in article 28 because of its vague nature and that for similar reasons it should be avoided in subparagraph (g) (see paragraph 34 above). The following reformulation of subparagraph (g) was proposed:

"(g) where procurement from a particular contractor or supplier is necessary in order to promote a policy specified in article 28(7)(c)(iii) and approval is obtained following public notice and adequate opportunity to comment".

The Working Group found the proposed reformulation acceptable, subject to the addition of the following lan-

guage intended to make clear the exceptional nature of subparagraph (g):

"... and procurement from no other contractor or supplier is capable of promoting those policies".

144. It was agreed that reference to the circumstances addressed by subparagraph (h) had become unnecessary in view of the modification of subparagraph (f) and that subparagraph (h) could therefore be deleted.

145. Doubts were expressed as to the advisability of retaining subparagraph (i). In particular, the view was expressed that the provision might preclude the use of competitive methods of procurement by permitting a procuring entity to award a procurement contract to a contractor or supplier willing to build or acquire special facilities or capacity, without requiring the procuring entity to determine whether any other contractors or suppliers would be willing to do the same and perhaps at a better price. It was further suggested that in those cases in which there actually was only one contractor or supplier capable of meeting the procuring entity's needs, subparagraph (i) was unnecessary. It was therefore agreed to delete subparagraph (i).

#### *Paragraph (new 1 bis)*

146. It was agreed to delete paragraph (new 1 bis) as a consequence of the deletion of subparagraph (new 1)(a).

#### *Paragraphs (1) and (2)*

147. It was agreed to defer consideration of record requirements for single source procurement proceedings until the consideration by the Working Group of the possibility of an omnibus provision governing record requirements for all methods of procurement. A question was raised whether there might be any procedural requirements relating to single-source-procurement proceedings, beyond record requirements, that might usefully be addressed in the Model Law. In response it was suggested that inclusion of additional procedural detail might raise the risk of over-complicating the Model Law.

## **II. Discussion of draft articles 36 to 42 of the Model Law on Procurement (A/CN.9/WG.V/WP.27)**

148. For the purpose of its consideration of the review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law, the Working Group had before it a report by the Secretariat (A/CN.9/WG.V/WP.27) outlining three possible approaches to the treatment of the question of review proceedings. The first approach was to prepare provisions intended to be adopted by an implementing State as an integral part of the Model Law. Draft articles 36 to 42 were presented to the Working Group for its consideration of that approach. The second approach was 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 in that articles 36 to 42 would serve as guidance to implementing States in evaluating the sufficiency and effectiveness of their review procedures. The provisions would contain all of the elements considered by the Commission to be essen-

tial components of a sufficient and effective means of review. Under the third 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, in the form of a recommendation to States setting forth the elements that it considered essential. A possible formulation for such a recommendation was presented to the Working Group.

149. The Working Group commenced its consideration of the question of review with a discussion of the three possible approaches. In support of the first approach, it was stated that the effectiveness of the Model Law as a benchmark of good procurement practice, both for States with procurement legislation in place and for States without such legislation, would be diminished if the Model Law did not contain minimum provisions on review of the type proposed in articles 36 to 42. However, objections were expressed with regard to the first approach because of the fact that review procedures touched on fundamental conceptual and structural aspects of diverse legal systems and systems of State administration, thereby rendering difficult the formulation of review provisions designed for universal application. As to the second approach, a view was expressed that it was not clear to what degree that approach differed from the third approach. The utility of the third approach was questioned on the ground that a mere recommendation would not be a sufficiently effective means of ensuring that States enacting the Model Law would also provide for the necessary review procedures. It was pointed out that the issuance by the Commission of a recommendation, which the Secretariat had proposed to be modelled after a Directive adopted by the Council of the European Communities (EC) dealing with review in cases covered by EC directives relating to procurement, would be less effective than the issuance of the directive by the Council of EC. That difference was due in particular to the fact that the EC directive was subject to the EC enforcement machinery. After deliberation, the Working Group decided to defer a decision on which of the three approaches to adopt until the completion of its consideration of draft articles 36 to 42.

### *Article 36*

#### *Right to review*

150. It was agreed that review provisions in the Model Law should include a rule along the lines of article 36, identifying generally the parties who would be entitled to seek review. It was noted that such a rule, which was referred to in some legal systems as a rule on standing, was typically defined in relation to the interest of a party in, or harm suffered from, an action of a governmental entity, and that it did not concern the ultimate merits of substantive claims involved in an action. However, it was widely felt that several of the key elements of the rule set forth in article 36 were too broadly worded and would thus create uncertainty as to the scope of the review procedures outlined in the Model Law. In particular, the concern was expressed that the reference to "any person" was not sufficiently precise, that the reference to the interest or injury that a person was required to have in order to be entitled to

seek review needed to be narrowed, that the reference to unlawful acts or decisions of, or procedures followed by, the procuring entity was too broad and might therefore encompass certain aspects of the procurement proceedings that should not give rise to private remedies, and that the permissibility of review at any stage of the procurement proceedings or after termination of the procurement proceedings left it unclear which aspects of the procurement process were subject to article 36 and whether there were any time limitations on review.

151. As to the manner in which reference should be made to the parties whose claims for review would be admissible, the Working Group agreed that, in place of referring to "any natural or juridical person", article 36 should refer to "any contractor or supplier". That term was preferable because it was defined in article 2 and included would-be contractors and suppliers. A question was raised as to the implications of including a reference to nationality, in view of the Working Group's decision at the eleventh session in connection with article 11 to generally avoid references to the nationality of contractors and suppliers so as to avoid the need to define nationality. It was also suggested that the reference to nationality might have the unintended effect of suggesting that foreign contractors and suppliers had a right to challenge a procuring entity's decision to restrict participation in procurement proceedings to domestic contractors and suppliers. In response, it was pointed out that the reference to nationality in article 36 was for the purpose of excluding nationality as a prerequisite for standing and that therefore it did not need to be defined and should not be related to the right of a procuring entity under the Model Law to engage in a wholly domestic procurement proceeding. It was agreed that there would be no reference to nationality.

152. Differing views were expressed as to the type of act, decision or procedure on the part of the procuring entity that would give a contractor or supplier standing to complain. According to one view, the current reference to "an unlawful act or decision of, or procedure followed by, the procuring entity" was satisfactory because it did not limit the right of a contractor or supplier to seek review on the basis of the nature of the act, decision or procedure in question. According to that view all actions of the procuring entity should be subject to review, and contractors and suppliers should not be precluded from seeking review on the basis of the nature of the act complained of. It would then be left to the reviewing body to determine in individual cases the merit of claims for review. The prevailing view, however, was that the extent to which the provisions of the Model Law gave rise to the right to review and to remedies needed to be narrowed because not all of the provisions of the Model Law imposed obligations which, if unfulfilled by the procuring entity, should properly be regarded as giving rise to a private right to review on the part of an aggrieved contractor or supplier.

153. It was noted that some provisions of the Model Law imposed a duty on the procuring entity to take a particular action or follow a particular procedure, while other provisions left matters to the discretion of the procuring entity. It was agreed that that distinction between duty and discretion and, when a duty was imposed, the purpose of that

duty, should serve as the basis for distinguishing between provisions that gave rise to a private right to review and those that did not. According to that approach, provisions obligating the procuring entity to exercise discretion would not give rise to private remedies, except to the extent that the procuring entity failed to exercise discretion at all or exercised it in an arbitrary fashion. Furthermore, there were some provisions involving the procuring entity's discretion that in no case should give rise to a private remedy. Thus, according to the approach agreed upon by the Working Group, the provisions of the Model Law dealing with qualification and selection of contractors and suppliers imposed duties on the procuring entity that gave rise to a private right to review, while provisions such as article 7, concerning the selection by the procuring entity of a method of procurement, and article 3 *bis*, concerning the relationship between the Model Law and international obligations of the enacting State, related to discretionary matters that were aimed at the general public interest and therefore not to be regarded as establishing any private rights. It was further agreed that review and remedies for breach of the duties imposed on the procuring entity with respect to the maintenance of records of procurement proceedings could only be properly discussed when the Working Group had decided upon the purpose and content of those records.

154. Several proposals were made as to the precise manner of indicating in the Model Law the provisions that imposed duties the breach of which would give rise to a cause of action. One proposal, based on the legislative drafting approach used in some States, was that article 36 should simply refer to the breach by the procuring entity of duties imposed by the Model Law. Another proposal, based on the legislative drafting approach used in some other States, was to include in the Model Law a list of the articles which imposed duties the violation of which would give rise to a cause of action. A concern was expressed that the risk inherent in such a list was that some provisions might be overlooked. Another difficulty cited with respect to such a list was that in some legal systems it might be regarded as improperly mixing substantive rules with questions of standing. It was pointed out, however, that, at least in those States in which the use of such a list was familiar, such an approach might be less likely to conflict with existing procedural rules of the general administrative law. In order to accommodate both types of approaches, it was suggested that the Model Law should present the alternatives to enacting States and permit them to adopt the more suitable approach. This could be done either by presenting the alternatives in the Model Law or by retaining only the simple rule in the text of the Model Law and setting forth the list of provisions giving rise to remedies in the commentary, with an indication that an enacting State could, if it so wished, incorporate the list into the text of the Model Law.

155. Yet another suggestion was that in the various sections of the Model Law where it was deemed appropriate to provide for remedies, in particular the sections on qualification and selection of contractors and suppliers, provisions could be included to indicate that those sections gave rise to private remedies, and that it might then be possible to leave procedural matters to be solved according to the applicable general administrative law of the enacting State.

It was suggested that such an approach would have the advantage of focusing on substantive rules on the right to review and remedies in the specific context of procurement, something that could not be done through the general administrative law of the enacting State, thereby avoiding encroachment into general areas of administrative law.

156. In line with the Working Group's decision that the right to review should concern only certain provisions of the Model Law, in particular qualification and selection of contractors and suppliers, it was agreed that the notion of interest or injury that a person would be required to have in order to be entitled to seek review should be linked to the actual or potential loss or damage suffered when the procuring entity violated duties established in those provisions. Concomitantly, actual or potential loss suffered as a result of a breach of provisions that granted the procuring entity discretion should be excluded from that notion.

157. As to the stage at which review may be sought, a question was raised whether article 36 was intended to cover actions of the procuring entity taken prior to the commencement of the procurement proceedings. The specific example cited concerned the exclusion by the procuring entity of a contractor or supplier from a list or roster of contractors or suppliers maintained by the procuring entity independently of any particular procurement proceedings. A question was also raised as to whether article 36 might be interpreted as referring not only to review related to the procurement proceedings, but also to review in connection with disputes related to the performance of the procurement contract. In response to those questions, it was noted that article 36 was intended to refer only to aspects of procurement proceedings addressed in the Model Law and that this should be made clear.

158. After deliberation, the Working Group requested the Secretariat to revise article 36 to reflect the discussion and decisions of the Working Group, including the decision to provide for the alternative methods referred to in paragraph 154, above, of listing or referring to the duties the breach of which would give rise to remedies.

#### *Article 37*

##### *Review by procuring entity or by approving authority*

##### *Paragraph (1)*

159. The view was expressed that it was inappropriate for the Model Law to provide that review should in the first instance be before the procuring entity or the approving authority. According to that view the likelihood that a procuring entity or an approving authority would overturn its own earlier decision was low and therefore, in view of the costs and time involved in pursuing such a path, the procedure envisaged in article 37 should not be required by the Model Law. It was also stated that the procedure in article 37 would contradict legislation in some States which gave aggrieved parties direct access to judicial review. The prevailing view, however, was that the basic approach in paragraph (1) was useful and should be retained. It was felt to be desirable to give the procuring entity an opportunity to reconsider a decision because there might be many cases in

which a procuring entity would of its own accord be willing to correct mistakes that had been made. Such an approach was commonly used and would avoid unnecessarily burdening the judiciary with cases that might have been resolved by the parties themselves. It was also pointed out that without such a procedure aggrieved contractors and suppliers that did not wish to pursue judicial or other methods of review would be left without any avenue of review. A suggestion that initial review by the procuring entity or the approving authority be made discretionary did not receive support.

160. The Working Group noted that the opening words of paragraph (1) ("Unless the procurement contract has already entered into force"), as well as paragraph (3), had been placed within square brackets in order to invite the Working Group to consider whether those provisions, which provided that the competence of the procuring entity or the approving authority to hear a complaint ceased upon the entry into force of the procurement contract, should be retained. It was also noted that the Secretariat had indicated that the underlying policy of those provisions was that, once the procurement contract entered into force, there were no corrective measures that the head of the procuring entity or of the approving authority could usefully require (apart from compensation), unless annulment of the procurement contract was authorized at that stage of the review process.

161. The Working Group recognized that there might be cases in which it would be appropriate for a procurement contract that had entered into force to be annulled. This might be the case, for example, where a large contract was awarded to a particular contractor or supplier as a result of fraud. However, it was generally felt that annulment of procurement contracts was particularly disruptive to the procurement process and generally not in the public interest and should therefore not be provided for in the Model Law. Instances in which annulment was appropriate would be dealt with adequately by the applicable contract or criminal law. It was agreed that the commentary should indicate that the lack of provisions in the Model Law on annulment did not preclude the availability of annulment under other bodies of law. Accordingly, no objections were raised to the retention of the text within square brackets at the beginning of paragraph (1).

##### *Paragraph (2)*

162. Support was expressed for the notion of limiting the period of time during which review before the head of the procuring entity or of the approving authority would be available. At the same time, it was pointed out that the length of that period of time might be determined according to the nature of the remedy being sought. For example, it would not be necessary to subject a claim for compensation for costs incurred in preparing a tender to a tight time limitation, whereas such a limitation would be appropriate where the remedy involved suspension of the procurement proceedings.

##### *Paragraph (3)*

163. The Working Group adopted the concepts in paragraph (3).

*Paragraph (4)*

164. A question was raised as to whether the proposed 20-day deadline would provide the head of the procuring entity or of the approving authority with a sufficient amount of time to conduct any needed investigations prior to the issuance of the written decision. This might particularly be a problem when large bureaucracies were involved. It was proposed that the provision be modified to refer to 20 working days, which would at least resolve any uncertainty as to the effect of holidays and weekends. Another proposal, which did not receive support, was that the procuring entity should be permitted to issue an oral decision within a short period of time, with a longer period of time permitted for the written decision. The Secretariat was requested to consider the question of the time-limit further in view of the discussion by the Working Group.

165. In the discussion of paragraph (4), the question arose whether the head of the procuring entity or of the approving authority should be required to suspend the procurement proceeding upon receipt of a petition for review. A concern was expressed that such a requirement would be disruptive of the procurement proceedings and might invite abusive practices such as frivolous complaints by contractors and suppliers aimed at forcing payments from a procuring entity that wished to avoid disruption of the procurement proceedings. At the same time, it was recognized that some provision on suspension might be appropriate in order to preserve the legitimate rights of aggrieved contractors and suppliers. The Working Group noted that possible issues relevant to the content of a provision on suspension included the identity of the issuer of the suspension, the elements that would have to be established in order to obtain a suspension, the duration of the suspension and which aspects of the procurement proceedings were to be suspended. The Working Group noted that article 41 dealt with suspension of procurement proceedings and decided to defer further discussion of suspension until its consideration of that article.

166. Misgivings were expressed about the reference in paragraph (4)(b) to the granting of compensation by the head of the procuring entity or of the approving authority. In particular, the concern was raised that such compensation payments were open to abuse. It was also pointed out that the procuring entity or approving authority might in many cases not have the authority to make such payments and that the feasibility of such an approach might depend upon the size of the entity in question and whether it had within itself a quasi-independent review body. The view was expressed that in order to avoid those problems the power to grant compensation should be vested in a court or other independent body. An opposing view was that the reference to payment of compensation could be retained because there was nothing inherently wrong in permitting the head of the procuring entity or of the approving authority to compensate aggrieved contractors or suppliers. Such an approach would avoid unnecessary litigation. It was further pointed out that subparagraph (b) was permissive and that it would therefore be left to the financial and budgetary controls of the enacting State to determine whether such direct compensation was appropriate. It was

proposed that subparagraph (b) be modified to emphasize the exceptional character of such payments. Another proposal was that an independent body should be charged with the responsibility of recommending to the head of the procuring entity or of the approving authority whether to pay compensation.

167. The Working Group agreed that the Model Law should enable the head of the procuring entity or of the approving authority to pay compensation. However, it was also agreed that that did not necessitate a mention of such compensation in the Model Law.

*Paragraph (5)*

168. It was suggested that consideration should be given to including in paragraph (5) a provision requiring the automatic referral of a petition for review to the next level of review upon an unfavourable decision by the head of the procuring entity or of the approving authority. The Working Group adopted the concepts in paragraph (5).

*Paragraph (6)*

169. The Working Group adopted the concepts in paragraph (6).

*Article 38**Administrative review*

170. The Working Group noted that article 38 provided for hierarchical administrative review and that States where hierarchical administrative review against administrative actions, decisions and procedures was not a feature of the legal system might choose to omit article 38 and provide only for judicial review (article 40). It was proposed that this option should be expressed in the Model Law, either by placing article 38 between square brackets or by adding an appropriate footnote.

*Paragraph (1)*

171. As regards the reference to "a person" in the opening words of the paragraph, it was agreed that that reference as well as any other reference in the article concerning the potential applicants for review should be aligned with the decision of the Working Group on article 36 as the general rule on standing (see paragraphs 150 to 158 above).

172. It was further agreed that paragraph (1) should include a time-limit for submission of complaints that should be sufficiently short so as not to adversely affect the progress of the tendering proceedings. It was also agreed that article 38 should require that notice of the complaint be given to the procuring entity or the approving authority so as to enable that body to carry out its obligation under article 39(1) to notify all contractors and suppliers of the complaint.

*Paragraph (2)*

173. Concerns were expressed that the opening words that empowered the review body to grant one or more of

the remedies listed in subparagraphs (a) through (h) would not be acceptable to those States where review bodies did not have that power but could merely make recommendations. With a view to accommodating those concerns, it was agreed that the words "may grant" should be replaced by the words "may [grant] [recommend]".

174. The list of possible remedies was found to be too narrow in one respect and too wide in another respect. It was agreed that the possibility of dismissing the complaint should be expressly listed as one of the possible measures of the review body. It was also agreed that subparagraph (f) should be deleted, in line with the earlier decision of the Working Group that annulment or setting aside of a procurement contract after its entry into force should not be envisaged in the Model Law but left to other branches of law (e.g., contract law or criminal law).

#### *Paragraphs (3) and (4)*

175. The Working Group adopted the concepts in paragraphs (3) and (4).

#### *Article 39*

##### *Certain rules applicable to review proceedings under article 37 [and article 38]*

#### *Paragraph (1)*

176. A suggestion was made that the procuring entity or the approving authority should be required to carry out its duty of notification under paragraph (1) promptly after having received notice of a complaint under article 37.

#### *Paragraph (2)*

177. Various concerns were expressed with regard to variants A and B of paragraph (2). Variant A was regarded as inappropriate, in view of the decision of the Working Group relating to annulment of the procurement contract (see paragraph 161). Another concern was that variant A was drafted in a way that would unjustifiably preclude the successful contractor or supplier from participating in the review proceedings. Yet another concern was that the words "by a person" were not consistent with the decision of the Working Group on the general rule of standing in article 36.

178. As regards variant B, one concern was that the first sentence was too embracing in that it might allow contractors or suppliers with frivolous claims to participate in the review proceedings. Another concern was that the first sentence did not sufficiently specify the category of persons in relation to the type or stage of procurement proceedings affecting their interests.

179. Yet another concern was that the right to participate in review proceedings was a basic right that should not be curtailed by the Model Law. It would be contrary to such a basic right if the review body were empowered, as was apparently done by the second sentence, to take a final decision on whether an aggrieved party could participate in the review proceedings. Accordingly, a suggestion was made that paragraph (2) should be deleted.

180. In the light of the above concerns, the Working Group, after deliberation, agreed to retain as paragraph (2) only the first sentence of variant B, subject to replacing the words "claiming that its interests" by the words "whose interests" and replacing the words "may request" by the words "has a right". It was understood that the review body would, on the basis of that provision, determine the question of the right to participate, like any other issue before it, but that the decision would be subject to any administrative or judicial review provided for in the laws of the enacting State.

#### *Paragraph (3)*

181. The Working Group adopted the concepts in paragraph (3).

#### *Article 40*

##### *Judicial review*

182. It was agreed that the words "a person" in the *chapeau* of article 40 should be changed to read "any contractor or supplier" in accordance with the earlier decision of the Working Group with respect to similar wording in article 36 of the Model Law.

183. A clarification was sought as to whether article 40 was intended to grant judicial review over procurement decisions under the Model Law on an exclusive basis or concurrent jurisdiction to the courts with the other administrative bodies that were given the power of review under articles 37 and 38 of the Model Law. It was replied that article 40 provided for judicial proceedings and conferred jurisdiction on the specified court or courts, and that it specified the circumstances in which an action might be commenced and that the existence of concurrent jurisdiction depended upon whether a State that had hierarchical administrative review required exhaustion of that administrative review.

184. It was proposed that the article should contain provisions on the nature and scope of judicial review that was to be conducted by a court under the article. The provisions could deal with such matters as whether the review by the court would be a complete review of the administrative action on the merits or whether the review would be restricted to errors of law on the part of the administrative organ and whether the court would be empowered to substitute its own decision for that of the administrative organ or whether it was merely empowered to annul that decision. It was stated that such provisions would be particularly useful in jurisdictions where judicial review of administrative acts was less developed or not sufficiently refined to take into account the specific characteristics of procurement proceedings.

185. In opposition, views were expressed that the Model Law should not contain provisions on the nature and scope of judicial review. It was stated that the matter would be difficult to deal with in the Model Law as State practice on the nature and scope of judicial review varied considerably from country to country. It was suggested that the need for

guidance to jurisdictions could be met by explanations in the commentary to the Model Law or in notes to article 40.

186. It was generally agreed that the article should be as broad as possible in stating the right of any aggrieved contractor or supplier to bring an action before a court of law. It was stated that judicial review was the most important vehicle of redress in the Model Law. It was further observed that under many international conventions the broadest possible access to courts by aggrieved parties was guaranteed.

187. It was proposed that article 40 should contain only the opening sentence and that the last sentence of the *chapeau* and subparagraphs (a) through (d) should be deleted. It was stated that that would ensure the broadest possible access to the courts. The proposal was accepted.

#### Article 41

##### *Suspension of procurement proceedings (and of performance of procurement contract)*

188. As regards the two approaches provided in article 41 as variant A and variant B, variant B was regarded as preferable to variant A, on the ground that it gave more discretion to the organ ordering the suspension. Such discretionary power was desirable since suspension of procurement proceedings or of a procurement contract could in some situations cause serious disruption to the proceedings and hardship to the procuring entity and the public. It was observed that suspension could for instance cause a delay in the completion of a project.

189. A number of suggestions were made with regard to the exercise of the power of suspension. One suggestion was that the authority exercising the power of suspension should be required to give reasons for its decision. Another suggestion was that consideration should be given to setting time-limits for the duration of a suspension so as to avoid delays in procurement proceedings. Yet another suggestion was that suspension might be better dealt with in respect of each level of authority exercising powers of review. It was observed that, for example, a decision of the first review authority not to exercise the power of suspension might create problems for other levels of review.

190. After discussion, it was felt that the issue of suspension raised many issues which needed further consideration. It was decided to request the Secretariat to prepare a note on the subject for the consideration of the Working Group at its fourteenth session.

#### Article 42

##### *Disciplinary, administrative or criminal responsibility of procuring entity*

191. A view was expressed that article 42 could be broadened so as to cover civil responsibility. The prevailing view, however, was that the provision was unnecessary. It was stated that the Model Law did not in any of its provisions affect rights under other laws. Given that situation there was no need to state that review proceedings had no effect on any disciplinary, administrative or criminal responsibility that the procuring entity or officer might bear under the law of the State.

192. The Working Group agreed to delete article 42.

#### III. Future plan of work, including preparation of commentary

193. At the conclusion of the Working Group's deliberations on draft articles 28 to 42 of the Model Law, the Working Group discussed its future plan of work, in particular, the preparation of the commentary. It was recalled that the Working Group, at its eleventh session, had endorsed its decision taken at the tenth session that the Model Law should be accompanied by a commentary and that it had discussed the possible functions and structure of the commentary without, however, taking a final decision with respect to such function and structure (A/CN.9/331, paras. 13-16).

194. It was pointed out that the Working Group, during its entire deliberations, had proceeded on the assumption that the Model Law would be accompanied by a commentary, eventually to be adopted by the Commission. For example, the Working Group had decided in respect of a number of issues not to settle them in the Model Law but to address them, sometimes with various options, in the commentary so as to provide guidance to States in implementing the Model Law.

195. The Working Group reaffirmed its earlier decision that the Model Law should be accompanied by a commentary. The Working Group also decided to consider in detail at its next session the possible function and structure of the commentary as well as the timing and procedure of its preparation.

196. The Working Group noted that the fourteenth session would be held in Vienna from 2 to 13 December 1991 and requested the Secretariat to revise the Model Law in light of the deliberations and decisions at the thirteenth session. It was decided to hold the fifteenth session, subject to approval by the Commission, from 22 June to 2 July 1992 in New York rather than from 3 to 14 August 1992 as originally scheduled and indicated in the report of the twenty-fourth session of the Commission.

## B. Working papers submitted to the Working Group on the New International Economic Order at its thirteenth session

### 1. *Procurement: draft articles 1 to 35 of Model Law on Procurement: report of the Secretary-General* (A/CN.9/WG.V/WP.30) [Original: English]

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\*See note to the title of article 31.

## 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 Working Group agreed that the commentary would not be revised until after the text of the Model Law had been settled and requested the Secretariat to revise the first draft of articles 1 through 35 to take account of the discussion and decisions at its eleventh session (A/CN.9/331, para. 222). At the twelfth session, the Working Group had before it the second draft of articles 1 through 35 (A/CN.9/WG.V/WP.28) as well as draft provisions on review of acts and decisions of, and procedures followed by, the procuring entity (draft articles 36 through 42, contained in A/CN.9/WG.V/WP.27). At that session, the Working Group reviewed the second draft of articles 1 through 27. It did not have sufficient time to review draft articles 28 to 35, or the draft articles on review, and decided to consider those articles at its thirteenth session.

3. The Working Group requested the Secretariat to revise articles 1 through 27 to take into account the discussion and decisions concerning those articles at the twelfth session (A/CN.9/343, para. 229). The revision of those draft articles, as well as the second draft of articles 28 through 35 (as those articles had appeared in A/CN.9/WG.V/WP.28), is contained in the present document. In addition, the present document contains several articles that have been added to the Model Law to implement the decision of the Working Group to add two methods of procurement to those provided for in earlier drafts (those new articles being articles 33 *bis* to 33 *sexies*, and article 34 *bis*, in the present document). Draft provisions on review, consisting of articles 36 through 42, are contained in A/CN.9/WG.V/WP.27.

4. At the twelfth session, the Secretariat was requested to report to the thirteenth session on the treatment in national procurement laws of competitive negotiation, one of the methods of procurement other than tendering that the Working Group had agreed the Model Law should allow under certain conditions. That report on competitive negotiation is contained in A/CN.9/WG.V/WP.31.

5. As indicated in A/CN.9/WG.V/WP.28, paragraphs 4 to 7, in preparing the second draft of articles 28 through 35 (not including articles 33 *bis* to 33 *sexies*, and article 34 *bis*, in the present document), the Secretariat implemented all deletions, changes and additions agreed upon by the Working Group at its eleventh session. In addition, the Secretariat has incorporated within square brackets in those articles proposals and suggestions made at that session but in respect of which agreement was not reached. Such proposals and suggestions would not be retained in the text unless the Working Group affirmatively decides to retain or to modify them.

6. In revising articles 1 through 27 to take account of the discussion and decisions of the Working Group at the twelfth session, the Secretariat has, except where otherwise indicated, implemented all deletions, changes and additions agreed upon by the Working Group at the twelfth session. A limited number of proposals and suggestions with respect to which decisions were not taken at the twelfth session, and which the Secretariat believes the Working Group may wish to consider further, have been incorporated within square brackets. The Working Group may wish to consider that the present text of those articles will serve as a preliminary draft of the Model Law to which future revisions would be made by the Working Group itself.

7. Throughout the present document, changes of and additions to wording that appeared in earlier drafts are in italics, except in the case of headings to articles, all of which are in italics as a matter of style. Deletions from earlier drafts are indicated in the notes following each article.

#### *Preamble<sup>1</sup>*

*[WHEREAS the Government of this State considers it desirable to regulate procurement of goods and construction so as to promote the objectives of:]<sup>2</sup>*

(a) maximizing economy and efficiency in procurement;<sup>3</sup>

(b) fostering and encouraging participation in procurement proceedings by competent contractors and suppliers, including, where appropriate, participation by competent contractors and suppliers regardless of nationality, and thereby promoting international trade;<sup>4</sup>

(c) promoting competition among contractors and suppliers for the supply of the goods or construction to be procured;

(d) providing for the fair and equitable treatment of all contractors and suppliers;

(e) promoting the integrity of, and fairness and public confidence in, the procurement process; and

(f) achieving transparency in the procedures relating to procurement.

*[Be it therefore enacted as follows:]<sup>5</sup>*

<sup>1</sup>Pursuant to A/CN.9/343, para. 54, the statement of objectives of the Model Law, which had been set forth in article 3 in earlier drafts, has been placed in a preamble (see also note 1 under article 3).

<sup>2</sup>The exact structure and presentation of the preamble would depend on the legislative drafting practice of the enacting State. The introductory portion of the preamble and the enacting formula at the conclusion of the preamble presented here are merely of an illustrative character and have therefore been placed in square brackets.

<sup>3</sup>In accordance with A/CN.9/343, para. 55, the reference to "efficiency" has been moved from the *chapeau* back to subparagraph (a).

<sup>4</sup>In accordance with A/CN.9/343, para. 58, the reference to participation by contractors and suppliers whose places of business or habitual residences are located outside the enacting State has been reformulated to refer to participation by contractors and suppliers "regardless of nationality". (See also note 1 under article 11.) The objective of "promoting international trade" has been added pursuant to A/CN.9/343, para. 57.

## CHAPTER I. GENERAL PROVISIONS

Article 1. *Scope of application\**

(1) This Law applies to all procurement by procuring entities, except as otherwise provided by this article.<sup>1</sup>

(2) This Law does not apply to procurement involving national security or national defence, except where, and to the extent that, the procuring entity expressly declares that it applies.<sup>2</sup>

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

<sup>1</sup>See A/CN.9/343, para. 11: the words "except as otherwise provided by this article" have been added at the initiative of the Secretariat.

<sup>2</sup>Pursuant to A/CN.9/343, para. 13, the national security exclusion has been broadened to cover cases "involving" national security or national defence. The words "and to the extent that" have been added in response to the suggestion in A/CN.9/343, para. 225, that the Model Law deal with questions relating to the application of the Model Law to procurement involving national security or national defence in a separate omnibus provision, rather than in individual articles. Under the present formulation, the enacting State would be able to exclude certain individual articles when the Model Law was applied to procurement involving national security or national defence. In the discussion of article 1 at the twelfth session, it was agreed that a State should also be able to exclude the application of the Model Law to particular types of procurement in a general manner or on a case-by-case basis (see A/CN.9/343, para. 14). An optional provision along the following lines could be added to article 1 to give such a right:

"(3) Except where, and to the extent, the procuring entity expressly declares to contractors and suppliers that this Law applies, this Law does not apply to procurement of . . . (each State enacting the Model Law may specify additional types of procurement to be excluded in a general manner), or to procurement excluded under the procurement regulations."

The Working Group may wish to consider whether permitting such an exclusion of the Model Law would be necessary in view of the various methods of procurement provided for in the Model Law that allow a procuring entity to take into account various objectives and circumstances. Furthermore, the Working Group may wish to consider whether such a provision, particularly one allowing the scope of application of the Model Law to be subject to the procurement regulations, would allow too much scope for countries to exclude various types of procurement and thereby to defeat the objectives of the Model Law.

\* \* \*

Article 2. *Definitions*

For the purposes of this Law:

(new a) "procurement" means the acquisition by any means, including by purchase, rental, lease or hire-purchase, 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;<sup>1</sup>

(a) "procuring entity" means:

## Option I

((i) any governmental department, agency, organ or other unit, or any subdivision thereof, in this State that engages in procurement, except . . . ;)

## Option II

((i) any department, agency, organ or other unit, or any subdivision thereof, of the ("Government" or other term used to refer to the national Government of the enacting State) that engages in procurement, except . . . ;)<sup>2</sup>

((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 electricity;<sup>3</sup>

(c) "construction" means all work associated with the construction, re-construction, 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 incidental to such work if they are provided for in the procurement contract;<sup>4</sup>

(d) [deleted];<sup>5</sup>

(e) [deleted];<sup>6</sup>

(f) "tender security" means a security for the performance of the obligations of a contractor or supplier submitting a tender, 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;<sup>7</sup>

(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;

(g ter) "two-stage tendering proceedings" means procedures engaged in, in accordance with article 33 bis, with a view towards entering into a procurement contract;<sup>8</sup>

(g quater) "request-for-proposals proceedings" means procedures engaged in, in accordance with articles 33 ter to 33 sexies, with a view towards entering into a procurement contract;<sup>9</sup>

(h) "competitive negotiation proceedings" means negotiations on a competitive basis between the procuring entity and at least two contractors and suppliers, governed by article 34, with a view towards entering into a procurement contract;<sup>10</sup>

(h bis) "request-for-quotations proceedings" means procedures engaged in, in accordance with article 34 bis, with a view towards entering into a procurement contract;<sup>9</sup>

(i) "single source procurement" means procedures engaged in, in accordance with article 35, with a view towards entering into a procurement contract;<sup>11</sup>

(i bis) "contractor or supplier" means any party or potential party, according to the context, to a procurement contract with the procuring entity;

(j) "responsive tender" means a tender that conforms to all requirements set forth in the tender solicitation documents, subject to article 28(4).<sup>12</sup>

<sup>1</sup>See A/CN.9/343, para. 19. The reference to telecommunications, transport or insurance services has been deleted in accordance with A/CN.9/343, para. 20. References to services elsewhere in the text have also been deleted.

<sup>2</sup>Pursuant to A/CN.9/343, para. 26, option I would be adopted by non-federal States and by federal States that could legislate for their subdivisions, and option II by States that enact the Model Law only with respect to organs of the national Government. In accordance with A/CN.9/343, para. 23, the reference in subparagraph (i) to "the administration" has been dropped.

<sup>3</sup>See A/CN.9/343, para. 30.

<sup>4</sup>See A/CN.9/343, para. 32. Language has been added to indicate that the incidental services are those to be procured under a single procurement contract covering the construction, rather than under a separate procurement contract covering those incidental services.

<sup>5</sup>The definition of the term "procurement proceedings" has been deleted pursuant to A/CN.9/343, para. 34. The Working Group may wish to re-examine that decision in view of the increase in the use of the term as a result of the addition of request-for-proposal proceedings (see note 2 under article 11).

<sup>6</sup>The definition of the term "international tendering proceedings" has been deleted pursuant to A/CN.9/343, para. 118.

<sup>7</sup>See A/CN.9/343, paras. 40 and 41. The Working Group may wish to reconsider the necessity of mentioning both letters of credit and stand-by letters of credit as separate forms of tender securities.

<sup>8</sup>See A/CN.9/343, para. 71.

<sup>9</sup>See A/CN.9/343, para. 72.

<sup>10</sup>See A/CN.9/343, para. 45.

<sup>11</sup>The foregoing definition has been modified as a result of the addition of request-for-proposals and request-for-quotations proceedings as methods of procurement under the Model Law.

<sup>12</sup>See A/CN.9/343, para. 52.

\* \* \*

### Article 3. [moved to preamble]<sup>1</sup>

<sup>1</sup>Pursuant to A/CN.9/343, para. 54, the statement of the underlying objectives of the Model Law has been moved to the preamble. The Working Group may wish to consider providing the option of setting forth the underlying objectives in an article of the Model Law, in order to accommodate those States where it is not customary to include preambles in legislation. This might be done, for example, by setting forth the objectives of the Model Law in an optional final paragraph to article 1, in which case the title of article 1 would become "Scope of application and objectives of Law".

\* \* \*

### 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 or arising out of any treaty or other form of agreement to which it is a party with one or more other States or under or arising out of any agreement with an intergovernmental international financing institution that is entered into by this State, the requirements of the treaty or agreement shall be applied; but in all other respects, the procurement shall be governed by this Law.<sup>1</sup>

<sup>1</sup>See A/CN.9/343, para. 62. The words "is entered into" replaces the words "that has already been or is subsequently entered into" in order to conform the reference to agreements with financing institutions to the reference to agreements with States.

\* \* \*

### 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.<sup>1</sup>

<sup>1</sup>In A/CN.9/343, para. 64, the Working Group agreed that article 4 should be modified to take account of the decision in A/CN.9/343, para. 14, that an enacting State should have the option of using the procurement regulations to exclude the application of the Model Law to certain types of procurement, accordingly. (See note 2 under article 1 concerning optional paragraph (3) of article 1.) Should the Working Group decide to retain such an approach, the following text could be added to article 4 by an enacting State that wished to use the procurement regulations in such a manner:

*"and to provide for the exclusion of the application of this Law pursuant to Article 1(3)."*

\* \* \*

### 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. [deleted]<sup>1</sup>

<sup>1</sup>Article 6 has been deleted in accordance with the decision in A/CN.9/343, para. 66, that the Model Law, instead of providing for the designation of a single organ to exercise the approval function, should provide for the designation of an organ in each article dealing with an act or decision that was subject to approval. Pursuant to A/CN.9/343, para. 67, parentheses have been placed around all references to approval in the Model Law to indicate that approval requirements need not be incorporated in legal systems in which approval of acts and decisions of the procuring entity by another administrative authority is contrary to practice.

\* \* \*

### Article 7. *Methods of procurement*<sup>1</sup>

(1) Except as otherwise provided by this Law, a procuring entity engaging in procurement shall do so by means of tendering proceedings.

(2) [Moved to article 34]<sup>1</sup>

(new 2) *The procuring entity may engage in procurement by means of*<sup>2</sup>

(a) *two stage tendering, subject to article 33 bis;*

(b) *request for proposals, subject to articles 33 ter to 33 sexes;*

(c) *competitive negotiation, subject to article 34;*

- (d) request for quotations, subject to article 34 bis;
- (e) single source procurement, subject to article 35.

(3) [Moved to article 35]<sup>1</sup>

(new 3) When, in accordance with this Law, the circumstances of a particular procurement fit the conditions for use of more than one of the methods referred to in paragraph (new 2), the selection of the method to be used shall be made on the basis of an order of preference corresponding to the order in which the methods are set forth in paragraph (new 2).<sup>2</sup>

(4) [Incorporated in articles 34 and 35]<sup>3</sup>

(5) A procuring entity that uses a method of procurement other than tendering proceedings pursuant to paragraphs (new 2) or (new 3) shall include in the record required under article 33 bis, 33 sexies, 34(4), 34 bis (5), or article 35(1) and (2), as the case may be, a statement of the circumstances on which it relied to justify the use of that method of procurement and shall specify the relevant facts.<sup>5</sup>

<sup>1</sup>The words "and conditions for their use" have been removed from the title in view of the decision in A/CN.9/343, para. 75, that the conditions under which each method may be used should be set out in the individual articles dealing with each method. Accordingly, the conditions for use of competitive negotiation, previously addressed in paragraph (2), are to be dealt with in article 34, and the conditions for use of single source procurement, previously set forth in paragraph (3), are to be set forth in article 35.

<sup>2</sup>Pursuant to A/CN.9/343, para. 75, paragraph (new 2) lists all methods of procurement provided for in the Model Law, subject to the conditions for use and procedures set forth in the individual articles dealing with each method.

<sup>3</sup>See A/CN.9/343, para. 79.

<sup>4</sup>See article 34 (new 1 bis) (the text of which follows note 3 to article 34) and article 35 (new 1 bis) (the text of which follows note 1 to article 35).

<sup>5</sup>Paragraph (5) has been modified to reflect the addition of two methods of procurement (request for proposals and request for quotations), as well as the decision to treat two-stage tendering as a separate procurement method. The exception for competitive negotiation in cases of national security has been removed in line with the inclusion of an omnibus provision, article 1(2), dealing with the application of the Model Law to procurement involving national security.

\* \* \*

## Article 8. Qualifications of contractors and suppliers

(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.<sup>1</sup>

(1) Subject to the right of contractors and suppliers to protect their intellectual property or trade secrets, the procuring entity may:

(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:

(new i) 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;<sup>2</sup>

- (i) have legal capacity to enter into the procurement contract;<sup>3</sup>
- (ii) are not insolvent, in receivership, 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 within a period of 5 years preceding the commencement of the procurement proceedings;<sup>4</sup>
- (v) [deleted]<sup>5</sup>
- (vi) [moved to subparagraph (new i)]

(b) [deleted]<sup>6</sup>

(2) Any requirement established pursuant to paragraph (1)(a)<sup>7</sup> 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 criterion, requirement or procedure with respect to the qualifications of contractors and suppliers other than those provided for in paragraph (1)(a).

(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 prequalification documents and the solicitation documents.

(2 ter) Subject to Article 11(1), the procuring entity shall establish no criterion, requirement or procedure with respect to the qualifications of contractors and suppliers that discriminates against or among contractors and suppliers or against categories thereof on the basis of nationality.<sup>8</sup>

(3) Except where prequalification proceedings have taken place, a contractor or supplier that claims to meet the qualification criteria shall not be precluded from participating in procurement proceedings for the reason that it has not provided proof that it is qualified pursuant to paragraph (1) if the contractor or supplier undertakes to provide such proof prior to the conclusion of the procurement proceedings and if it is reasonable to expect that the contractor or supplier will be able to do so.<sup>9</sup>

<sup>1</sup>See A/CN.9/331, para. 45.

<sup>2</sup>See A/CN.9/343, para. 102.

<sup>3</sup>The reference to the law of the State of which a contractor or supplier is a national has been deleted in accordance with A/CN.9/343, para. 95.

<sup>4</sup>The reference to liability in civil proceedings for loss arising from the performance or failure to perform a procurement contract has been deleted in accordance with A/CN.9/343, para. 101.

<sup>5</sup>See A/CN.9/331, para. 50.

<sup>4</sup>Paragraph (1)(b) has been deleted because the replacement of the right of the procuring entity to inspect the books of contractors and suppliers with a right only to require contractors and suppliers to provide verification of their statements concerning their qualifications (A/CN.9/343, para. 103) appears not to provide the procuring entity with any right not already given to it under paragraph (1)(a).

<sup>5</sup>The substance of the text that formerly appeared at this point ("and any criterion established by the procuring entity for the evaluation of the qualifications of contractors and suppliers under paragraph (1)(a)(vi)") is covered by the general reference to paragraph (1)(a) and that text has therefore been deleted. The indicated language has been aligned with paragraph (2 *ter*).

<sup>6</sup>The proviso at the beginning of the paragraph has been added since discriminatory eligibility rules are permitted under article 11(1). See A/CN.9/343, para. 107, as well as paras. 118 to 120.

<sup>7</sup>The words "subject to the efficient operation of the procurement system", that appeared at the beginning of the paragraph, have been deleted in accordance with A/CN.9/343, para. 108; concerning the indicated changes, see A/CN.9/343, paras. 109 and 110.

\* \* \*

#### Article 8 bis. *Prequalification proceedings*<sup>1</sup>

(1) The procuring entity may engage in prequalification proceedings with a view towards identifying, prior to the submission of tenders or proposals in procurement proceedings conducted pursuant to chapters II or III,<sup>2</sup> contractors and suppliers that are qualified. The provisions of article 8 shall apply to prequalification proceedings.<sup>3</sup>

(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 invitation to prequalify<sup>4</sup> and that pays the price, if any, charged for those documents.

(3) The prequalification documents shall contain [the information necessary to enable contractors and suppliers to prepare and submit applications to prequalify, including, but not limited to,]<sup>5</sup>

##### [Option I

the information required to be provided under the procurement regulations.<sup>6</sup>

##### Option II

the information required to be included in the invitation to tender pursuant to article 14(1), except subparagraphs (e) and (g) thereof, as well as<sup>7</sup> the following information:

(a) instructions for preparing and submitting prequalification applications;

(b) [deleted]<sup>8</sup>

(c) a summary of the principal required terms and conditions of the procurement contract to be entered into as a result of the procurement proceedings;<sup>9</sup>

(d) any documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their qualifications;

(e) the procedures to be used for evaluating the qualifications of contractors and suppliers;<sup>10</sup>

(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, taking into account the reasonable needs of the procuring entity;<sup>11</sup>

(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]<sup>12</sup>

(3 bis) The procuring entity shall respond to any request by a contractor or supplier for clarification of the prequalification documents that is received by the procuring entity within a reasonable time 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 given in sufficient time to enable the contractor or supplier to make a timely submission of its application to prequalify and shall be communicated to all contractors and suppliers to which the procuring entity provided the prequalification documents.<sup>13</sup>

[(3 ter) Any request for clarification and any response thereto by the procuring entity and any addendum to the prequalification documents shall be made in writing, including any other means 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, and of its content, is communicated to the recipient of the request or response in writing, including by any other means that provides a record of the confirmation, and provided that, in the case of a response, the response is communicated to all contractors and suppliers to which the procuring entity provides the prequalification documents.]<sup>14</sup>

(4) The procuring entity shall promptly notify each contractor and supplier submitting an application to prequalify whether or not it has<sup>15</sup> been prequalified [and shall make available to the general public the names of all contractors and suppliers that have been prequalified].<sup>16</sup> Only contractors and suppliers that have been prequalified are entitled to participate further in the procurement proceedings.<sup>17</sup>

(5) The procuring entity shall upon request communicate to contractors and suppliers that have not been prequalified the grounds therefore, but the procuring entity is not required to specify the evidence or give the reasons for its finding that those grounds were present.<sup>18</sup>

[(6) A procuring entity that has engaged in prequalification proceedings is not precluded from re-evaluating at a later stage of the procurement proceedings the qualifications of contractors and suppliers that have been prequalified.]<sup>19</sup>

<sup>1</sup>Pursuant to a proposal in A/CN.9/343, para. 136, the substance of article 16 has been moved to new article 8 bis in chapter I.

<sup>2</sup>The reference to procurement proceedings under chapter III has been added as a consequence of the inclusion of the provisions on prequalification proceedings in chapter I (in article 8 *bis*).

<sup>3</sup>See A/CN.9/343, para. 139, concerning the deletion of the exclusion of prequalification proceedings in limited tendering proceedings.

<sup>4</sup>See note 2 under article 12.

<sup>5</sup>See A/CN.9/343, para. 147. The Working Group is invited to consider whether the retention of the text within brackets might have the unintended effect of prompting disputes as to whether the procuring entity has included in the prequalification documents the information necessary to enable contractors and suppliers to prepare and submit applications to prequalify.

<sup>6</sup>Two options for paragraph (3) are presented in response to the request in A/CN.9/343, para. 145, that the Secretariat consider how the Model Law might permit the incorporation of detailed requirements as to the contents of the prequalification documents in the procurement regulations rather than in the text of the Law. The commentary would indicate that, under option I, the requirements enacted in the procurement regulations should mirror those set forth in option II. The Working Group may wish to consider whether providing an option to the enacting State of not establishing detailed requirements in the Law itself would be consistent with the opinion of the Working Group in A/CN.9/343, para. 144, that deleting the detailed requirements from the text of the Model Law might defeat the objectives of the Model Law and prejudice uniformity of law.

<sup>7</sup>See A/CN.9/343, paras. 122 and 148.

<sup>8</sup>Subparagraph (b), that referred to additional information that would be useful to the contractors or suppliers in preparing their prequalification documents, has been deleted pursuant to A/CN.9/343, para. 149.

<sup>9</sup>The term "procurement proceedings" is used in place of the term "tendering proceedings" in order to accommodate application of the provision to procurement involving methods other than tendering.

<sup>10</sup>The mention of criteria for evaluating the qualifications of contractors and suppliers has been deleted from subparagraph (e) since those criteria are referred to in the *chapeau* by way of the reference to article 14(1).

<sup>11</sup>See note 1 under article 11; it is suggested that the commentary refer to the need to take into account the time needed by contractors and suppliers in proceedings in which contractors and suppliers participate regardless of nationality.

<sup>12</sup>In the preparation of the second draft, subparagraph (h) was reformulated and moved to paragraph (3 *bis*) pursuant to A/CN.9/331, para. 76.

<sup>13</sup>See A/CN.9/343, para. 151.

<sup>14</sup>A provision analogous to article 22(3) concerning the form and method of communication of requests for clarification and responses thereto has been added at the initiative of the Secretariat.

<sup>15</sup>See A/CN.9/343, para. 152.

<sup>16</sup>At the twelfth session, differing approaches were discussed, but no decision was reached, as to the extent to which paragraph (4) should require the disclosure of the names of the contractors and suppliers that have been prequalified (see A/CN.9/343, paras. 153 to 155). In addition to the approach in the text, one approach was to say nothing about disclosure. Another approach was to require the procuring entity to specify the extent and time of disclosure in the prequalification documents. A further approach was to require the procuring entity to provide the information on request to suppliers and contractors that submitted a prequalification application and to disclose the information to the general public only after acceptance of a tender. Yet another approach was to require disclosure to contractors and suppliers but to prohibit any further disclosure.

<sup>17</sup>The words "to participate further in the procurement proceedings" replace the words "to submit tenders" in order to accommodate procurement methods other than tendering.

<sup>18</sup>See A/CN.9/343, para. 156.

<sup>19</sup>The Working Group decided in A/CN.9/343, para. 161, to defer a decision on the necessity for paragraph (6) or on its formulation until the consideration of article 28(8 *bis*).

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## Article 9. [merged with article 8]<sup>1</sup>

<sup>1</sup>In the preparation of the second draft, article 9 was merged with article 8 pursuant to A/CN.9/331, para. 45.

\* \* \*

## Article 10. Rules concerning documentary evidence provided by contractors and suppliers

(1) *When the procuring entity requires the legalization of documentary evidence provided by contractors and suppliers to demonstrate their qualifications in procurement proceedings, the procuring entity shall not impose any requirements as to the legalization of the documentary evidence other than those provided for in the laws of this State relating to the legalization of documents of the type in question.<sup>1</sup>*

(2) [deleted]<sup>1</sup>

(3) [deleted]<sup>1</sup>

<sup>1</sup>See A/CN.9/343, para. 113, concerning the reformulation of paragraph (1) and the deletion of paragraphs (2) and (3), which established certain requirements with respect to legalization of documents concerning qualifications of contractors and suppliers.

\* \* \*

## CHAPTER II. TENDERING PROCEEDINGS

### Section I. Participation by contractors and suppliers<sup>1</sup>

#### Article 11. Participation by contractors and suppliers<sup>1</sup>

(1) *Contractors and suppliers are permitted to participate in procurement proceedings without regard to nationality, except in cases in which, on the grounds of economy or efficiency, the procuring entity restricts participation to domestic contractors and suppliers and in cases in which, on grounds specified [in the procurement regulations or] in other provisions of law, the procuring entity decides to restrict participation in procurement proceedings on the basis of nationality. A procuring entity that restricts participation on the basis of nationality shall include in the record of the procurement proceedings a statement of the circumstances on which it relied and shall specify the relevant facts.<sup>2</sup>*

(1 *bis*) *In procurement proceedings in which participation is limited to domestic contractors and suppliers pursuant to paragraph (1), the procuring entity shall not be required to employ the procedures set forth in articles 8(2 *ter*), 12(1 *bis*), 14(1)(1 *bis*), 14(1)(g), 14(2)(b *bis*), 14(2)(c), 17(2)(i *bis*), 17(2)(k), 17(2)(q), 20(4), and 26(1)(b) of this Law.<sup>3</sup>*

(2) [deleted]<sup>1</sup>

<sup>1</sup>The title that section I and article 11 bore in earlier drafts, "international tendering proceedings", has been replaced consequent to the Working Group's decision in A/CN.9/343, para. 118, that article 11 should avoid the use of the term "international tendering proceedings". In article 11 that term is replaced by the reference to tendering proceedings in which contractors and suppliers may participate "without regard to nationality". The term "international tendering proceedings" is also deleted or replaced elsewhere in the Model Law.

<sup>2</sup>Pursuant to A/CN.9/343, para. 120, paragraph (1) establishes a presumption in favour of participation by contractors and suppliers regardless of nationality, except where such participation would not be consistent with economy and efficiency, a ground specified in the procurement regu-

lations, or the laws of the enacting State. The reference to the use of the procurement regulations to restrict participation is placed in square brackets in order to invite the Working Group to consider further the desirability of such a use of the procurement regulations. In order to promote transparency, a procuring entity that decides to restrict participation on the basis of nationality is required to justify its decision in the record of the procurement proceedings. The term "procurement proceedings" is used here and elsewhere in chapter II in view of the application of the provisions in question to procurement proceedings involving methods other than tendering.

<sup>2</sup>Pursuant to A/CN.9/343, para. 120, paragraph (1 *bis*) specifically refers to special procedures formerly encompassed within the term "international tendering proceedings" and requires the employment of those procedures, except in the circumstances referred to in paragraph (1 *bis*).

<sup>3</sup>Paragraph (2) was deleted in the preparation of the second draft pursuant to A/CN.9/331, para. 58.

\* \* \*

## Section II. Solicitation of tenders and of applications to prequalify

### Article 12. *Solicitation of tenders and of applications to prequalify*

(1) A procuring entity shall solicit tenders, or,<sup>1</sup> where applicable, applications to prequalify, from all interested contractors and suppliers by causing an invitation to tender or an invitation to prequalify, as the case may be,<sup>2</sup> 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).

(1 *bis*) The invitation to tender or invitation to prequalify shall also be published, in a language customarily used in international trade, at a minimum in a newspaper of wide international circulation or relevant trade publication or technical journal of wide international circulation.<sup>3</sup>

(2) (a) Notwithstanding the provisions of paragraph (1), the procuring entity may, when necessary for reasons of economy and efficiency, (and subject to approval by . . . (each State may designate an organ to issue the approval),<sup>4</sup> solicit tenders by sending<sup>5</sup> invitations to tender only to particular contractors or 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 invitation to tender or the invitation to prequalify may be sent<sup>6</sup> to contractors and suppliers in writing, including by any other means that provides a record of its contents. However, where there is an urgent need for the goods or construction to be procured or where the estimated value of the procurement contract is less than the amount set forth in the procurement regulations, tenders or applications to prequalify may be solicited from the selected contractors and suppliers by informing them of the contents of the invitation to tender or the invitation to prequalify by telephone and sending<sup>5</sup> the invitation to tender or the invitation to prequalify to them immediately thereafter in writing, including by any other means that provides a record of the contents of the invitation to tender or the invitation to prequalify.

<sup>1</sup>See A/CN.9/343, para. 123.

<sup>2</sup>Pursuant to A/CN.9/343, para. 122, the separate terms "invitation to prequalify" and "invitation to tender" replace the term "notice of proposed procurement", which in earlier drafts referred to the instrument used to solicit either applications to prequalify or tenders. The Working Group may wish to consider, for the purpose of referring to the instrument used to solicit tenders, to revert to the use of the term "notice of proposed procurement" or to use a similar term, such as "invitation to participate in procurement proceedings" or "invitation to offer", that does not contain a reference to a particular method of procurement. Such an approach could be taken in view of the incorporation by reference of portions of articles 12 and 14 into the provisions dealing with procurement through requests for proposals (see article 33 *ter*(3) and (4)). See also note 4 under article 33 *ter*.

<sup>3</sup>The substance of paragraph (1 *bis*), which earlier appeared in paragraph (1), has been moved to paragraph (1 *bis*) in line with the Working Group's decision with respect to article 11 (see notes 1 and 3 under that article). See also A/CN.9/343, paras. 125 and 126.

<sup>4</sup>See A/CN.9/343, para. 130.

<sup>5</sup>See A/CN.9/343, paras. 128 and 131.

\* \* \*

### Article 13. [deleted]<sup>1</sup>

<sup>1</sup>Deleted in the preparation of the second draft pursuant to A/CN.9/331, para. 62.

\* \* \*

### Article 14. *Contents of invitation to tender and invitation to prequalify*<sup>1</sup>

(1) The invitation to tender shall contain at least the following information:

- (a) the name and address of the procuring entity;
- (b) the nature and quantity of the goods 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 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);
- (d *bis*) a declaration, which may not later be altered, that contractors and suppliers may participate in the procurement proceedings regardless of nationality, or a declaration that participation is limited on the basis of nationality, as the case may be;<sup>2</sup>
- (e) the means of obtaining the solicitation documents and the place from which they may be obtained;<sup>3</sup>
- (f) the price, if any, charged by the procuring entity for the solicitation documents;<sup>4</sup>
- (f *bis*) the currency and means of payment for the solicitation documents;<sup>4</sup>
- (g) the language or languages in which the solicitation documents are available;<sup>5</sup>
- (h) the place and deadline for the submission of tenders;
- (i) [deleted]<sup>6</sup>
- (j) [deleted]<sup>7</sup>

(2) *An invitation to prequalify<sup>8</sup> need not contain the information referred to in paragraph (1)(e), (g) or (h), but shall contain the information referred to in paragraph (1)(a), (b), (c), (d), (d bis) and (f),<sup>9</sup> as well as the following 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;<sup>10</sup>

(b bis) the currency and terms of payment for the prequalification documents;<sup>10</sup>

(c) the language or languages in which the prequalification documents are available; and<sup>5</sup>

(d) the place and deadline for the submission of applications to prequalify.

<sup>8</sup>See note 2 under article 12.

<sup>9</sup>See A/CN.9/343, paras. 121 and 134. Under the present formulation, the procuring entity would be permitted to alter a declaration that restricted the procurement proceedings to domestic contractors and suppliers.

<sup>10</sup>In view of the incorporation by reference of provisions dealing with solicitation documents in tendering proceedings into article 33 *ter*(4)(a)(ii) (request for proposals), the term "solicitation documents" is used rather than the term "tender solicitation documents".

<sup>5</sup>The reference to currency and means of payment for solicitation documents, formerly contained in subparagraph (f), is set apart in subparagraph (f bis) in accordance with the modification of article 11 (see notes 1 and 3 under that article).

<sup>6</sup>See note 1 under article 11.

<sup>7</sup>Subparagraph (i), which referred to the tender security, has been deleted pursuant to A/CN.9/343, para. 133.

<sup>8</sup>Subparagraph (j), which referred to the right of recourse under the Model Law, has been deleted pursuant to A/CN.9/343, para. 133.

<sup>9</sup>See note 2 under article 12.

<sup>10</sup>See A/CN.9/343, para. 135. The new provision in subparagraph (d bis) has been added to the information required to be included in the invitation to prequalify and the requirement of information about the place and deadline for submitting tenders has been excluded.

<sup>11</sup>The reference to the currency and terms of payment for the prequalification documents, formerly contained in subparagraph (b), is set apart in subparagraph (b bis) in accordance with the modification of article 11 (see notes 1 and 3 under that article).

\* \* \*

#### Article 15. [merged with article 8]<sup>1</sup>

<sup>1</sup>See A/CN.9/331, para. 66, and note 1 to article 15 in A/CN.9/WG.V/ WP.28.

\* \* \*

### Section III. Prequalification of contractors and suppliers<sup>1</sup>

#### Article 16. [moved to article 8 bis]<sup>1</sup>

<sup>1</sup>This section will be deleted if the Working Group affirms the transfer of the substance of article 16 to article 8 bis (see note 1 under article 8 bis).

\* \* \*

### Section IV. Solicitation documents<sup>1</sup>

<sup>1</sup>See note 3 under article 14.

\* \* \*

#### Article 17. Solicitation documents<sup>1</sup>

(1) The procuring entity shall provide the solicitation documents to contractors and suppliers in accordance with the procedures and requirements specified in the invitation to tender. If prequalification proceedings have been engaged in, the procuring entity shall provide a set of solicitation documents to each contractor and supplier that has been prequalified and that pays the price, if any, charged for those documents.

(2) The solicitation documents shall contain [the<sup>2</sup> 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, including, but not limited to,]<sup>3</sup> the following information:

(a) instructions for preparing tenders;

(b) the criteria and procedures, in conformity with the provisions of article 8, relative to the evaluation of the qualifications of contractors and suppliers and relative to the reconfirmation of qualifications pursuant to article 28(8 bis);<sup>4</sup>

(c) [merged with subparagraph (b) in the preparation of the second draft]

(d) any documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their qualifications;<sup>5</sup>

(e) the nature and required technical and quality characteristics, in conformity with article 20,<sup>6</sup> of the goods or construction to be procured, 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 or the construction is to be effected;

(f) the terms and conditions of the procurement contract and the contract form, if any, to be signed by the parties;<sup>7</sup>

(g) if alternatives to the characteristics of the goods, construction, contractual terms and conditions or other requirements set forth in the solicitation documents are permitted,<sup>8</sup> a statement to that effect;

(h) if contractors and suppliers are permitted to submit tenders for only a portion of the goods or construction to be procured, a description<sup>9</sup> of the portion or portions for which tenders may be submitted;

(i) the manner in which the tender price is to be formulated and expressed;<sup>10</sup>

(i bis) the currency or currencies in which the tender price is to be formulated and expressed;<sup>10</sup>

(j) [deleted]<sup>11</sup>

(k) the language or languages, *in conformity with article 23*, in which tenders are to be prepared;<sup>12</sup>

(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, *including securities such as labour and materials bonds*, and with respect to the type of institutions or entities from which such securities will be acceptable;<sup>13</sup>

(m) the manner, place and deadline for the submission of tenders, *in conformity with article 24*;<sup>14</sup>

(n) the means by which, pursuant to article 22, contractors and suppliers may seek clarifications of the solicitation documents and *a statement as to whether the procuring entity intends to convene a meeting of contractors and suppliers*;<sup>15</sup>

(n bis) [deleted]<sup>15</sup>

(o) the period of time during which tenders shall be in effect, *in conformity with article 25*;<sup>16</sup>

(p) the place, date and time for the opening of tenders, *in conformity with article 27*;<sup>16</sup> 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);<sup>16</sup>

(q) the currency that will be used for the purpose of evaluating and comparing tenders pursuant to article 28(8)<sup>16</sup> and either the exchange rate that will be used for the conversion of tenders into that currency or a statement that the rate *published* by a specified financial institution prevailing on a specified date will be used;<sup>17</sup>

(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 *procurement* proceedings;

(s) references to this Law, the procurement regulations and other laws and regulations directly pertinent to the *procurement* proceedings, *provided, however, 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*;<sup>18</sup>

(t) the name(s), *functional title(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 *procurement* proceedings, without the intervention of an intermediary;<sup>19</sup>

(u) *any commitments to be made by the contractor or supplier outside of the procurement contract, such as commitments relating to countertrade and to the transfer of technology*;<sup>20</sup>

(v) [deleted]<sup>21</sup>

((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);<sup>22</sup>

(x) if the procuring entity reserves the right to reject all tenders pursuant to article 29, a statement to that effect;

(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.

<sup>12</sup>The substance of article 18, which sets forth the required contents of the solicitation documents, has been merged with article 17 in order to provide, in the same article that imposes on the procuring entity the obligation to provide solicitation documents, an indication of the meaning of the term "solicitation documents". The title has been modified accordingly.

<sup>13</sup>See A/CN.9/343, para. 164.

<sup>14</sup>Brackets have been placed around a portion of paragraph (2) in order to invite the Working Group to consider whether retention of that text might have the unintended effect of giving rise to claims that the procuring entity failed to provide certain information not referred to in subparagraphs (a) through (y) that was nevertheless "necessary". The information in subparagraphs (a) through (y) might be regarded as a sufficient itemization of the information that should be provided to contractors and suppliers.

<sup>15</sup>See A/CN.9/343, paras. 163 and 166.

<sup>16</sup>See A/CN.9/343, para. 167.

<sup>17</sup>See A/CN.9/343, para. 168. The Working Group may wish to consider further the necessity of retaining the cross-references here and elsewhere in article 17.

<sup>18</sup>See A/CN.9/343, paras. 171 and 173.

<sup>19</sup>See A/CN.9/343, para. 174.

<sup>20</sup>See A/CN.9/343, para. 175.

<sup>21</sup>The mention of the currency in which the tender price is to be formulated is set apart in subparagraph (i bis) in accordance with the modification of article 11 (see notes 1 and 3 under that article).

<sup>22</sup>See A/CN.9/331, para. 89.

<sup>23</sup>See A/CN.9/343, para. 163. See also note 6.

<sup>24</sup>See A/CN.9/343, para. 177; the reference to any choice offered by the procuring entity with respect to the tender security has been deleted pursuant to A/CN.9/343, para. 177.

<sup>25</sup>See A/CN.9/343, para. 178.

<sup>26</sup>Paragraph (n bis), that referred to a reservation by the procuring entity of the right to modify the solicitation documents, has been deleted pursuant to A/CN.9/343, para. 198.

<sup>27</sup>The illustrative list of procedures and criteria for evaluating and comparing tenders has been deleted pursuant to A/CN.9/343, para. 180.

<sup>28</sup>Concerning the deletion of the reference to "international tendering proceedings", see note 1 to article 11. The word "published" replaces the word "issued".

<sup>29</sup>Pursuant to A/CN.9/343, para. 183, subparagraph (s)(ii) has been deleted and the substance of subparagraph (s)(i) has been retained in modified form.

<sup>30</sup>The reference to "functional title(s)" has been added in order to take account of possible personnel changes in the procuring entity.

<sup>31</sup>See A/CN.9/343, para. 184.

<sup>32</sup>Subparagraph (v), which referred to approval required for acts and decisions of the procuring entity, has been deleted pursuant to A/CN.9/343, para. 185.

<sup>33</sup>The Working Group decided in A/CN.9/343, para. 186, to defer a decision as to the retention of the subparagraph until after it has considered the section on review.

\* \* \*

## Article 18. [merged with article 17]

\* \* \*

## Article 19. *Charge for solicitation documents*

The procuring entity may charge contractors and suppliers a sum for solicitation documents provided to them. The sum shall reflect only the cost of printing the solicitation documents and providing them to contractors and suppliers.

\* \* \*

**Article 20. Rules concerning description of goods or construction in prequalification documents and solicitation documents; language of prequalification documents and solicitation documents**

(1) Specifications, plans, drawings and designs setting forth the technical or quality characteristics of the goods or construction 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 documents with a view to creating<sup>1</sup> obstacles to participation by contractors or suppliers in the procurement proceedings,<sup>2</sup> nor shall such specifications, plans, drawings, designs, requirements, symbols or terminology be included or used that have the effect of creating<sup>1</sup> 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 or construction 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 or construction 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]<sup>3</sup>

(4) 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).<sup>4</sup>

<sup>1</sup>See A/CN.9/343, para. 191.

<sup>2</sup>The reference to international procurement proceedings and to foreign contractors and suppliers has been deleted in accordance with the modification of article 11. It may be considered that no specific prohibition against obstacles to foreign contractors and suppliers is necessary in view of the presumption in the Model Law that participation is permitted regardless of nationality, except in limited circumstances. Were such a specific provision considered desirable, it might be added as follows, with an appropriate reference included in article 11(2):

"(1 bis) Specifications, plans, drawings, designs, requirements, symbols or terminology shall not be included or used with a view to, or having the effect of, creating obstacles to participation of contractors and suppliers regardless of nationality."

<sup>4</sup>Deleted in the second draft pursuant to A/CN.9/331, para. 108.

<sup>3</sup>See note 1 to article 11. The rule on the prevailing language in the event of a conflict between language versions has been deleted pursuant to A/CN.9/343, para. 194.

\* \* \*

**Article 21. [deleted]**<sup>1</sup>

<sup>1</sup>Deleted in the second draft pursuant to A/CN.9/331, para. 114.

\* \* \*

**Article 22. Clarifications and modifications of solicitation documents**

(1) A contractor or supplier may request a clarification of the solicitation documents from the procuring entity. The procuring entity shall respond to any request by a contractor or supplier for clarification of the solicitation documents that is received by the procuring entity within a reasonable time prior to the deadline for the submission of tenders. The response by the procuring entity, which shall not identify the source of the request, shall be given in sufficient time to enable the contractor or supplier to make a timely submission of its tender and shall be communicated to all contractors and suppliers to which the procuring entity provides the solicitation documents.<sup>1</sup>

(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 to them.<sup>2</sup> 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 those contractors and suppliers.

(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, including by any other means 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, including by any other means that provides a record of the confirmation and provided that, in the case of a response, the response is communicated to all contractors and suppliers to which the procuring entity provided the solicitation documents.<sup>3</sup>

(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, and its responses to those requests, without identifying the sources of the requests. The minutes shall be prepared in writing, including by any other means that provides a record of the information contained therein and shall be provided to all contractors and suppliers to which the procuring entity provided the solicitation documents.

<sup>1</sup>See A/CN.9/343, para. 195.

<sup>2</sup>The stipulation that a procuring entity may modify the solicitation documents only if it has reserved the right to do so in those documents has been deleted pursuant to A/CN.9/343, para. 198. See also note 15 under article 18.

<sup>3</sup>See A/CN.9/343, para. 200.

\* \* \*

## 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 or in any other language which the procuring entity specifies in the tender solicitation documents.<sup>1</sup>

<sup>1</sup>See A/CN.9/343, para. 202.

\* \* \*

### 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 *all interested* contractors and suppliers to prepare and submit their tenders and shall take into account the reasonable needs of the procuring entity.<sup>1</sup>

(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 bis) The procuring entity may, prior to the deadline for the submission of tenders, extend the deadline if, due to circumstances beyond the control of contractors or suppliers, it is not possible for contractors or suppliers to submit their tenders by the deadline.<sup>2</sup>

(2 ter) Notice of any extension of the deadline shall be given promptly in writing, *including* by any other means that provides a record of the information contained therein, to each contractor and supplier to which the procuring entity provided the solicitation documents. However, notice of an extension of the deadline may be communicated by telephone *provided that such telephone notice is given to all such contractors and suppliers and*<sup>3</sup> provided that, immediately thereafter, confirmation of the notice is communicated to the contractors and suppliers in writing, *including* by any other means that provides a record of the confirmation.

(3) A tender received by the procuring entity after the deadline for the submission of tenders shall not be opened<sup>4</sup> and shall be returned to the contractor or supplier that submitted it.

(4) Tenders shall be submitted in writing and in sealed envelopes. The procuring entity shall *[on request]* provide

to the contractor or supplier a receipt showing the date and time when the tender was received.<sup>5</sup>

<sup>1</sup>Pursuant to A/CN.9/343, para. 203, the words "all interested" have been added and the reference to international tendering proceedings and foreign contractors and suppliers has been deleted.

<sup>2</sup>See A/CN.9/343, para. 205.

<sup>3</sup>See A/CN.9/343, para. 206.

<sup>4</sup>The words "or considered" have been deleted pursuant to A/CN.9/343, para. 207.

<sup>5</sup>Pursuant to A/CN.9/343, para. 207, the second sentence, which permitted submission of tenders by means other than in writing and in sealed envelopes, has been deleted; the words "on request" have been added at the initiative of the Secretariat.

\* \* \*

### 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. 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<sup>1</sup> 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. The request and the responses thereto shall be made in writing, *including* 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, *including* by any other means that provides a record of the confirmation.<sup>2</sup>

(b) *Contractors and suppliers that agree to an extension of the period of effectiveness of their tenders shall extend or procure an extension of the period of effectiveness of tender securities provided by them or, if it is not possible to do so, provide new tender securities, to cover the extended period of effectiveness of their tenders. A contractor or supplier whose tender security is not extended, or that has not provided a new tender security, is considered to have refused the request to extend the period of effectiveness of its tender.*<sup>3</sup>

(3) A contractor or supplier may modify or withdraw its tender prior to the deadline for the submission of tenders, *but not thereafter.*<sup>4</sup> Such modification or withdrawal shall be communicated to the procuring entity in writing, *including* 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.

<sup>1</sup>The words "in exceptional circumstances" have been deleted in accordance with A/CN.9/343, para. 209.

<sup>2</sup>The alignment of the final sentence with changes agreed to for article 22(3), referred to in A/CN.9/343, para. 209, appears not to be necessary in view of the differing circumstances addressed in this subparagraph and in article 22(3), which deals with responses to requests for clarification of

the solicitation documents. Unlike clarifications by the procuring entity of the solicitation documents, responses by contractors and suppliers to requests to extend the period of effectiveness of a tender do not have to be communicated to other contractors and suppliers.

<sup>1</sup>See A/CN.9/343, para. 210.

<sup>2</sup>See A/CN.9/343, para. 213.

\* \* \*

## Section VI. Tender securities

### Article 26. *Tender securities*

(1) When 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;

(a bis) the solicitation documents may stipulate that the institution or entity issuing the tender security *and the institution or entity, if any, confirming the tender security* must be acceptable to the procuring entity;<sup>1</sup>

(b) notwithstanding the provisions of subparagraph (1)(a bis), a tender security shall not be rejected by the procuring entity on the grounds that the tender security was not issued by an institution or entity in this State if the tender security and the institution or entity otherwise conform to lawful requirements set forth in the solicitation documents, unless the acceptance by the procuring entity of such a tender security would be in violation of a law of this State;<sup>2</sup>

(c) [moved to subparagraph (a bis)]

(d) the procuring entity may, without being precluded from stipulating in the solicitation documents other circumstances under which it is entitled to claim the amount of the tender security, 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:<sup>3</sup>

(i) withdraws or modifies its tender after the deadline for submission of tenders; or<sup>4</sup>

(ii) [deleted]<sup>5</sup>

(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 after its tender has been accepted.

(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 document 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, or

(d) the withdrawal of the tender in connection with which the tender security was supplied prior to the deadline for the submission of tenders.<sup>6</sup>

<sup>1</sup>In A/CN.9/343, para. 217, the Secretariat was requested to consider combining subparagraphs (b) and (c). It appears that keeping these provisions separate would make clear that the procuring entity may in all cases impose the condition that the issuer of the tender security must be acceptable to the procuring entity and that the procuring entity may reject a tender security issued by an institution considered not creditworthy (i.e., even in cases of wholly domestic procurement in which subparagraph (b) would not apply pursuant to article 11). Because it appeared preferable that that principle be stated before stating the rule in paragraph (b), the substance of subparagraph (c) has been moved to subparagraph (a bis). The reference to a confirming institution or entity has been added pursuant to A/CN.9/343, para. 218.

<sup>2</sup>See A/CN.9/343, paras. 215 to 217.

<sup>3</sup>See A/CN.9/343, para. 220. The Working Group may wish to consider whether the *chapeau*, as presently formulated, provides unnecessarily broad latitude to the procuring entity with respect to setting the required terms and conditions of the tender security.

<sup>4</sup>See A/CN.9/343, para. 221.

<sup>5</sup>Subparagraph (d)(ii), which referred to the forfeiture of the tender security for a refusal to accept a correction of an arithmetical error, has been deleted pursuant to A/CN.9/343, para. 221.

<sup>6</sup>See A/CN.9/343, para. 223.

\* \* \*

## 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 the deadline specified in any extension of the deadline, at the place and in accordance with the procedures specified in the solicitation documents.

(2) All contractors and suppliers that have submitted tenders or their representatives shall be permitted by the procuring entity to be present at the opening of tenders.<sup>1</sup>

(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 on request<sup>2</sup> to 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(1).<sup>3</sup>

<sup>1</sup>See A/CN.9/343, para. 227. The Working Group agreed in A/CN.9/343, para. 225, that the right of contractors and suppliers to be present at the opening of tenders should not apply in cases of national security or national defence in which the Model Law was exceptionally applied. Under article 1(2), the procuring entity may exclude article 27(2) when applying the Model Law to procurement involving national security and national defence.

<sup>2</sup>See A/CN.9/343, para. 228.

\* \* \*

### 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.]*<sup>1</sup> No change in the tender price or other matter of substance in the subparagraph (b).

[(b) The procuring entity shall correct purely arithmetical errors apparent on the face of a tender.]<sup>2</sup>

(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);<sup>3</sup>

(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;<sup>4</sup>

[(d) if the tender is received by the procuring entity after the deadline for the submission of tenders].<sup>5</sup>

(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.<sup>6</sup>

(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.<sup>7</sup>

(5) [deleted]<sup>8</sup>

(6) [deleted]<sup>9</sup>

(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),<sup>10</sup> 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.<sup>11</sup>

(b) [deleted]<sup>12</sup>

(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,<sup>13</sup> which shall be ascertained on the basis of objective and quantifiable criteria, to the extent possible, includ-

ing, 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].<sup>14</sup>

[(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.]<sup>15</sup>

(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.<sup>16</sup>

(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.<sup>17</sup>

(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.<sup>18</sup>

(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 involved<sup>19</sup> in the decision of which tender should be accepted, except as provided in article 33(2).

(10) [deleted]<sup>20</sup>

\*The second draft of article 28, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28. The reference to approval in paragraph (3) should be modified in accordance with A/CN.9/343, paras. 66 and 67, and the references to services in paragraph (7)(c) should be deleted in accordance with A/CN.9/343, para. 20 (see note 1 under article 2).

<sup>1</sup>See A/CN.9/331, para. 117.

<sup>2</sup>See 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).

<sup>3</sup>Pursuant 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).

<sup>4</sup>The 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).

<sup>5</sup>This 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.

<sup>6</sup>See A/CN.9/331, para. 152. With respect to the requirement of approval, see note 1 to article 6.

<sup>7</sup>Pursuant 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.

<sup>8</sup>See A/CN.9/331, para. 159.

<sup>9</sup>See A/CN.9/331, para. 164.

<sup>10</sup>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 subparagraph (c) has been added.

<sup>11</sup>See A/CN.9/331, para. 169.

<sup>12</sup>See A/CN.9/331, para. 167.

<sup>13</sup>The 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".

<sup>14</sup>The 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.

<sup>15</sup>See A/CN.9/331, para. 172.

<sup>16</sup>See 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.

<sup>17</sup>See A/CN.9/331, para. 174.

<sup>18</sup>See 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. [The reference to article 16 should be read as a reference to article 8 *bis* (see note 1 under article 8 *bis*).]

<sup>19</sup>Added on the initiative of the Secretariat to achieve greater clarity.

<sup>20</sup>See 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.<sup>1</sup>

(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).<sup>2</sup>

(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.<sup>3</sup>

(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.]<sup>4</sup>

\*The second draft of article 29, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28. The references to approval in paragraphs (1) and (1 *bis*) should be modified in accordance with A/CN.9/343, paras. 66 and 67, and the reference to services in paragraph (1 *bis*) should be deleted in accordance with A/CN.9/343, para. 20 (see note 1 under article 2).

<sup>1</sup>See 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.

<sup>2</sup>See 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.

<sup>1</sup>See A/CN.9/331, para. 181.

<sup>4</sup>See 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).*<sup>1</sup>

\*The second draft of article 30, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying note, as it appeared in A/CN.9/WG.V/WP.28.

<sup>1</sup>Paragraphs (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 proceedings*<sup>1</sup>

<sup>1</sup>See A/CN.9/331, para. 186. [See also the note to the title of article 31.]

\* \* \*

#### Article 31. *Two-stage tendering proceedings\**

(1) [Subject to approval,]<sup>1</sup> 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;*<sup>2</sup> or

(b) *due to the nature of the goods, construction [or services], the procuring entity is unable to formulate detailed technical specifications.*<sup>2</sup>

(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.*<sup>3</sup>

(4) The procuring entity may engage in *negotiations*<sup>4</sup> 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.*<sup>5</sup> A contractor or supplier not wishing to submit a final tender may withdraw from the tendering proceedings [without forfeiting its tender security].<sup>6</sup> The final tenders shall be evaluated and compared in order to ascertain the most economic tender as defined in article 28(7)(c).<sup>7</sup>

(6) The procuring entity shall include in the *record*<sup>8</sup> required under article 33 a statement of the circumstances on which it relied in invoking paragraph (1) of this article, specifying the relevant facts.

\*The second draft of article 31, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28. At the twelfth session, the Working Group, in connection with its review of article 7, 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 the decision to treat that method as a method of procurement other than tendering (see A/CN.9/343, para. 80). In line with that decision, the substance of article 31 would appear in section I of chapter III, as article 33 bis, and the present section would be deleted. The reference to approval in the *chapeau* of paragraph (1) should be modified in accordance with A/CN.9/343, paras. 66 and 67, and the references to services in paras. (1)(a) and (5) should be deleted in accordance with A/CN.9/343, para. 20 (see note 1 under article 2).

<sup>1</sup>See note 1 to article 6.

<sup>2</sup>See 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.

<sup>3</sup>The 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.

<sup>4</sup>See A/CN.9/331, para. 191. The word "article" has been added to achieve greater clarity.

<sup>5</sup>See A/CN.9/331, paras. 190 and 192.

<sup>6</sup>The reference to the tender security has been placed within square brackets pursuant to the proposal in A/CN.9/331, para. 192.

<sup>7</sup>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 pursuant to A/CN.9/331, para. 189.

<sup>8</sup>Pursuant 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 proceedings<sup>1</sup>

## Article 32. Acceptance of tender and entry into force of procurement contract<sup>\*</sup>

(1) The tender that has been ascertained to be the most economic tender pursuant to article 28(7)(c) shall be accepted.<sup>2</sup> 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.<sup>3</sup> 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),<sup>4</sup> 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.<sup>5</sup>

(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,]<sup>6</sup> the procuring entity and<sup>6</sup> 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),<sup>4</sup> 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 interfere<sup>6</sup> 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;<sup>6</sup>
- (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.<sup>5</sup>

(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)<sup>7</sup> and that is in force may be accepted.<sup>8</sup> The notice provided for in paragraph (1) shall be given to the contractor or supplier that submitted that tender.<sup>9</sup>

(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.]<sup>10</sup>

(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).<sup>11</sup>

<sup>\*</sup>The second draft of article 32, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28.

<sup>1</sup>Pursuant to A/CN.9/331, para. 207, the term "minutes of tendering proceedings" has been changed to "record of tendering proceedings".

<sup>2</sup>Pursuant 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.

<sup>3</sup>See A/CN.9/331, paras. 70 and 78.

<sup>4</sup>See A/CN.9/331, para. 196.

<sup>5</sup>Paragraphs (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.

<sup>6</sup>See A/CN.9/331, paras. 202, 203 and 206.

<sup>7</sup>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.

<sup>8</sup>Pursuant 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".

<sup>9</sup>Paragraph (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.

<sup>10</sup>See A/CN.9/331, para. 117.

<sup>11</sup>Pursuant to A/CN.9/331, para. 195, alternative 2 of paragraph 6(b) has been deleted.

\* \* \*

## Article 33. Record of tendering proceedings<sup>\*1</sup>

(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;<sup>2</sup> 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;*<sup>3</sup> 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*<sup>4</sup> 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]*<sup>5</sup> 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;<sup>6</sup>

(b) information relating to the examination, evaluation and comparison of tenders[, and tender prices,] shall not be disclosed.<sup>7</sup>

<sup>2</sup>The second draft of article 33, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28.

<sup>3</sup>Pursuant 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.

<sup>4</sup>Pursuant to A/CN.9/331, para. 45, the words "eligibility and" that appeared in the first draft have been deleted.

<sup>5</sup>See A/CN.9/331, para. 152.

<sup>6</sup>Pursuant to A/CN.9/331, para. 209, the words "any person" replace the words "the general public" that appeared in the first draft.

<sup>7</sup>Pursuant 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.

<sup>8</sup>See A/CN.9/331, para. 210.

<sup>9</sup>See 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

### [Section I. Two-stage tendering proceedings]<sup>1</sup>

Article 33 bis. [reserved]

<sup>1</sup>See the note to the title of article 31.

\* \* \*

### Section II. Request-for-proposals proceedings<sup>1</sup>

Article 33 ter. Request for proposals

(1) (Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may engage in procurement by means of request for proposals when the procuring entity has not decided upon the particular nature or specifications of goods or construction to be procured and seeks proposals as to various possible means of meeting its needs.<sup>2</sup>

(2) The provisions of chapter II of this Law, with the exception of articles 25, 27 and 30, shall apply to request-for-proposals proceedings except to the extent those provisions are derogated from in section II of chapter III.<sup>3</sup>

(3) A procuring entity shall solicit proposals from all interested contractors and suppliers by causing a request for proposals or, if prequalification proceedings are to be engaged in, an invitation to prequalify, to be published in accordance with article 12 or, in accordance with article 12, by sending a request for proposals only to particular contractors and suppliers selected by it.<sup>4</sup>

(4) (a) The request for proposals shall contain at least the following information:

(i) a description of the procurement need for which the procuring entity is seeking proposals, including any technical specifications and other parameters to which proposals must conform, and the location of any construction to be effected;

(ii) the information referred to in article 14(1), with the exception of subparagraph (b).<sup>5</sup>

(b) Unless the request for proposals specifies that the procuring entity will issue a separate set of solicitation documents in accordance with article 33 quater, the request for proposals shall contain, in addition to the information referred to in article 14(1)(a) and (1)(d bis), the information referred to in article 33 quater.<sup>6</sup>

(c) If prequalification proceedings are to be engaged in, the invitation to prequalify shall contain the information referred to in paragraph (4)(a)(i) and the information referred to in article 14(2), with the exception of the information referred to in article 14(1)(b).<sup>7</sup>

<sup>1</sup>Section II has been added pursuant to the decision in A/CN.9/343, paras. 75, 81 and 82, to provide in the Model Law for procurement by request for proposals. Section II contains provisions setting forth the conditions and procedures for use agreed upon by the Working Group, as well as provisions on issues that appear to the Secretariat to warrant coverage in the Model Law.

<sup>2</sup>See A/CN.9/343, para. 81.

<sup>3</sup>Paragraph (2) derogates from article 25 since limitations on the right of the contractor or supplier to modify or withdraw its proposal are inconsistent with the flexibility required for request for proposals proceedings. In view of the provision concerning opening of proposals contained in article 33 *quinquies*(1), and the provision on negotiation in article 33 *quinquies*(2), paragraph (2) also derogates from articles 27 and 30.

<sup>4</sup>The reference to article 12 incorporates the publication requirements outlined in that article, as well as the possibility of limiting participation in the procurement proceedings to contractors and suppliers selected by the procuring entity. In line with the suggestion in note 2 under article 12, the Working Group may wish to consider using a term other than "request for proposals" to describe the medium by which the procuring entity solicits proposals.

<sup>5</sup>Most of the information requirements set forth in article 14(1) for the invitation to tender are incorporated by subparagraph (4)(a)(ii). Subparagraph (4)(a)(i) replaces the requirement in article 14(1)(b), since, in request for proposal proceedings, the procuring entity is not in a position to describe the goods or construction to be procured with the same degree of precision as in tendering proceedings.

<sup>6</sup>In cases in which the procuring entity can provide in the request for proposals the information necessary for contractors and suppliers to prepare their proposals, solicitation documents would not be issued. Pursuant to paragraph (4)(b), requests for proposals in such cases are to contain the types of information that would otherwise be found in the solicitation documents. The reference to article 14(1)(a) concerns the name and address of the procuring entity, and the reference to article 14(1)(d *bis*) refers to the declaration by the procuring entity as to participation by contractors regardless of nationality. Such a declaration would be relevant in those cases in which the procuring entity was soliciting proposals by advertising rather than by selective invitation.

<sup>7</sup>Paragraph (4)(c) sets forth the required contents of an invitation to prequalify in request-for-proposals proceedings by incorporating the provisions of article 14(2). The reference in article 14(2) to article 14(1)(b) is excluded because a requirement for information about the goods or construction to be procured is incorporated by way of the reference to paragraph (4)(a)(i) (see note 5).

\* \* \*

#### Article 33 *quater*. Solicitation documents

(1) *The procuring entity shall provide a set of solicitation documents to contractors and suppliers in accordance with the procedures and requirements specified in the request for proposals. If prequalification proceedings have been engaged in, the procuring entity shall provide a set of solicitation documents to each contractor and supplier that has been prequalified and that pays the price, if any, charged for those documents.*<sup>1</sup>

(2) *The solicitation documents shall contain the following information:*<sup>2</sup>

(a) *a description of the procurement need for which the procuring entity is seeking proposals, including any technical specifications and other parameters to which proposals must conform, and the location of any construction to be effected; and the desired or required time, if any, when the goods are to be delivered or the construction is to be effected;*<sup>3</sup>

(b) *the criteria, in accordance with article 33 *quinquies*, to be used for evaluating the proposals and the relative weight to be afforded to the different criteria; and*<sup>4</sup>

(c) *the information referred to in article 17(2), with the exception of subparagraphs (c), (g) and (p).*<sup>5</sup>

<sup>1</sup>With the exception of the reference to cases in which solicitation documents are not issued, the foregoing provision is analogous to article 17(1).

<sup>2</sup>Unlike in the *chapeau* of article 17(2), there is no reference to information concerning procedures for the opening of proposals (see note 2 under article 33 *quinquies*).

<sup>3</sup>Subparagraph (a) corresponds to article 17(2)(e), but is adapted to request for proposals proceedings.

<sup>4</sup>See A/CN.9/343, para. 82.

<sup>5</sup>Article 17(2)(e) is not incorporated because subparagraph (a) contains a provision specific to request for proposals proceedings concerning the description of the goods or construction to be procured. Article 17(2)(g), concerning a statement as to whether contractors and suppliers are to be permitted to present alternatives to requirements set forth in the solicitation documents, is not relevant to request-for-proposals proceedings, which solicit various possible types of solutions. Article 17(2)(p) is not incorporated because public opening is not required for request for proposals proceedings (see note 3 under article 33 *ter*) and because procedures and criteria for evaluation and comparison of proposals are referred to in paragraph (4)(b).

\* \* \*

#### Article 33 *quinquies*. Opening, examination, evaluation and comparison of proposals

(1) *Proposals shall be opened in such a manner as to avoid disclosure of the contents of proposals to competing contractors and suppliers.*<sup>1</sup>

(2) *The procuring entity may conduct negotiations with contractors and suppliers about their proposals and seek or permit revisions of proposals. Negotiations between the procuring entity and a contractor or supplier shall be confidential, and, except as provided in article 33 *sexies*, one party to the negotiations shall not reveal or disclose to any third person any documentation or information relating to the negotiations without the consent of the other party.*<sup>2</sup>

(3) *In selecting the contractor or supplier with which to enter into a procurement contract, the procuring entity shall evaluate the proposals using only the criteria that have been set forth in the request for proposals in accordance with article 33 *ter*(4) or in the solicitation documents in accordance with article 33 *quater*(2)(b). Those criteria may measure both the competence of the contractor or supplier and the effectiveness of its proposal in meeting the procuring entity's needs. The effectiveness of a proposal in meeting the needs of the procuring entity shall be evaluated separately from the price.*<sup>3</sup>

(4) *Except as otherwise provided in this article, examination, evaluation and comparison of proposals shall be conducted in accordance with the procedures set forth in article 28.*

<sup>1</sup>In tendering proceedings, the public opening of tenders pursuant to article 27 results in the identification of contractors and suppliers that have submitted tenders and the disclosure of the prices of those tenders. Under article 33(1), there is no requirement that the opening of proposals be public. Instead the procuring entity is required to avoid disclosure of the contents of proposals to competing contractors and suppliers. Such a disclosure might compromise the negotiations with contractors and suppliers that take place after opening of the proposals. Disclosure of the prices of proposals is not required since the prices of proposals, unlike the prices of tenders, are subject to negotiation and modification. While paragraph (1) does not require the procuring entity to disclose upon the opening of the proposals the names of contractors and suppliers that submitted the proposals, article 33 *sexies* does require the identification of those contractors and suppliers in the record of the proceeding made available to the general public upon the entry into force of the procurement contract.

<sup>2</sup>While in tendering proceedings negotiations between the procuring entity and contractors for the purpose of effecting modifications in the price or substance of tenders are prohibited by articles 28(1)(a) and 30, such negotiations may be an essential element in request-for-proposals proceedings. In order to ensure that negotiations do not compromise competition or lead to abuses in the proceedings, the procuring entity is prohibited from disclosing to a contractor or supplier information derived from or about proposals made by other contractors or suppliers.

<sup>3</sup>See A/CN.9/343, para. 82.

\* \* \*

#### Article 33 *sexies*. *Record of request-for-proposals proceedings*<sup>1</sup>

(1) *The procuring entity shall prepare a record of the request-for-proposals proceedings. The record shall contain a brief description of the procurement need for which the procuring entity requested proposals; the names and addresses of the contractors or suppliers from which the procuring entity obtained proposals; information relative to the qualifications, or lack thereof, of those contractors and suppliers; the price and a summary of the other principal terms and conditions of each proposal and of the procurement contract; a summary of the evaluation and comparison of the proposals; 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).*

(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.*

<sup>1</sup>This article is based on article 33.

\* \* \*

### Section III. *Competitive negotiation proceedings*

#### Article 34. *Competitive negotiation proceedings*<sup>\*</sup>

(1) *In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of contractors and suppliers to ensure effective competition.*

(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.*<sup>2</sup>

(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).*<sup>3</sup>

(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.*<sup>3</sup>

<sup>\*</sup>The second draft of article 34, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying notes, as it appeared in A/CN.9/WG.V/WP.28. In addition, set out below, following note 3, are the texts of paragraphs (new 1) and (new 1 bis), that, in accordance with A/CN.9/343, para. 75, set forth the conditions for the use of competitive negotiation agreed upon by the Working Group and the condition formerly found in article 7(4) (see note c below). Those additional paragraphs would precede paragraph (1) in the present text.

<sup>1</sup>The final phrase of this paragraph, which appeared in the first draft, has been deleted pursuant to A/CN.9/331, para. 216.

<sup>2</sup>The final phrase of this paragraph, which appeared in the first draft, has been deleted pursuant to A/CN.9/331, para. 217.

<sup>3</sup>See A/CN.9/331, para. 218.

*Texts of paragraphs (new 1) and (new 1 bis)*

(new 1) *(Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may 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 to be procured, it is necessary to negotiate with contractors or suppliers in order to enable the procuring entity to obtain the solution which represents the best value;*

(b) *when there is an urgent need for the goods or construction and engaging in tendering proceedings 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 in quantities sufficient to establish their commercial viability or to recover research and development costs;*

(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; or*

(e) *when tendering proceedings have been engaged in but no tenders were submitted or 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;*<sup>4</sup>

(f) *when the estimated value of the procurement contract is less than the amount set forth in the procurement regulations.*<sup>5</sup>

(new 1 bis) *The procuring entity shall not divide its procurement into separate contracts for the purpose of invoking paragraph (new 1)(f).*

<sup>4</sup>Concerning the approval requirement, see A/CN.9/343, para. 75. Subparagraphs (a) through (d) set forth the conditions for use of competitive negotiation proceedings agreed upon in A/CN.9/343, paras. 85 to 89.

<sup>5</sup>The Working Group may wish to consider including the foregoing condition, which appeared in earlier drafts of the Model Law in article 7(2), but was not included in the conditions agreed upon in A/CN.9/343, paras. 85 to 89.

<sup>6</sup>Retention of the foregoing provision, previously found in article 7(4), would depend on the decision with regard to subparagraph (f).

\* \* \*

## Section IV. Request-for-quotations proceedings<sup>1</sup>

### Article 34 bis. Request for quotations

(1) [(Subject to approval by ... (each State designates an organ to issue the approval),)] the procuring entity may engage in procurement by means of request for quotations for the procurement of standardized goods when the estimated value of the procurement contract is less than the amount set forth in the procurement regulations.<sup>2</sup>

(2) The procuring entity shall not divide its procurement into separate contracts for the purpose of invoking paragraph (1).<sup>3</sup>

(3) [The procuring entity shall request quotations from at least [3] contractors.] Each contractor or supplier from whom a quotation is requested shall be permitted to give only one price quotation and shall not be permitted to change its quotation. No negotiations shall take place between the procuring entity and a contractor or supplier with respect to a quotation submitted by the contractor or supplier.<sup>4</sup>

(4) The procurement contract shall be awarded to the contractor or supplier quoting the lowest price.<sup>5</sup>

(5) (a) The procuring entity shall prepare a record of the request for quotations proceedings. The record shall contain the names and addresses of contractors and suppliers from which the procuring entity has requested quotations; the price and a summary of the other principal terms and conditions of each quotation and 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).

(b) The record of the request for quotations 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.<sup>6</sup>

<sup>1</sup>The addition of section IV implements the decision in A/CN.9/343, para. 72, that the Model Law should provide for procurement through request for quotations.

<sup>2</sup>See A/CN.9/343, para. 90. The approval requirement agreed on in A/CN.9/343, para. 75, is placed within square brackets in order to invite the Working Group to consider whether an approval requirement is appropriate in view of the low values and quantities involved in procurement by request for quotations.

<sup>3</sup>Paragraph (2) prohibits the procuring entity from fragmenting a procurement so as to fall below the threshold referred to in paragraph (1) and to thereby avoid tendering proceedings.

<sup>4</sup>See A/CN.9/343, para. 91. A requirement that a minimum number of quotations be solicited is included for consideration by the Working Group.

<sup>5</sup>See A/CN.9/343, para. 91.

<sup>6</sup>The present provision is based on similar requirements for other methods of procurement.

\* \* \*

## Section V. Single source procurement

### Article 35. Record of single source procurement<sup>\*</sup>

(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.<sup>1</sup>

<sup>\*</sup>The second draft of article 35, which was not reviewed by the Working Group at the twelfth session, is presented here, with the accompanying note, as it appeared in A/CN.9/WG.V/WP.28. Previously, the conditions for use of single source procurement were set forth in article 7(3) and (4). Pursuant to A/CN.9/343, para. 75, the Working Group may wish to consider adding those conditions and procedures for use to article 35 in paragraphs (new 1) and (new 1 bis), as set forth below, following note 1. Those additional paragraphs, which would precede paragraph (1) in the present text, set forth the conditions for use that had appeared in the second draft in article 7(3) and that were affirmed in A/CN.9/343, para. 92. If the conditions for use were to be included in article 35, the title of the article would be modified to read "single source procurement".

<sup>1</sup>See A/CN.9/331, para. 220.

#### Texts of paragraphs (new 1) and (new 1 bis)

(new 1) (Subject to approval by ... (each State designates an organ to issue the approval),) the procuring entity may procure the goods or construction by soliciting a proposal or price quotation from a single contractor or supplier when:

(a) the estimated value of the procurement contract is less than the amount set forth in the procurement regulations;

(b) the goods or construction are available only from a particular contractor or supplier, or a particular contractor or supplier has exclusive rights in respect of the goods or construction and no reasonable alternative or substitute exists;

(c) there is an urgent need for the goods or construction, making it impossible or imprudent to use other methods of procurement because of the amount of time involved in using those methods;

(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;<sup>2</sup>

(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 reasons of national security or national defence there is a need for secrecy in respect of the procuring entity's procurement needs;

(g) procurement from a particular contractor or supplier is necessary in order to promote socio-economic policies specified in the procurement regulations;<sup>3</sup>

(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;

(i) the scope or volume of the goods or construction 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 or construction.

(new 1 bis) The procuring entity shall not divide its procurement into separate contracts for the purpose of invoking paragraph (new 1)(a).<sup>4</sup>

<sup>\*</sup>The reference to competitive negotiation proceedings and tendering proceedings that appeared in earlier drafts has been replaced by a reference to "other methods of procurement" in view of the addition to the Model Law of request for proposals and request for quotations.

<sup>2</sup>The Working Group may wish to consider whether subparagraph (d) should be expanded to cover construction and whether subparagraphs should be added to

authorize single source procurement, under certain conditions, in cases of expansion of existing construction or repeat orders of goods not covered by subparagraph (d). Such provisions might be formulated along the following lines:

"(d bis) there is a need to expand an existing construction, provided that the procurement contract is awarded to the contractor or supplier that executed the original work and that the supplementary work does not exceed [...] per cent of the amount of the original procurement contract;"

"(d ter) there is a need to procure additional goods, provided that the procurement contract is awarded to the contractor or supplier that provided the original goods and that the supplementary procurement does not exceed [...] per cent of the amount of the original procurement contract;"

The Working Group may wish to consider whether subparagraph (g), even with its scope limited to the promotion of specified socio-economic policies, would provide too much scope to a procuring entity to defeat the objectives of the Model Law.

\*See note 4 under article 7.

## CHAPTER IV. REVIEW

(Draft articles 35 to 42, which concern the review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law, are contained in A/CN.9/WG.V/WP.27.)

## 2. Procurement: competitive negotiation: note by the Secretariat (A/CN.9/WG.V/WP.31) [Original: English]

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### INTRODUCTION

1. As reported in A/CN.9/WG.V/WP.22, paras. 59 to 61, and 201 to 213, the procurement laws of many countries provide for procurement by negotiation between the procuring entity and contractors and suppliers prior to the award of the procurement contract. In view of the presence of such provisions in the procurement laws of many countries, the first draft of article 7 of the Model Law on Procurement (A/CN.9/WG.V/WP.24) provided for a method of procurement referred to as "competitive negotiation", which could be used when tendering proceedings had been engaged in but were unsuccessful or when the estimated value of the procurement contract was below a level set in the procurement regulations. Draft article 34 established certain procedural requirements designed to incorporate objectivity, fairness and competition into the competitive negotiation proceedings. At the eleventh session, in reviewing the first draft of article 7, the Working Group affirmed that it was desirable for the Model Law to provide for

competitive negotiation as a method of procurement available to the procuring entity in certain circumstances in which tendering was not a suitable method of procurement (A/CN.9/331, para. 41). At that session, there was also significant support for expanding the circumstances in which competitive negotiation proceedings could be used beyond those provided for in the first draft of article 7 (A/CN.9/331, para. 42). In reviewing the second draft of article 7 at the twelfth session, the Working Group reaffirmed its decision to retain competitive negotiation in the Model Law in certain specified circumstances (A/CN.9/343, para. 70) and agreed upon conditions to be set forth in the Model Law for the use of that method of procurement (A/CN.9/343, para. 85).<sup>1</sup>

<sup>1</sup> In accordance with the Working Group's decision that article 7 should list all the methods of procurement available under the Model Law, and that the conditions and procedures for use of those methods should be set forth in the individual articles dealing with those uses, it is suggested in A/CN.9/WG.V/WP.30 that the conditions for use of competitive negotiations agreed upon by the Working Group should be located in article 34.

2. During the adoption of the report of the twelfth session, the Secretariat was requested to prepare a report to the next session on provisions in national procurement laws relating to the conditions and procedures for use of the competitive negotiation method of procurement.<sup>2</sup> The present document contains that report.

## I. GENERAL REMARKS

3. The method of procurement most commonly mandated in procurement legislation is publicly advertised competitive tendering, open to all eligible and qualified contractors and suppliers. An important reason for the predominant use of competitive tendering is that it generally is most likely to lead to economy and efficiency in the use of public funds, in addition to serving as a safeguard against waste, corruption and favouritism. Notwithstanding the preference for competitive tendering, the procurement laws of most countries recognize that in certain situations competitive tendering may not be an appropriate method of procurement. Therefore, the procuring entity is often permitted to use certain other methods of procurement, including engaging in negotiations with one or more contractors or suppliers with a view to entering into a procurement contract.

4. The present report focuses on the provisions in national laws that establish conditions for use and procedures for use of the type of procurement method referred to in the draft Model Law as "competitive negotiation". In considering the conditions and procedures for use of such a method, it is necessary to bear in mind that competitive negotiation is a distinct method of procurement, apart from other methods of procurement which involve a degree of pre-award negotiation between the procuring entity and contractors and suppliers. In competitive negotiation proceedings as provided for in the draft Model Law and in the procurement laws of a number of countries, the procuring entity is given a relatively free hand to conduct the procurement proceedings as it sees fit, in particular with respect to the selection of negotiating partners, the conduct of the negotiations and the examination and comparison of proposals. By contrast, methods such as two-stage tendering and request for proposals proceedings, though they involve some degree of negotiation, are subject to a relatively elaborate procedural framework. This report covers only negotiation as a separate method of procurement, not negotiation as an element in some other method of procurement.

5. The laws of a number of countries do not provide, as does the draft Model Law, for two distinct methods of procurement to cover, on the one hand, cases in which negotiation with only one contractor or supplier is possible (covered under the draft Model Law by single source procurement) and, on the other hand, cases in which negotiations can be conducted with more than one contractor or supplier (covered under the draft Model Law by competitive negotiation). Instead, such laws list the various conditions in which the procuring entity is permitted to procure

by negotiation, including single source situations. Some of those laws include a general requirement that in negotiation proceedings the procuring entity, to the degree possible, should negotiate with a sufficient number of contractors and suppliers judged susceptible of filling the procurement need so as to ensure competition. To the extent that conditions for the use of negotiation in those types of statutes relate only to single source procurement, they are not discussed in the present report.

## II. CONDITIONS FOR USE OF NEGOTIATION

6. In the procurement laws of some countries, designated governmental authorities or procuring entities themselves are given broad discretion to authorize or to engage in procurement through negotiation when it is considered appropriate to do so. In some of those countries, procuring entities operating in particular economic sectors (e.g., transportation or energy) are given more discretion than procuring entities operating in other sectors in deciding whether to procure through negotiation. A reason for such an approach may be that procuring entities operating in certain sectors often procure goods or construction of a high degree of technological sophistication or complexity and negotiation is regarded as essential for meeting the needs of the procuring entity (see paragraph 7 below). However, instead of granting such discretion, or in addition to doing so, the procurement laws of most countries specifically define the types of conditions in which a procuring entity may engage in procurement through negotiation. The principal types of conditions for the use of negotiation that are found in national procurement laws and that appear to be relevant to further consideration by the Working Group are discussed below. Those conditions are generally of the type agreed upon by the Working Group for the use of competitive negotiation under the Model Law (see A/CN.9/343, para. 85).

### A. Nature of goods being procured

7. The procurement laws of many countries set forth conditions for the use of negotiation that relate to the nature of the goods or construction being procured. The laws of a number of countries authorize procurement through negotiation when the goods or construction are of a high degree of technological sophistication or are particularly complex or unique. For example, some statutes refer to the procurement of non-standardized, technologically advanced goods, such as ships, aircraft or computers, that must be specially tailored to meet the needs of the procuring entity as a case in which the negotiation may be used. Provisions are also found in some countries authorizing negotiation when there is a need for the contractor or supplier to make use of a patent or special process in which it has a proprietary interest in order to meet the needs of the procuring entity or when only a few contractors or suppliers have the technical or commercial capability of meeting the procuring entity's needs. Yet other provisions are found permitting negotiation when the nature of the goods or construction make it impossible for a contractor or supplier to make a prior estimate of the overall price of the procurement contract. The laws of a number of countries explicitly permit the

<sup>2</sup>Because the request for the present report was made during the adoption of the report of the twelfth session rather than during the deliberations of the Working Group or during its discussion of future work, no mention is found of that request in the report of the twelfth session.

procurement through negotiation of works of an artistic nature.

8. The laws of some countries authorize procurement through negotiation when the goods or construction, due to their particular nature or intended use, have to be purchased or executed in a certain place.

### B. Purpose of procurement

9. Procurement laws generally contain provisions authorizing procurement through negotiation on the basis of the purpose for which goods or construction are being procured. Foremost in this category are provisions authorizing negotiation for procurement involving national defence or national security considerations. A factor cited in many such provisions is the need to maintain secrecy. Other defence-related factors cited in some laws as possible justifications for procurement through negotiation include the need to develop production capacity in certain industries and the need to maintain the rapid production capacity of certain industries.

10. Procurement laws also generally authorize the procurement through negotiation of goods or construction to be used for the purpose of research or testing. The procurement laws of some countries permit negotiation when goods or construction are being procured for other specified purposes (e.g., in connection with the official residences of certain government officials or for the use of certain government instrumentalities).

### C. Urgency

11. The laws of most countries permit procurement through negotiation in cases in which there is an urgent need for the goods or construction. In some of those countries, however, resort to negotiation on the grounds of urgency is limited to cases in which the urgency arises from circumstances, such as natural disasters, that are unforeseeable or not attributable to the procuring entity. A particular case of urgency to which reference is made in the laws of some countries is the default in the performance of a procurement contract by a contractor or supplier or a rescission of a procurement contract by the procuring entity. In some countries, resort to negotiation in such cases is authorized only if it is not possible to select a new contractor or supplier on the basis of tenders submitted in the tendering proceedings that gave rise to the original procurement contract.

### D. Amount of procurement contract

12. While the laws of many countries authorize negotiation in the context of high value procurement, at the same time provisions are commonly found permitting the procuring entity to engage in procurement through negotiation for contracts whose estimated value falls below a specified level. In some countries, the level below which negotiation is permitted varies according to the type of goods or construction being procured.

### E. Unsuccessful tendering proceedings

13. The procurement laws of a number of countries permit procurement through negotiation when the procuring entity has engaged in tendering proceedings but either no tenders or no responsive tenders have been submitted. Some statutes that give the procuring entity the right to procure through negotiation following unsuccessful tendering proceedings impose limitations on that right. In particular, provisions are found requiring the procuring entity to attempt the tendering proceedings a second time before resorting to negotiation. In some countries, the second tendering proceedings may be avoided in cases of urgency. Another limitation stipulated in the laws of some countries is that negotiation may be used following unsuccessful tendering proceedings only if the original terms of the procurement contract to be concluded are not substantially altered.

## III. PROCEDURES FOR USE OF NEGOTIATION

14. Procedures to be followed in procurement through negotiation are typically characterized by a higher degree of flexibility than the procedures applied to other methods of procurement. Few rules and procedures are established to govern the process by which the parties negotiate and conclude their contract. In some countries procurement laws allow procuring entities virtually unrestricted freedom to conduct negotiations as they see fit. The procurement laws of other countries establish a procedural framework for negotiation designed to maintain fairness and objectivity and to bolster competition by encouraging participation of contractors and suppliers. Provisions on procedures for procurement through negotiation address a variety of issues discussed below, in particular, requirements for approval of the procuring entity's decision to procure through negotiation, selection of negotiating partners, criteria for comparison and evaluation of offers, and the record of the procurement proceedings.

### A. Approval

15. A threshold requirement found in many countries is that a procuring entity obtain the approval of a higher authority prior to engaging in procurement through negotiation. Such provisions generally require the application for approval to be in writing and to set forth the grounds necessitating the use of negotiation. Approval requirements are intended, in particular, to ensure that the negotiation method of procurement is used only in appropriate circumstances. The laws of some countries require approval only for contracts whose value exceeds a specified level. In some provisions of that type, different levels are set for different types of procurement (e.g., the level above which approval would be required may be higher for the procurement through negotiation of construction than for the procurement through negotiation of supplies).

16. Some procurement laws that stipulate unsuccessful tendering proceedings as a grounds for resorting to negotiation (see paragraph 13 above) exempt the procuring entity from the approval requirement if all contractors and suppli-

ers that participated in the procurement proceedings and that met eligibility requirements are given an opportunity to participate in the negotiations.

#### **B. Selection of negotiating partners**

17. In order to make the negotiation proceedings as competitive as possible, the procurement laws of a number of countries contain a general requirement that the procuring entity must engage in negotiations with as many contractors or suppliers judged susceptible of meeting the procurement need as circumstances permit. Beyond such a general provision, there is no specific provision in the laws of some countries on the minimum number of contractors or suppliers with whom the procuring entity is to negotiate. The laws of some other countries, however, require the procuring entity, where practicable, to negotiate with, or to solicit proposals from a minimum number of contractors or suppliers (e.g., three). The procuring entity is permitted to negotiate with a smaller number in certain circumstances, in particular, when less than the minimum number of contractors or suppliers were available. The laws of some countries further specify that negotiation of contracts whose value falls within a specified range must involve a minimum number of contractors or suppliers from certain categories or lists (e.g., economically disadvantaged contractors and suppliers).

18. Under the laws of many countries the procuring entity is allowed to contact directly the contractors and suppliers with whom it wishes to negotiate without the need to advertise the procurement proceedings or adhere to any other formal notice requirements. However, the laws of a number of countries require a notice of the negotiation proceedings to be given to contractors and suppliers in a specified manner. For example, the procuring entity may be required to publish the notice in a particular publication. Such notice requirements are intended to bring the procurement proceedings to the attention of a wider range of contractors and suppliers than might otherwise be the case, thereby promoting competition. Some laws also provide that, as in formal tendering, the notice should contain specified types of information and should be issued in sufficient time to allow contractors and suppliers to prepare offers. In the

procurement laws of some countries, formal notice requirements are applicable to procurement through negotiation only if the estimated value of the procurement contract is above a specified level.

19. In some countries, notice requirements are waived when the procuring entity resorts to negotiation following unsuccessful tendering proceedings (see paragraph 13 above) if all qualified contractors or suppliers that submitted tenders are permitted to participate in the negotiations or if no tenders at all were received.

20. Eligibility requirements for participation of contractors and suppliers in negotiation proceedings are another aspect of the selection of negotiating partners addressed in some procurement laws. Generally the formal eligibility requirements applicable to contractors and suppliers in tendering proceedings also apply in negotiation proceedings.

#### **C. Criteria for comparison and evaluation of offers**

21. The procurement laws of some countries refer to general criteria for comparing and evaluating offers made during the negotiations and for selecting the winning contractor or supplier. For example, the procuring entity may be required to negotiate the "most economical" or "most advantageous" procurement contract, taking into account factors such as the technical merit of an offer, price, operating and maintenance costs, the effect of the contract terms on the contractor or supplier, and the profitability and development potential of the procurement contract.

#### **D. Record of procurement proceedings**

22. The laws of a number of countries require a procuring entity that engages in procurement through negotiation to establish a record of the procurement proceedings. Provisions of this type require the record to include information concerning the circumstances necessitating the use of negotiation, the contractors or suppliers invited to negotiate, the contractors or suppliers that requested to participate, and the contractors or suppliers that were excluded from participating and the grounds for their exclusion.

**C. Report of the Working Group on the New International Economic Order on the work  
of its fourteenth session  
(Vienna, 2-13 December 1991) (A/CN.9/359) [Original: English]**

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## 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.<sup>1</sup> The Working Group commenced its work on this topic at its tenth session (17 to 25 October 1988), by considering a study of procurement prepared by the Secretariat.<sup>2</sup> 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 discussion and decisions at the session.<sup>3</sup>

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 that 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. 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.<sup>4</sup>

3. At the twelfth session (8 to 19 October 1990), the Working Group had before it the second draft of articles 1 to 35 (A/CN.9/WG.V/WP.28), as well as draft provisions on review of acts and decisions of, and procedures followed by, the procuring entity (draft articles 36 to 42, contained in A/CN.9/WG.V/WP.27). At that session, the Working Group reviewed the second draft of articles 1 to 27. It did not have sufficient time to review draft articles 28 to 35, or the draft articles on review of acts and decisions of, and procedures followed by, the procuring entity and decided to consider those articles at its thirteenth session. The Working Group requested the Secretariat to revise articles 1 to 27 to take into account the discussion and decisions concerning those articles at the twelfth session.<sup>5</sup> The Secretariat was also requested to report to the thirteenth session of the Working Group on the treatment in national procurement laws of competitive negotiation, one

<sup>1</sup>Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17), para. 243.

<sup>2</sup>A/CN.9/WG.V/WP.22.

<sup>3</sup>A/CN.9/315, para. 125.

<sup>4</sup>A/CN.9/331, para. 222.

<sup>5</sup>A/CN.9/343, para. 229.

of the methods of procurement other than tendering that the Working Group had agreed the Model Law should allow under certain conditions.

4. At the thirteenth session (15 to 26 July 1991), the Working Group had before it draft articles 1 to 35 (A/CN.9/WG.V/WP.30) and draft articles 36 to 42 (review provisions, A/CN.9/WG.V/WP.27), as well as a note by the Secretariat on competitive negotiation (A/CN.9/WG.V/WP.31). At that session the Working Group reviewed draft articles 28 to 42 of the Model Law. The Working Group requested the Secretariat to revise articles 28 to 42 taking into account the discussion and decisions at that session. In addition the Working Group requested the Secretariat to prepare a report on suspension of procurement proceedings to aid it in its further consideration of article 41.<sup>6</sup>

5. The Working Group, which was composed of all States members of the Commission, held its fourteenth session in Vienna from 2 to 13 December 1991. The session was attended by representatives of the following States members of the Working Group: Argentina, Canada, China, Cuba, Czechoslovakia, France, Germany, Iran (Islamic Republic of), Japan, Libyan Arab Jamahiriya, Mexico, Spain, Togo, 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: Bolivia, Brazil, Greece, Holy See, Indonesia, Lebanon, Pakistan, Peru, Philippines, Poland, Republic of Korea, Yemen, Sudan, Switzerland, Thailand, Turkey and Zaire.

7. The session was also attended by observers from the following international organizations:

(a) *United Nations organizations*: International Bank for Reconstruction and Development, International Trade Centre UNCTAD/GATT;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Committee;

(c) *International non-governmental organizations*: International Bar Association.

8. The Working Group elected the following officers:

*Chairman*: Mr. Leonel Pereznieta (Mexico)

*Vice-Chairman*: Ms. Corinne B. Zimmerman (Canada)

*Rapporteur*: Mr. Hossein Ghazizadeh (Islamic Republic of Iran).

9. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.V/WP.32);

(b) Procurement: draft articles 1 to 27 (A/CN.9/WG.V/WP.30) and draft articles 28 to 42 (A/CN.9/WG.V/WP.33) of Model Law on Procurement;

(c) Procurement: suspension of procurement proceedings: note by the Secretariat (A/CN.9/WG.V/WP.34).

10. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Procurement.
4. Other business.
5. Adoption of the report.

11. With respect to its consideration of agenda item 3, the Working Group decided to turn its attention first to draft articles 1 to 27 of the Model Law on Procurement (A/CN.9/WG.V/WP.30), and then to draft articles 28 to 42 (A/CN.9/WG.V/WP.33). It was decided to consider the report on suspension of procurement proceedings (A/CN.9/WG.V/WP.34) at the time of the consideration of the articles in the Model Law dealing with review of acts and decisions of, and procedures followed by, the procuring entity under the Model Law (articles 36 to 42).

12. The deliberations and decisions of the Working Group with respect to its consideration of draft articles 1 to 27 of the Model Law on Procurement are contained in chapter I of the present report.

13. The deliberations and decisions of the Working Group with respect to its consideration of draft articles 28 to 42, and with respect to the note on suspension of procurement proceedings, are contained in chapter II of the report. Gaps in the numbering of articles 1 through 41 in the present report reflect the fact that, during the course of the preparation of the Model Law, certain articles have been deleted or incorporated into other articles, without the draft articles having been renumbered.

## DELIBERATIONS AND DECISIONS

### I. Discussion of draft articles 1 to 27 of Model Law on Procurement

(A/CN.9/WG.V/WP.30,  
and annex to A/CN.9/WG.V/WP.33)

#### *General remarks*

14. It was recalled that at earlier points in its consideration of draft articles of the Model Law, the Working Group had agreed to turn its attention, at a later stage, to the structure of the Model Law. The Working Group affirmed its intention to keep the question of structure in mind as its review of the draft Model Law progressed. The Working Group also noted that it had been agreed at the last session to allocate time during the present session to consider the possible function and structure of a commentary, as well as the timing and procedure of its preparation.

#### *Preamble*

15. The Working Group affirmed that the Model Law should contain a statement of objectives since such a statement would provide a useful tool for interpretation. It was noted that, pursuant to a decision taken at the twelfth session, the location of the statement of objectives had been moved from article 3 to the preamble. However, the view was expressed that the inclusion of a preamble would not

<sup>6</sup>A/CN.9/356, para. 196.

accord with the legislative drafting approach used in some States. It was suggested that the Model Law should refer to the possibility of setting forth the statement of objectives in a substantive provision in order to accommodate the need of such States to enact the Model Law in a manner consistent with their practice. An opposing view was that the Model Law should not encourage disparity among enacting States as to the location of the statement of objectives since such disparity might foster inconsistent judicial interpretation, thereby diminishing the degree of uniformity of law achieved by the Model Law. After deliberation, the Working Group decided that the statement of objectives should be retained in the preamble, but that at the same time it should be made clear, perhaps in a commentary, that enacting States had the option of setting forth the statement of objectives in a substantive provision.

16. As to the content of the statement of objectives, the view was expressed that the reference in subparagraph (b) to the competence of contractors and suppliers was superfluous and could cause confusion since the question of competence was properly the subject of substantive provisions governing qualifications of contractors and suppliers. In view of that observation, it was agreed to delete the word "competent".

#### *Article 1*

##### *Scope of application*

17. The Working Group considered the revised version of article 1 as contained in document A/CN.9/WG.V/WP.30.

18. General agreement was expressed with the basic thrust of paragraphs (1) and (2), which established the presumption of the applicability of the Model Law, while excluding application to procurement involving national defence and national security unless otherwise decided by the procuring entity. However, some hesitation was expressed with regard to paragraph (3), which implemented the decision that the Model Law should permit enacting States to opt for exclusion of the application of the Model Law to additional types of procurement in a general manner or on a case-by-case basis. In particular, the propriety of permitting exclusion of the Model Law by way of procurement regulations was questioned. The view was expressed that if, despite the provision of six methods of procurement covering a broad range of possible circumstances, it would be considered necessary to provide for grounds for exclusion beyond national security and defence, any such additional grounds should, for the sake of transparency, be set forth in the Model Law itself.

19. The prevailing view was that the Model Law should provide States with the possibility of excluding application of the Model Law in a general manner or on a case-by-case basis and that this should be expressly provided for in the Model Law rather than merely referred to in the commentary. At the same time, it was agreed that it should be made clear that the making of additional exceptions was strictly optional. It was felt that exclusion by regulation was a necessary option since it would not always be possible for an enacting State to envisage at the time of enactment all the

types of circumstances that might arise in which exclusion of the Model Law would be desirable. Without the flexibility afforded by exclusion through regulations, enacting States would be left only with the time-consuming avenue of seeking statutory amendments when circumstances arose that had not been envisaged at the time of enactment, thus limiting the acceptability of the Model Law. There was also general agreement with the approach taken in paragraph (3) to case-by-case application of the Model Law, namely, that such a case-by-case approach should apply only to types of procurement specified in the Model Law or in the procurement regulations, thereby ensuring transparency and preventing informality in the exclusion process.

20. It was observed that the use of procurement regulations to exclude application of the Model Law highlighted the need to ensure public availability of such regulations. It was also recalled that the question of the effect of a failure by an enacting State to issue procurement regulations on provisions of the Model Law referring to procurement regulations had arisen with respect to a number of other provisions considered by the Working Group. In this context, the possibility of such a failure to issue procurement regulations was said to underscore the need to make it clear that the issuance of procurement regulations served as a prerequisite for making exclusions beyond those provided for in the Model Law. A view was expressed that questions such as the effect of a failure to issue procurement regulations might be dealt with in article 4.

21. The Working Group next considered the manner in which article 1 was formulated. In that regard, it was observed that there might be an apparent inconsistency between the presumption in paragraph (1) of the general applicability of the Model Law and the presumption in paragraph (3) of non-applicability to certain types of procurement. It was also pointed out that uncertainty might result from the fact that paragraph (3) referred to an express declaration by the procuring entity to contractors and suppliers concerning application of the Model Law to normally excluded areas, while paragraph (2) referred to a similar express declaration without specifying to whom that declaration had to be made. Finally, it was suggested that it should be made clearer that the specification by the enacting State of additional exclusions may be made only in the Model Law itself or in the procurement regulations.

22. In order to address those concerns of a drafting nature, it was proposed that article 1 should be reformulated along the following lines:

"This Law applies to all procurement by procuring entities other than

(a) procurement involving national security or national defence,

(b) ... (each State enacting the Model Law may specify in the Model Law additional types of procurement), or

(c) procurement of a type specified in the procurement regulations

except where and to the extent that the procuring entity declares to contractors and suppliers at the beginning of the procurement proceedings that this Law does apply."

23. It was suggested that additional clarity might be achieved by replacing the word "specified" in subparagraph (c) by the word "excluded". It was also suggested that the reference to the duty of the procuring entity to inform contractors and suppliers of the application of the Model Law in normally excluded areas "at the beginning of the procurement proceedings" was vague and should be replaced by specific references to the various instruments that were used to solicit participation in procurement proceedings, such as invitations to tender or to prequalify and requests for proposals or for quotations. Subject to those refinements, the Working Group agreed to the reformulation of article 1 along the proposed lines.

## Article 2

### Definitions

24. The Working Group considered the revised version of article 2 as contained in document A/CN.9/WG.V/WP.30.

25. Prior to commencing its review of article 2, the Working Group recalled its previous decision to reconsider the necessity of retaining all the definitions currently included therein. The attention of the Working Group was also drawn to the need to formulate cross-references in the definitions to the operative provisions of the Model Law in a consistent manner in order to avoid uncertainty. It was also suggested that, once the definitions have been finalized, they should be arranged in alphabetical order.

#### "Procurement" (subparagraph (new a))

26. It was proposed that the words "if the value of those incidental services does not exceed that of the goods or construction themselves" in subparagraph (new a) should be deleted. In support of that proposal it was stated that the words introduced a mathematical formula for deciding when services should be construed as incidental which was unnecessarily rigid and artificial and would be difficult to apply in practice. According to that view, there might be elements other than value that would be relevant in determining whether a particular contract concerned predominantly goods (or construction) or services. It was also pointed out that deletion of the language in question would not preclude the use of a purely mathematical approach where appropriate. It was further suggested that, rather than attempting to define the notion of incidentality of services by reference to a purely mathematical formula, it would be more appropriate to outline in a commentary the various elements, including value, that would be relevant to a determination of whether services were an incidental component.

27. In response to the proposal to delete the language in question, it was pointed out that the inclusion of a mathematical measure, while possibly presenting some difficulties in certain exceptional cases in which it was difficult to separate services from the goods or construction, would provide a degree of general certainty as to the meaning of the word "incidental" that would otherwise not be available. Discussion of the matter in a commentary was said to be an inadequate manner of dealing with an issue that affected the scope of application of the Model Law. It was

also noted that the language, which reflected a formulation used in the GATT Agreement on Government Procurement as well as in the United Nations Convention on Contracts for the International Sale of Goods, was in line with the earlier decision of the Working Group that, at least at the present time, the Model Law should not address the procurement of services. A concern was expressed that deletion of the language might create an inconsistency with the GATT Agreement on Government Procurement that would cause difficulties for States that were parties to that Agreement. After deliberation, the Working Group decided to retain the subparagraph in its present form and to include in the commentary a discussion of the determination of whether services were incidental.

#### "Procuring entity" (subparagraph (a))

28. It was agreed to add the word "and" at the end of each version of subparagraph (i) in order to make clear that subparagraph (ii) would be additional to either version of subparagraph (i).

#### "Goods" (subparagraph (b))

29. It was proposed to add the word "systems" to the illustrative list of goods contained in subparagraph (b). In response, a concern was raised that the inclusion of that term might give particular prominence to the problem of defining incidental services since, in the case of the purchase of systems such as computer systems, services were a relatively costly component. However, the Working Group was of the opinion that that concern alone should not be a ground for not adding the reference to systems since the problem of incidental services also arose with respect to other items listed in the definition. The proposal was accepted.

#### "Construction" (subparagraph (c))

30. A concern was expressed that the words "if they are provided for in the procurement contract" might be interpreted as requiring that the incidental activities covered were only those referred to in a procurement contract that was in a specific documentary form. In order to avoid this implication, it was agreed to use instead the words "if they form part of the procurement contract".

#### "Tender security" (subparagraph (f))

31. A view was expressed that the definition raised matters of substance and should therefore appear instead in article 26, which dealt with tender securities. The prevailing view was that it should be retained in its present position (see, however, paragraph 139). As to the content of the definition, it was suggested that the reference to the "obligations" of a contractor or supplier might erroneously imply a reference to performance obligations under the procurement contract. In order to avoid that implication, it was agreed to begin the definition instead by referring to a security "given by a contractor or supplier to the procuring entity to guarantee entry into a contract if the contract is awarded to the contractor or supplier". It was also agreed to delete the reference to letters of credit from the illustrative list of instruments that could serve as tender securities so as not to give undue prominence to what would be an unusual use of ordinary commercial letters of credit in a guaranty function.

*"Currency" (subparagraph (g))*

32. The Working Group found the definition of "currency" to be generally acceptable.

*Definitions of procurement methods (subparagraphs (g bis) to (i))*

33. A view was expressed that the use of the words "in accordance with" in the definitions to refer to the substantive provisions governing the various methods of procurement might erroneously imply that the definitions were meant to apply to procurement methods only to the extent that those methods were correctly used. On a more fundamental level, the Working Group agreed to delete the definitions of all of the procurement methods available under the Model Law on the ground that those definitions largely consisted of references to operative provisions and therefore were of little value at this stage of the development of the Model Law.

*"Contractor or supplier" (subparagraph (i bis))*

34. The Working Group found the definition of "contractor or supplier" to be generally acceptable.

*"Responsive tender" (subparagraph (j))*

35. The view was expressed that it was not appropriate to include in article 2 the definition of "responsive tender" since it touched on matters of substance that were properly the subject of operative provisions of the Model Law such as article 28 dealing with the examination and evaluation of tenders. There was broad support for this view, although at the same time it was pointed out that deletion of the definition might be less desirable if the term were used in the Model Law at points other than article 28. Accordingly, the Working Group requested the Secretariat to examine the frequency and location of use of the term, and to delete the term from the list of definitions if its use was essentially limited to the provisions on examination and evaluation of tenders. The Secretariat was also requested to consider whether the substance of the definition might be usefully incorporated in article 28.

*Article 3 bis**International agreements or other international obligations of this State relating to procurement*

36. The Working Group considered the revised version of article 3 bis as contained in document A/CN.9/WG.V/WP.30.

37. A proposal was made to expand article 3 bis so as to include a reference to intergovernmental agreements concluded between different levels of government in federal States. It was suggested that such a clause would be considered a necessity by States with a federal structure because agreements might be concluded between the national government of the federal State and its subdivisions, as well as between individual subdivisions, relating to matters covered by the Model Law. A degree of hesitation was expressed as to the proposal on the ground that it might intrude into matters of internal constitutional and adminis-

trative arrangements, matters perhaps better left to the commentary. It was also suggested such an expansion would restrict the scope of application of the Model Law to the detriment of uniformity. After discussion, the Working Group came to the conclusion that the proposed expansion was desirable, particularly in the case of federal States in which the national government did not possess the power to legislate for its subdivisions with respect to matters covered by the Model Law. In such cases, a provision in the Model Law, such as that found in article 2(a), providing for its implementation at different levels of government would not suffice. Neither was it felt to be appropriate to leave to the commentary a matter of such importance to the scope of application of the Model Law. Mention was made of the possibility of placing the new provision in a separate paragraph in order to avoid the mixing of national with international issues.

38. The Working Group gave its agreement to a proposal to replace the words "shall be applied" by the words "shall prevail" as the latter formulation was deemed more appropriate for dealing with the inconsistencies referred to in article 3 bis.

*Article 4**Procurement regulations*

39. The Working Group considered the revised version of article 4 as contained in document A/CN.9/WG.V/WP.30.

40. The view was expressed that the present formulation of article 4 was overly broad and might have the unintended effect of permitting, by way of the procurement regulations, conduct not envisaged under the Model Law. Accordingly, it was proposed that language along the lines of "to carry out the purposes and provisions of this Law" should be used in place of the existing expression "elaborate upon or supplement this Law". The proposal met with the agreement of the Working Group, which requested the Secretariat to revise article 4 so as to find the precise formulation needed to indicate that the procurement regulations must be within the spirit and purposes of the Model Law.

41. The Working Group considered whether to include in article 4 a general rule on the effect of a failure to issue procurement regulations on provisions of the Model Law that referred to such regulations. It was observed, in that regard, that it might be difficult to come up with such a general rule since the effect of non-issuance might vary from one provision to another. In particular, it was suggested that, whereas in one provision the effect of non-issuance might be that the procuring entity is deprived of the power to take a particular action, in another provision the result of non-issuance might be an enhancement of the procuring entity's power. Accordingly, the Working Group decided to forego the addition of a general rule and instead to consider the matter for specific regulation at the relevant points in the Model Law.

42. Expression was given to the notion that the Model Law might address the manner in which the procurement regulations were to be developed, for example, by provid-

ing for an opportunity for interested parties to comment on the regulations during a preparatory stage. However, it was generally felt that the manner in which the procurement regulations were developed was a matter beyond the scope of the Model Law.

43. It was agreed that the addition of a reference to exclusion of the Model Law by way of the procurement regulations, as mentioned in note 1 to article 4 (A/CN.9/WG.V/WP.30), was unnecessary.

#### Article 5

##### *Public accessibility of procurement law, procurement regulations and other legal texts relating to procurement*

44. The Working Group considered the revised version of article 4 as contained in document A/CN.9/WG.V/WP.30 and found that article to be generally acceptable.

#### Article 7

##### *Methods of procurement*

45. The Working Group considered the revised version of article 7 as contained in document A/CN.9/WG.V/WP.30.

##### *Paragraphs (1) and (new 2)*

46. The Working Group recalled its extensive deliberations at the last session concerning article 7 and noted that the current text implemented the decisions that had been reached at that session. Those decisions included the addition of two new methods of procurement, namely, request for proposals and request for quotations. It was also recalled that considerable attention had been given to the question of overlap between the conditions for use of various methods of procurement other than tendering, in particular two-stage tendering, request for proposals, and competitive negotiation. Paragraph (new 3) contained the solution to the problem of overlap that had been agreed upon at the last session. That solution involved an order of preference to be followed by the procuring entity in selecting a procurement method when the circumstances of a given case fit the conditions for use of more than one method of procurement other than tendering.

47. The Working Group engaged in a further review of the presentation of the various methods of procurement other than tendering, focusing on two specific questions. The first question, on the legislative level, was whether it would be advisable for the Model Law, as it presently did, to recommend to enacting States to incorporate all the methods of procurement set forth in the Model Law, in particular in view of the fact that enacting States would not necessarily be familiar with each of those methods. The second question, on the level of practice, was whether anything further could be done to ameliorate the problem of overlap between the conditions for use of the various methods of procurement other than tendering.

48. Differing views were expressed as to the first question. One view was that it was preferable to recommend

that the full array of procurement methods should be enacted since this might usefully expose enacting States to methods that they were not familiar with, without necessarily compelling their use. The prevailing view, however, was that it would be inappropriate and futile to recommend the incorporation of each of the methods, in particular since it was not the practice in most States to employ such a wide range of procurement methods and since three of the methods (two-stage tendering, request for proposals and competitive negotiation) were apparently somewhat interchangeable. The interchangeability of those methods was said to be evidenced by the fact that they were used in different States for similar procurement situations. It was recalled in this connection that the decision to include all of those three methods stemmed partly from the desire on the part of the Working Group to accommodate that divergent practice in the Model Law and thus enhance the acceptability of the Model Law.

49. It was suggested that the Model Law should recommend a particular structure for selecting methods of procurement, for example, that at least one of two-stage tendering, request for proposals and competitive negotiation would have to be selected. However, it was generally agreed that the actual structure of the choice of procurement methods other than tendering to be incorporated into national law should be left to the enacting State. It was further agreed that possible criteria to be used by a legislature in making a selection should be given in the commentary. For example, the commentary could point out that an enacting State might wish to base its selection on the relative degree of competition found available under the different methods.

50. The Working Group then turned its attention to whether anything further could be done to clarify the decision to be made by the procuring entity in practice as to the choice of a procurement method, particularly in cases of overlap of the conditions for use. One suggestion was to ensure that it was sufficiently clear that tendering proceedings were to be engaged in for all procurement, except in those cases that fit only within the conditions for use of methods other than tendering. It was suggested that this might be done by including tendering proceedings in the list of procurement methods set forth in paragraph (new 2). As to the possibility of overlap between the conditions for use of methods of procurement other than tendering, it was generally felt that the order of preference provided in paragraph (new 3) for cases of overlap was a sufficient measure. It was also noted that the problem of overlap would be eased somewhat as a result of the decision to give enacting States the option of not incorporating each of the methods of procurement, in that the problem of overlap would diminish if an enacting State did not adopt each of the methods of procurement. It was further noted that the commentary might provide practical guidance to procuring entities in selecting a procurement method.

51. The practical difficulties that might arise from overlap were said to be further diminished by the fact that, under the current version of article 36, the Model Law did not provide for a private remedy for a failure by the procuring entity to correctly exercise its discretion in selecting a method of procurement. It was suggested that this restric-

tion might be mentioned in article 7, although the general view was that a clear provision in the chapter on review would suffice. A related question was raised as to whether a private remedy would be available in cases which did not involve the potential applicability of two methods of procurement, but in which the procuring entity simply selected a method of procurement in disregard of the conditions for use of that method. It was agreed to defer consideration of that question until further review of article 36.

52. It was observed that the words "subject to" found in the cross-references in paragraph (new 2) to provisions containing the conditions and procedures for use of the various procurement methods might convey an unintended notion of limitation. Wording along the lines of "in accordance with" or "as provided in" was suggested as a possible replacement.

#### *Paragraph (new 3)*

53. A proposal was made to inject a degree of flexibility and discretion into the order of preference to be followed when the circumstances of a given procurement fit the conditions for use of more than one of the methods of procurement other than tendering in order to ensure that the most appropriate method was used. It was suggested that this added flexibility might be achieved by establishing the principle that the procuring entity could, in cases of overlap, select the "most appropriate" method. According to such a scheme, the order of preference would come into play when two methods were deemed equally appropriate. That proposal failed to attract support as it was considered inconsistent with the approach that the Working Group had decided upon, namely, that, in order to ensure transparency and the highest possible level of competition, there should be no discretion left to the procuring entity in the selection of a procurement method in cases of overlap. Doubts were also expressed on the ground that the concept of appropriateness was vague and would be difficult to define, resulting in an excess of discretion. By contrast, under the present scheme, the selection of a procurement method would have to be justified in relation to specific conditions for use set out in the operative provisions. Accordingly, the Working Group found paragraph (new 3) to be generally acceptable (see, however, paragraph 197).

#### *Paragraph (5)*

54. It was agreed that, in line with a decision that had been taken at the last session in connection with record requirements (A/CN.9/356, para. 58), the words "and shall specify the relevant facts" should be deleted, and that the words "statement of the circumstances" should be replaced by the words "statement of the grounds and circumstances".

### *Article 8*

#### *Qualifications of contractors and suppliers*

55. The Working Group considered the revised version of article 8 as contained in document A/CN.9/WG.V/WP.30.

#### *Paragraph (new 1)*

56. The Working Group found paragraph (new 1) to be generally acceptable.

#### *Paragraph (1)*

57. The view was expressed that subparagraph (a)(ii) displayed the difficulty inherent in requiring a contractor or supplier to prove a negative fact, namely, the absence of insolvency. It was suggested that it might be preferable to instead place an affirmative duty on the procuring entity to ascertain the solvency of the contractor or supplier. A similar view was expressed with regard to subparagraph (a)(iv).

58. It was agreed to add the words "or their principals or officers" to the beginning of subparagraph (a)(iv). It was also agreed that the subparagraph should not specify the length of time during which contractors or suppliers were to be free of any criminal offence or other transgression of the type referred in question. It was felt that the setting of the length of time was a matter better left to the enacting State.

59. It was noted that administrative proceedings were commonly used to suspend or disbar contractors and suppliers found guilty of wrongdoing such as faulty accounting, default in contractual performance, or fraud. Accordingly, it was agreed to add a provision authorizing the procuring entity to disqualify contractors or suppliers that had been found guilty in such administrative proceedings. It was proposed that, in order to implement this decision, words along the lines of "or otherwise disqualified under administrative suspension or disbarment proceedings" should be added to subparagraph (a)(iv). It was also suggested that, rather than grounds for suspension or disbarment being specified in the Model Law, examples of the types of offences concerned should be referred to in the commentary. In a similar vein, a proposal that the Model Law should go so far as to include provisions establishing the basis for such proceedings did not receive support, in particular since such proceedings were not used in all jurisdictions.

#### *Paragraph (2)*

60. The Working Group found paragraph (2) to be generally acceptable.

#### *Paragraph (2 bis)*

61. It was agreed to add the words "if any" after the words "prequalification documents" in paragraph (2 bis) in order to take account of cases in which there were no prequalification proceedings.

#### *Paragraph (2 ter)*

62. The Working Group found paragraph (2 ter) to be generally acceptable.

#### *Paragraph (3)*

63. It was stated that the words "prior to the conclusion of the procurement proceedings" used in paragraph (3) to identify the deadline by which contractors and suppliers would be required to present proof of their qualifications were vague, in particular since there might be differing views as to the point at which procurement proceedings were concluded. The Working Group agreed to a proposal that contractors and suppliers should be required to present

proof prior to examination and evaluation of tenders. It was observed, however, that that formulation appeared to be relevant specifically to tendering proceedings.

#### *Article 8 bis*

##### *Prequalification proceedings*

64. The Working Group considered the revised version of article 8 *bis* as contained in A/CN.9/WG.V/WP.30.

##### *Paragraphs (1) and (2)*

65. The Working Group found paragraphs (1) and (2) to be generally acceptable.

##### *Paragraph (3)*

66. The Working Group next considered the manner in which the Model Law should refer to the required contents of the prequalification documents. At the previous session, the Working Group had discussed whether the Model Law should list the required contents in detail or whether it might be sufficient to refer to the procurement regulations. The Secretariat was requested to consider the manner in which both approaches might be incorporated into the Model Law as options to be given to enacting States. In response to that request, the text before the Working Group at the present session presented two approaches. Under the first approach ("Option I"), the Model Law would refer to the procurement regulations for the list of required contents. By contrast, the second approach ("Option II") provided for a full listing in the Model Law of the requirements. In order to ensure uniformity under Option I, it was suggested that the commentary should indicate to enacting States that the procurement regulations should incorporate all of the requirements listed in the Model Law under Option II. Upon further deliberation, the Working Group decided that it would not be appropriate to include optional approaches with respect to this issue. It was agreed that Option II was preferable to Option I in particular because of the risk that not establishing the detailed requirements in the Model Law would run counter to the objectives of the Model Law and prejudice uniformity of law. It was also pointed out that the requirements listed in Option II were an indispensable bare minimum that would otherwise have to be listed in the procurement regulations, and that the remaining feature of Option I, namely the right to use the procurement regulations to list additional requirements, was available under subparagraph (g) of Option II. Reference was also made to the difficulties that might arise if a State that had selected Option I failed to promulgate procurement regulations.

67. It was agreed that the bracketed reference in the *chapeau* to the information that was "necessary" should be deleted. That reference was considered unnecessary and likely to have the unintended effect of prompting disputes as to whether the procuring entity had included in the prequalification documents all the information necessary to enable contractors and suppliers to prepare and submit applications to prequalify. It was accepted that paragraph (3) should indicate clearly that it referred to the minimum information required to be included and that a procuring

entity would remain free to provide additional information if necessary. To this end, it was agreed that the words "shall contain" in the *chapeau* of paragraph (3) should be replaced by the words "shall include". Other agreed changes to Option II included the addition of the price of the solicitation documents (article 14 (1)(f)) to the excluded items mentioned in the *chapeau*, and the replacement of the words "required to be included", found in the *chapeau*, by the word "specified". It was also agreed to replace the words "requirements established by the procuring entity" in subparagraph (g) by the words "requirements that may be established by the procuring entity" in view of the possibility of non-issuance of procurement regulations and so as to avoid suggesting that the establishment of additional requirements was mandated.

##### *Paragraph (3 bis)*

68. With regard to the response time allowed to the procuring entity, it was agreed to replace the words "shall be given in sufficient time" by the words "shall be given within a reasonable period of time". It was felt that the existing formulation might lead to disputes as to what amounted to "sufficient time".

##### *Paragraph (3 ter)*

69. It was noted that paragraph (3 *ter*) would be deleted in view of the addition of article 10 *bis*, which contained a consolidated provision on communications between the procuring entity and contractors and suppliers.

##### *Paragraph (4)*

70. A number of interventions were directed at the need to make clearer the framework within which prequalification proceedings were to be conducted. The features of that framework that were referred to were the principle that the prequalification decision must be based on the criteria set forth in the prequalification documents, that a decision must be made with respect to each contractor and supplier that applied for prequalification, and that the results of the prequalification exercise must be conveyed in a timely fashion to the contractors and suppliers involved. While the Working Group recognized that the elements of this framework were set forth, either explicitly or implicitly, in the various articles governing qualifications and prequalification proceedings, in particular article 8 (new 1) and (2 *bis*) and in the second sentence of article 8 *bis* (1), as well as in paragraph (4), it was agreed that additional clarity would be desirable. A view was also expressed that some other detailed aspects of the contents of the prequalification documents might be mentioned, such as the requirement that contractors and suppliers applying for prequalification submit proper addresses.

71. No objections were raised to the retention of the bracketed language in paragraph (4), which established an obligation on the part of the procuring entity to make available to the general public the names of the contractors and suppliers that had been prequalified. It was agreed, however, that such disclosure would only be required upon written request. It was also noted that the disclosure aspect of paragraph (4) might not be incorporated in States in which such disclosure was contrary to confidentiality laws.

### *Paragraph (5)*

72. The Working Group found paragraph (5) to be generally acceptable.

### *Paragraph (6)*

73. It was noted that, at the twelfth session, the Working Group had decided to defer a decision on the necessity for paragraph (6) or on its formulation until the consideration of article 28(8 *bis*), which referred to the right of the procuring entity to request contractors and suppliers to reconfirm their qualifications. The Working Group recalled that at the thirteenth session it had considered article 28(8 *bis*) and had reached certain conclusions concerning the approach to be taken in the Model Law towards the question of reconfirmation. In particular, it had been agreed that, in the interest of fairness, the reconfirmation of qualifications should be limited to verifying whether the data submitted at the initial or prequalification stage had changed and that the Model Law should make it clear that the criteria to be used in reconfirming qualifications should be the same as those used in prequalification. In that light, the Working Group had also agreed that the use of the word "re-evaluating" in article 8 *bis* (6) needed to be reconsidered. At the present session, the Working Group reaffirmed its earlier decision as to the need to provide for reconfirmation and the basic approach to be followed.

74. While no specific objections were raised in principle to the modification of the text of paragraph (6) proposed by the Secretariat with a view to avoiding the use of the word "re-evaluating", there was a clear sentiment, as in the case of paragraph (4), that the framework in which the reconfirmation aspect of the prequalification proceedings operated needed to be particularly clear. In that regard, it was suggested that paragraph (6) should refer to the rules set forth in article 28 (8 *bis*) as to the criteria to be used for reconfirmation.

75. A more general question was raised as to whether the provisions on qualifications and on prequalification, as currently formulated, gave the procuring entity sufficient leeway to disqualify contractors and suppliers that submitted false or inaccurate information concerning their qualifications. It was pointed out that the submission of false and inaccurate information was a problem that arose with a certain degree of frequency and that the procuring entity needed to be empowered to respond appropriately at any stage of the procurement proceedings. It was said that the need for such a safety-valve was heightened by the fact that procuring entities sometimes did not carefully examine information on qualifications until a successful contractor or supplier had been selected. It was suggested that the Model Law was not clear as to the steps a procuring entity was permitted to take in cases of false or inaccurate information. The Working Group agreed that the Model Law should clearly provide for disqualification on such grounds at any stage of the procurement proceedings.

76. The Working Group then considered the following proposed reformulation of paragraph (6) intended to reflect the deliberations and decisions that had preceded:

"The procuring entity may require the contractor or supplier submitting the successful tender to reconfirm its qualifications in accordance with the criteria utilized to

prequalify such contractor or supplier in light of the circumstances at the time and may disqualify a contractor or supplier if it finds at any time that the prequalification or reconfirmation information submitted is false or inaccurate."

77. Subject to the drafting refinement that it should be made clear that the procuring entity was to disqualify contractors and suppliers that failed to reconfirm, the proposed text generally met with the agreement of the Working Group. However, differing views were expressed as to the proposed restriction of reconfirmation to the successful contractor or supplier. One view was that such a restriction was appropriate because, both from the standpoint of the efficiency of the procuring entity and of fairness to contractors and suppliers, the point of selection of a successful contractor and supplier was the most relevant point of time for reconfirmation in view of the continually shifting circumstances that contractors and suppliers often found themselves in. In particular, it was suggested that a procuring entity engaged in evaluating tenders would not be inclined to interrupt that process in order to engage in reconfirmation. It was also observed that, where no prequalification had taken place, it was common practice for procuring entities not to consider qualifications until a successful contractor or supplier had been chosen. The view was also expressed that the proposed restriction would help to curb arbitrary or abusive use of reconfirmation to exclude contractors and suppliers from procurement proceedings.

78. The prevailing view, however, was that the right of the procuring entity to request reconfirmation should not be restricted to any particular stage of the procurement proceedings nor limited to the successful contractor or supplier. It was noted that such a flexible approach merely left the matter to the discretion of the procuring entity, which would be unlikely to exercise its right to request reconfirmation in a futile manner. This approach was also viewed favourably because it would permit a procuring entity to request several contractors or suppliers submitting the most interesting tenders to reconfirm their qualifications at the same time. Without such an option, time would be lost in the event that the successful contractor and supplier failed to reconfirm its qualifications, since the procuring entity would be limited to sequentially requesting contractors and suppliers to reconfirm. It was further pointed out that, from the standpoint of speedy resolution of grievances through recourse proceedings, as well as from the standpoint of detecting false and inaccurate information, the possibility of reconfirmation at earlier stages was preferable.

79. A final addition to paragraph (6) agreed upon by the Working Group was that, as in the case of the rule in paragraph (4) for prequalification proceedings generally, the procuring entity should be obligated to notify the results of the reconfirmation.

### *Article 10*

#### *Rules concerning documentary evidence provided by contractors and suppliers*

80. The Working Group considered the revised version of article 10 as contained in document A/CN.9/WG.V/WP.30 and found that article to be generally acceptable.

*Article 10 bis**Communications between procuring entity and contractors and suppliers*

81. The Working Group considered the text of article 10 *bis* as found in the annex to A/CN.9/WG.V/WP.33.

82. Reference was made to the increasing use of electronic data interchange ("EDI") for communications between procuring entities and contractors and suppliers in connection with procurement proceedings. There was a consensus that the use of such evolving communication techniques needed to be accommodated. However, a question was raised as to whether the reference solely to telephone communication and the terminology used in the present formulation of article 10 *bis* was broad enough. In particular, attention was focused on whether the word "record" would be universally recognized as appropriate since it might be interpreted as requiring a printed form, while some EDI transmissions which were stored in computer form did not automatically appear in a printed form. It was pointed out that the present formulation was based on one used in the recently adopted United Nations Convention on the Liability of Operators of Transport Terminals in International Trade and had been tailored to encompass the use of EDI. The Working Group requested the Secretariat to review article 10 *bis* in view of the concerns that had been raised, as well as in the light of UNCITRAL's ongoing activities in the EDI field.

83. Beyond the question of the precise formulation of article 10 *bis*, it was suggested that consideration should be given to covering in article 10 *bis* the provisions on communication found in article 12(2)(b), referring to means of communication other than telephone, and encompassing the communication of solicitation documents (see paragraphs 102 and 106).

*Article 10 ter**Record of procurement proceedings*

84. The Working Group considered the text of article 10 *ter* as found in the annex to A/CN.9/WG.V/WP.33.

*Paragraph (1)*

85. The Working Group agreed to refer here and at other points in article 10 *ter* to "offers", in addition to referring to tenders, proposals and quotations, in order to make it clear that coverage of competitive-negotiation proceedings was being contemplated. The Working Group found paragraph (1) to be otherwise generally acceptable.

86. It was agreed to add a provision reflecting the requirement in article 11(1) that a procuring entity that restricted participation in procurement proceedings on the basis of nationality would have to state in the record the grounds and circumstances for the restriction. There was a consensus that this portion of the record should not be subject to the disclosure requirements of article 10 *ter*.

*Paragraph (2)*

87. The Working Group considered the outstanding question of the point of time at which the relevant portions of the record should be made available to the general public. It was generally agreed that the earlier point of time should be chosen, namely the acceptance of the tender, proposal, offer or quotation. It was noted that a provision along these lines might have to be adjusted in jurisdictions with laws governing confidentiality.

*Paragraph (2 bis)*

88. Differing views were expressed as to the point of time at which disclosure of the relevant portions of the record should be made to contractors and suppliers. One view was that the disclosure requirement should not be triggered until the entry into force of the procurement contract in order to avoid unwarranted disruption of the procurement proceedings. It was suggested that such an approach was necessary in order to avoid spawning spurious claims for review based on information disclosed in the record. The prevailing view, however, was that disclosure to contractors and suppliers was required at the earlier stage, i.e., upon acceptance of the tender, proposal, offer or quotation, so as to give meaning to the right to seek review. It was noted that delaying disclosure until entry into force would in many cases have the effect of depriving aggrieved contractors and suppliers of a meaningful remedy since, under a large body of law, the procurement proceedings were deemed concluded upon the entry into force of the procurement contract. In this connection, the attention of the Working Group was drawn to the important role of private remedies in the enforcement of procurement legislation. Finally, the Working Group agreed that paragraph (2 *bis*) should not implicitly restrict the power of a court to order disclosure at an earlier point of time.

*Paragraph (3)*

89. It was agreed that paragraph (3) was unnecessary and should therefore be deleted since the access to the record by governmental bodies exercising an audit or control function over the procuring entity would not depend on provisions in the Model Law.

*Paragraph (4)*

90. The Working Group requested the Secretariat to review the formulation of paragraph (4) so as to ensure that it was clearly limited to an exclusion of liability for money damages and did not exclude the possibility of injunctive and other forms of relief.

*Article 10 quater**Inducements from contractors and suppliers*

91. The Working Group agreed to the expansion of the provision on inducements to cover all methods of procurement available under the Model Law. At the same time, it was noted that article 10 *ter* (1)(f) required the inclusion in the record of information on disqualification of contractors and suppliers on the grounds of inducements and that that information would be disclosed pursuant to article 10 *ter*

(2 *bis*). A concern was expressed that such disclosure would be unwarranted and, particularly in cases in which the offering of the inducement was not the subject of criminal proceedings, might expose the procuring entity to liability under libel rules. While the Working Group was of the view that the information should be included in the record, it was agreed to add a provision to the present article limiting disclosure of that portion of the record to the contractor or supplier alleged to have offered the inducement. Disclosure of the information to the contractor or supplier alleged to have misbehaved was designed to permit that contractor or supplier to seek review if it felt that the disqualification was unjustified. It was therefore agreed to modify article 10 *ter* (2 *bis*) accordingly.

### Article 11

#### *Participation by contractors and suppliers*

92. The Working Group considered the revised version of article 11 as contained in A/CN.9/WG.V/WP.30.

93. A proposal was made to transfer article 11 to chapter I so as to apply to all methods of procurement the presumption that contractors and suppliers were permitted to participate in procurement proceedings without regard to nationality. Some doubts were expressed as to the appropriateness and necessity of such an expansion of article 11 on the ground that it would not reflect actual practice. In particular, it was pointed out that the procurement methods other than tendering available under the Model Law were largely geared to circumstances in which the procuring entity knew which particular contractors or suppliers it wished to approach. It was also pointed out that the presumption of internationality was already applicable to two-stage tendering by way of the incorporation by reference of chapter II, and that article 33 *ter* (2) provided a vehicle for the procuring entity embarking on request-for-proposals proceedings to obtain an expression of interest from contractors and suppliers internationally. A concern was raised that the application of article 11 to request-for-proposals proceedings might appear to be inconsistent with the notion contained in article 33 *ter* (2) that the solicitation of expressions of interest in participating in request-for-proposals proceedings did not confer any rights on contractors and suppliers.

94. The prevailing view was in favour of the proposal to move article 11 to the general provisions. It was felt that the extension of the presumption of internationality to methods of procurement other than tendering would encourage greater openness in procurement and thereby promote one of the important objectives of the Model Law, without compelling the procuring entity to engage in international procurement counter to economy and efficiency or the other grounds mentioned in article 11. It was also suggested that the generalized application of article 11 would help to ensure equal treatment of foreign contractors and suppliers when procurement proceedings involving methods other than tendering were conducted on an international footing.

95. The Working Group agreed that paragraph (1) needed to be refined in order to clarify that it was composed of two distinct components, the first referring to the closure of procurement proceedings to all but domestic contractors

and suppliers, and the second referring to nationality-based restrictions stemming from factors such as tied-aid arrangements and boycott legislation. As to the first component, the view was expressed that permitting restriction to domestic participants on the basis of "economy and efficiency" was an imprecise and vague notion. However, the prevailing view was that the alternative to such a formulation would be no restriction at all on the right of the procuring entity to engage in domestic procurement and that it was preferable therefore to retain the present approach. It was agreed that the application of the notion of economy and efficiency should be explained in the commentary. It was further agreed that the reference in paragraph (1) to economy "or" efficiency should be modified to reflect the more restrictive formulation economy "and" efficiency found in article 12 (2)(a).

96. The Working Group noted that, in view of the decision to expand the application of article 11, it would be appropriate to apply to the methods of procurement other than tendering the requirement that the procuring entity declare to contractors and suppliers whether the procurement proceedings were open to participation without regard to nationality. Such a requirement was presently, by way of article 14(1)(d *bis*), applicable to tendering proceedings. It was also noted that, while the grounds for any restriction of internationality would not have to be stated in the instrument soliciting participation, that ground would, pursuant to article 11 (1), have to be stated in the record. It was further agreed that the reference in the last sentence of paragraph (1) to that record requirement should be aligned with the language agreed upon for similar references elsewhere in the Model Law, namely, to refer to a "statement of the grounds and circumstances", with the deletion of the requirement that the procuring entity should "specify the relevant facts".

97. The Working Group recalled its decision at the twelfth session to reformulate article 11 so as to avoid referring to "international" procurement proceedings and to avoid the concomitant need to refer to "foreign" contractors and suppliers. It was recognized that, while the revised formulation permitted the Model Law to avoid raising the sometimes complicated question of the definition of "foreign", the use of the term "domestic" raised similar problems of definition. However, the Working Group affirmed its preference for the revised formulation in that it placed the burden on the enacting State of the procuring entity to determine which contractors and suppliers it wished to consider as domestic.

#### *Paragraph (1 bis)*

98. The Working Group agreed that it should be made clear that the procuring entity remained free to apply in wholly domestic procurement the measures to which paragraph (1 *bis*) referred. Particular reference was made to the possible relevance to domestic procurement of the provisions concerning currency, payment and language.

### Article 12

#### *Solicitation of tenders and of applications to prequalify*

99. The Working Group considered the revised version of article 12 as contained in A/CN.9/WG.V/WP.30.

*Paragraphs (1) and (1 bis)*

100. The Working Group found paragraphs (1) and (2) to be generally acceptable.

*Paragraph (2)*

101. The view was expressed that, while it might be the natural tendency of procuring entities to prefer to deal with limited lists of contractors and suppliers, the Model Law should not provide for the limited tendering procedure contemplated in paragraph (2). It was suggested that paragraph (2) granted an excessive degree of discretion to the procuring entity and that, at most, a limited procedure should be available only when the procuring entity could identify all potential contractors or suppliers. The prevailing view was that limited tendering was a widely used approach that the Model Law had to take into account. It was suggested that the discretion granted to the procuring entity was usefully tempered by the requirement in the second sentence of subparagraph (a) that the number of contractors and suppliers invited to participate should be sufficient to ensure effective competition. In order to promote greater transparency, the Working Group decided to add a requirement, akin to the one found in article 11 (1), that the procuring entity should state in the record the grounds and circumstances underlying the decision to limit the tendering proceedings.

102. It was noted that, in view of the addition of paragraph (1 bis), a reference to that paragraph needed to be added to the proviso at the beginning of subparagraph (a).

103. The discussion by the Working Group revealed the need to make it clearer that subparagraph (b), with its reference to urgent circumstances, did not provide an alternate ground to the grounds set forth in subparagraph (a) for engaging in limited tendering, but rather was subject to subparagraph (a) and only referred to the manner of communicating the invitation to tender in limited tendering proceedings. It was agreed that, in the reference at the beginning of subparagraph (b) to a writing requirement, the words "may be sent in writing" should be replaced by the words "shall be sent". At the same time, the Working Group noted that the formulation of subparagraph (b) would have to be reviewed with a view to the use of methods of communication involving EDI.

*Article 14**Contents of invitation to tender and invitation to prequalify*

104. The Working Group considered the revised version of article 14 as contained in A/CN.9/WG.V/WP.30.

105. The Working Group affirmed the approach in article 14 (1) (d bis), which excluded alteration of declarations that tendering proceedings were open to international participation, but permitted the opening to international participation of tendering proceedings originally declared to be domestic.

*Article 17**Solicitation documents*

106. The Working Group considered the revised version of article 17 as contained in A/CN.9/WG.V/WP.30 and in the annex to A/CN.9/WG.V/WP.33.

*Paragraph (1)*

107. It was pointed out that there were States in which solicitation documents and other documentation relating to procurement proceedings were being transmitted through the use of EDI techniques and that such use of EDI in procurement proceedings was likely to continue evolving and spreading. It was proposed in that light that the Model Law should go beyond what had been agreed to with respect to the communications covered by article 10 bis and should contain a general provision enabling enacting States to permit the use of EDI in place of traditionally paper-based documentation. The proposal met with the agreement of the Working Group. At the same time, the Working Group struck a note of caution to the effect that such a provision needed to take account of the fact that the procedures in the Model Law reflected a practice that was rooted in paper-based documentation, as was seen in the Working Group's decision at the twelfth session to retain the requirement in article 24(4) that tenders should be in writing. It was also noted that the use and availability of EDI was not uniform around the world.

*Paragraph (2)*

108. The Working Group decided to delete the bracketed reference in the *chapeau* to the inclusion in the solicitation documents of "necessary" information on the ground that such a reference was unnecessary and might have the unintended effect of prompting disputes as to whether solicitation documents included all the necessary information. It was also agreed that the *chapeau* should make it clear that the procuring entity was not precluded from including in the solicitation documents information beyond that listed in paragraph (2).

109. The Working Group then turned its attention to specific aspects of the required contents of solicitation documents. A suggestion was made that subparagraph (e) should refer to incidental services.

110. The view was expressed that subparagraph (e bis) went too far in requiring that the solicitation documents reveal the manner in which non-price factors would be quantified. It was pointed out that all that was normally required in practice was that the solicitation documents should indicate the relative weight to be assigned to non-price factors in the evaluation and comparison of tenders, whereas the present formulation might be read as requiring the detailed disclosure of the actual formulas and scoring schemes. In support of the existing formulation it was suggested that the more detailed level of disclosure would have a beneficial effect and that the language was sufficiently flexible to permit a more limited disclosure. However, it was a concern that that flexibility might lead to disputes, and in view of the established practice the Working Group opted for the more limited approach. Accord-

ingly, it was decided to replace the words "and the manner in which any such non-price factors are to be quantified" by the words "and the relative weight of such non-price factors".

111. It was agreed that the requirement in subparagraph (f) that the solicitation documents should indicate the terms and conditions of the procurement contract needed to be softened since there would be cases in which the procuring entity would not be in a position to describe fully the terms of the procurement contract at the time of the drawing up of the solicitation documents.

112. The Working Group agreed to the addition to subparagraph (i) of a requirement that the solicitation documents should specify the composition of the price to be quoted in tenders. It was also agreed that this new text, in addition to citing transportation and insurance charges as examples of price elements, should also cite as examples duties and taxes.

113. It was agreed that subparagraph (i) should make it clearer that the solicitation documents should indicate any particular requirements as to the form and the issuer of the tender security that must be met in order for the tender security to be acceptable.

114. The Working Group noted that, in view of the change in terminology in article 28(7) agreed to at the previous session, the term "most economic tender" in subparagraph (p) would be replaced by the term "successful tender".

115. The view was expressed that it was sufficient to refer to any other requirements relating to the preparation and submission of tenders and that it would therefore be possible to delete the words "and to the procurement proceedings" at the end of subparagraph (r), since those words were ambiguous and seemed unnecessary. It was pointed out, however, that the preparation and submission of tenders represented only one aspect of the procurement proceedings and that the procuring entity might, in some cases, impose requirements that did not, strictly speaking, relate to the preparation or submission of tenders themselves, but that nevertheless merited mention in the solicitation documents. For example, the procuring entity might require contractors to attend a pre-tendering meeting at a construction site in order for contractors to be deemed eligible. It was proposed that the formulation might be made clearer by referring to "other aspects of the procurement proceeding". It was also suggested that consideration should be given to moving the substance of subparagraph (r) to the end of paragraph (2) since subparagraph (r) was in the nature of a "catch-all" provision.

116. The Working Group decided to retain subparagraph (w), on which it had deferred a decision at the twelfth session. A proposal to delete subparagraph (w) on the ground that its substance could be considered covered under subparagraph (s) did not receive support, as it was generally felt that the purposes of the two provisions differed. At the same time, it was felt that the subparagraph needed to be refined in order to make its meaning clear, namely, that the solicitation documents must give notice of

the right afforded under article 36 to contractors and suppliers to seek review, and not that the procuring entity was enabled to limit in the solicitation documents the extent of its liability under the review provisions of the Model Law.

117. Subject to minor modifications, the Working Group agreed to the language that had been proposed for addition to subparagraph (y) to implement the decision at the previous session that the solicitation documents should refer to any final approvals required for entry into force of the procurement contract, as well as to the time expected to be needed for such approvals to be obtained. Those modifications included the use of the word "execution" in place of the word "signature" and the introduction of the notion of "estimated period of time". The latter modification was urged because the procuring entity might not be able to predict with certainty the amount of time that would be needed to obtain a final approval. It was also agreed that subparagraph (y) should be revised so as to make it clear that it was the procurement contract, rather than the tender itself, that entered into force.

#### Article 19

##### *Charge for solicitation documents*

118. The Working group considered the text of article 19 as contained in A/CN.9/WG.V/WP.30 and found that article to be generally acceptable.

#### Article 20

##### *Rules concerning description of goods or construction in prequalification documents and solicitation documents; language of prequalification and solicitation documents*

119. The Working Group considered the revised version of article 20 as contained in A/CN.9/WG.V/WP.30.

##### *Paragraph (1)*

120. A proposal was made to delete the last part of paragraph (1), which established an objective test prohibiting specifications and related requirements that had the effect of creating obstacles to participation of contractors and suppliers, regardless of whether the procuring entity had the intention of creating such obstacles. According to that proposal, paragraph (1) would be left only with a subjective test, i.e. specifications and related requirements that created obstacles would only be prohibited if it was the intent of the procuring entity to create such obstacles. A modified proposal was to refer simply to the prohibition of specifications and related requirements that created obstacles, without specifying whether the subjective "intent" or the objective "effects" test was to be followed, leaving that matter to be determined under other laws. The Working Group decided to accept the latter proposal.

121. It was proposed that paragraph (1) should only be directed to obstacles that were "unnecessary". This proposal failed to gain support as the Working Group affirmed its earlier decision against such a limitation.

*Paragraph (1 bis)*

122. It was agreed that a provision should be included stating the principle that specifications and related requirements which created obstacles to foreign contractors and suppliers were not to be used. The wording proposed by the Secretariat was found to be acceptable, subject to the replacement of the word "regardless" by the word "because". At the same time, the Working Group affirmed its earlier decision in regard to paragraph (3) that the Model Law should not accord a preference to international standards.

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

123. The Working Group found paragraphs (2), (3) and (4) to be generally acceptable.

*Article 22**Clarifications and modifications of solicitation documents*

124. The Working Group considered the revised version of article 22 as contained in A/CN.9/WG.V/WP.30.

*Paragraph (1)*

125. It was agreed to replace the words "in sufficient time to enable the contractor or supplier" by words along the lines of "in a reasonable time to enable the contractor or supplier", as the latter formulation was regarded as less likely to lead to disputes.

*Paragraph (2)*

126. It was proposed that paragraph (2) should require that addenda to the solicitation should be communicated to contractors and suppliers in a reasonable time to enable the addenda to be taken account of in the preparation and submission of tenders. It was agreed, however, that the proposed modification was unnecessary as the point was covered adequately in article 24(2), which required the procuring entity to extend the deadline for submission of tenders when necessary in cases of clarification or modification of the solicitation documents.

*Paragraph (3)*

127. It was noted that paragraph (3) would be deleted as a consequence of the addition of article 10 *bis*.

*Paragraph (4)*

128. The Working Group agreed with a suggestion that paragraph (4) should specify that the minutes of the meeting of contractors and suppliers were to be provided to contractors and suppliers promptly and prior to the deadline for submission of tenders. A related suggestion was that, since the minutes might contain information of an importance tantamount to that of an addendum to the solicitation documents, the timing of the transmission of the minutes might require an extension of the deadline for submission of tenders and that specific mention of this should be made.

*Article 23**Language of tenders*

129. The Working Group considered the revised version of article 23 as contained in A/CN.9/WG.V/WP.30 and found that article to be generally acceptable.

*Article 24**Submission of tenders*

130. The Working Group considered the revised version of article 24 as contained in A/CN.9/WG.V/WP.30.

*Paragraph (1)*

131. As in the case of article 22(1), the Working Group agreed to replace the concept of "sufficient time" by the concept of "reasonable time". It was also agreed that, in place of referring to "all interested contractors and suppliers", paragraph (1) should refer to all contractors and suppliers to whom the procuring entity had provided the solicitation documents.

*Paragraphs (2) and (2 bis)*

132. A proposal was made to expand the grounds for extension of the deadline for the submission of tenders to include the situation in which an insufficient number of contractors and suppliers responded to an invitation to tender. That proposal did not attract support, in particular because it was felt that merely extending the deadline would not resolve such a problem. It was pointed out that a procuring entity in such a case would be better advised to restart the tendering proceedings and to advertise in a more effective manner. A broader proposal was made that paragraphs (2) and (2 *bis*) should leave the question of extension of the deadline entirely to the discretion of the procuring entity, subject only to the giving of notice to contractors and suppliers. In support of that proposal it was stated that the current formulation unnecessarily restricted the discretion of the procuring entity in determining whether to extend the deadline for the submission of tenders. That proposal also failed to attract support, as the Working Group felt that it would be inappropriate to inject such a degree of discretion and flexibility in regard to as important a procedural aspect of tendering procedures as the deadline for submission of tenders.

133. A question was raised as to whether the provision in paragraph (2 *bis*) permitting extension of the deadline where circumstances beyond the control of contractors or suppliers prevented the submission of tenders was meant to apply only to circumstances which affected all contractors and suppliers (e.g., a mail strike in the country of the procuring entity) or whether it applied even when the circumstance affected as few as a single contractor or supplier (e.g., a mail strike in the country of one of the contractors or suppliers). One view was that the Model Law should not permit the procuring entity to extend the deadline if only a single contractor or supplier was prevented from submitting its tender. Another view was that such an option should be open to the procuring entity, but that the current formulation could be interpreted as being sufficiently flex-

ible to give the procuring entity the necessary discretion. According to that view, the matter was better left to statutory interpretation since a more specific statement of the right of the procuring entity to accommodate the needs of a single contractor or supplier might encourage an excessive degree of attention by the procuring entity to the needs of particular contractors or suppliers. However, the prevailing view was that, since paragraph (2 *bis*) was understood to encompass circumstances that affected even a single contractor or supplier, this should be made explicit. It was felt that such a clear approach would recognize the necessary discretion of the procuring entity without compelling the procuring entity to accommodate individual contractors and suppliers. Accordingly, it was decided that reference should be made to any circumstance beyond the control of "a" contractor or supplier.

#### *Paragraph (2 ter)*

134. It was noted that paragraph (2 *ter*) would be deleted in view of the addition of article 10 *bis*.

#### *Paragraph (3)*

135. The Working Group found paragraph (3) to be generally acceptable, but agreed with a suggestion that its substance should appear following the substance of paragraph (4).

#### *Paragraph (4)*

136. A view was expressed that the requirement that tenders should be submitted in writing was overly rigid in view of the increasing use of EDI techniques and of the possibility that methods of maintaining confidentiality in the EDI context might exist. In response, it was recalled that the Working Group had decided to add a provision enabling enacting States to incorporate the use of EDI and that the matter should be considered in that context (see paragraph 106). It was also noted that EDI was not uniformly available throughout the world.

137. It was agreed to replace the words "the tender" in the second sentence by the words "its tender".

### *Article 25*

#### *Period of effectiveness of tenders; modification and withdrawal of tenders*

138. The Working Group considered the revised version of article 25 as contained in A/CN.9/WG.V/WP.30 and found that article to be generally acceptable.

### *Article 26*

#### *Tender securities*

139. The Working Group considered the revised version of article 26 as contained in A/CN.9/WG.V/WP.30.

140. The Working Group agreed with a proposal to incorporate into article 26 the definition of the term "tender security" currently located in article 2 (*f*).

#### *Paragraph (1)*

141. A question was raised as to whether subparagraph (*a bis*) was redundant in view of similar language in article 17 (2) (*1*). It was noted that there were several other instances of repetition in the operative provisions of statements made in article 17 concerning the contents of the solicitation documents and that this raised a question of structure to which the Working Group might wish to return at a later stage.

142. It was agreed to add to subparagraph (*a bis*) a reference to the form and substance of the tender security as an aspect of the acceptability of the tender security to which the solicitation documents may refer. A proposal that a requirement should be included that the solicitation documents should specify the currency of a tender security in the form of a cash deposit did not attract support, in particular because such forms of tender security were relatively rare, and also because it was felt that the point was adequately covered by the reference to the form and substance of the tender security.

143. It was proposed that subparagraph (*a bis*) should require the solicitation documents to specify which institution or class of institutions would be acceptable to the procuring entity for the issuance of the tender security. The rationale behind that proposal was to prevent the situation from arising in which a contractor or supplier found out only after having posted a tender security that the issuer of its security was unacceptable. The Working Group found that the proposed requirement would be difficult to apply. However, in order to address the problem the proposal was intended to cover, the Working Group agreed to add a provision requiring that, in advance of the submission of tenders, the procuring entity would be obligated to respond to a request from a contractor or supplier to confirm the acceptability of a proposed issuer or of a confirming institution, if required.

144. The view was expressed that the rule in subparagraph (*b*) barring rejection of tender securities due to foreign issuance was excessively weakened by the exception granted to procuring entities that were not permitted by law to accept tender securities of foreign issuers. The Working Group recalled its previous discussion of this question and affirmed that such an exception needed to be incorporated into the Model Law. However, in view of the fact that such an exception would not be needed in all enacting States, it was decided that the optional character of the exception should be indicated.

145. A proposal was made to delete in subparagraph (*b*) the words "if the tender security and the institution or entity otherwise conform to lawful requirements set forth in the solicitation documents" on the grounds that those words were unnecessary. Upon examination, the Working Group decided not to accept the proposal since, without the language in question, subparagraph (*b*) would override subparagraph (*a bis*). It was agreed, however, that the word "lawful" was unnecessary in view of subparagraph (*a bis*) and should be deleted.

146. The Working Group decided to delete the language in subparagraph (*d*) permitting the procuring entity to

specify grounds for forfeiture of the tender security other than withdrawal or modification of the tender following the deadline for submission, or failure to sign a procurement contract or to provide a required performance security. It was felt that those were the only grounds for forfeiture that the Model Law should recognize.

#### *Paragraph (2)*

147. The Working Group found paragraph (2) to be generally acceptable.

### *Article 27*

#### *Opening of tenders*

148. The Working Group considered the revised version of article 27 as contained in A/CN.9/WG.V/WP.30.

149. A question was raised as to whether there might be cases, other than procurement involving national security or defence, in which the procuring entity should be permitted not to apply the public-opening requirements set forth in article 27. The Working Group was of the view that the requirements in article 27 represented an important pillar of transparency and discipline in tendering proceedings and that exceptions should not be countenanced. At the same time, it was noted that, under article 1, the enacting State could exclude, or provide for the limited application of, the Model Law in certain types of procurement.

## **II. Discussion of draft articles 28 to 41 of Model Law on Procurement (A/CN.9/WG.V/WP.33)**

### *Article 28*

#### *Examination, evaluation and comparison of tenders*

150. The Working Group considered the revised version of article 28 as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

151. The Working Group agreed to the retention of subparagraph (b), the decision on which had been deferred at the previous session. It also agreed to a proposal to add a requirement that a procuring entity that exercised its right to correct an arithmetical error apparent on the face of the tender should give notice of the correction to the contractor or supplier that submitted the tender. Subject to that amendment, paragraph (1) was found to be generally acceptable.

#### *Paragraph (2)*

152. The Working Group considered the question whether the use of the words "shall reject a tender" implied a duty on the part of the procuring entity to take some formal action of rejection with respect to rejected tenders. It was agreed that, if this was not the intended import, language along the lines of "shall not accept a tender" would be preferable. In considering this question, the Working Group examined the merits of a proposal to re-

quire the procuring entity to give contractors and suppliers whose tenders were rejected notice of rejection immediately upon the taking of the decision to reject. The Working Group decided not to incorporate such a procedure, in particular because it was considered to be an unjustified added burden on the procuring entity at a time when it was busy evaluating tenders and that it might suggest that the procuring entity would have to make a specific decision on each tender with respect to each of the criteria listed in paragraph (2). Accordingly, in order to avoid suggesting the need for a formal action of rejection, it was decided to replace the words "shall reject a tender" by the words "shall not accept a tender".

153. It was proposed that subparagraph (a) should be deleted in view of the provisions elsewhere in the Model Law specifically dealing with the qualifications of contractors and suppliers. That proposal failed to generate support as it was felt to be indeed appropriate to refer to lack of qualifications on the part of the submitting contractors or supplier in a provision listing all of the other grounds for rejection of a tender. The Working Group did agree, however, that the cross-reference in subparagraph (a) to article 8(3) had been rendered unnecessary by the decision in article 8(3) to require that contractors and suppliers should submit evidence of qualification at the latest prior to the commencement of examination of tenders.

#### *Paragraph (3)*

154. It was noted that paragraph (3) had been incorporated in article 10 *quater*.

#### *Paragraph (4)*

155. The Working Group recalled the decision made during the discussion of the definition of "responsive tender" in article 2(j) to incorporate in paragraph (4) the notion that, in order to be considered responsive, a tender had to conform to all of the requirements set forth in the solicitation documents.

#### *Paragraph (7)*

156. Differing views were expressed as to a suggestion that the term "lowest evaluated tender" used in subparagraphs (c)(ii) and (d) should be replaced by the term "most favourable tender". Support for the alternate term was expressed on the grounds that the term "lowest evaluated tender" might suggest that price was the dispositive factor and that the term appeared to be opaque and contradictory. The prevailing view, however, was that the term "most favourable tender" connoted an undesirable degree of subjectivity, while the existing term, despite its drawbacks, was preferable because it suggested a greater degree of objectivity.

157. A view was expressed that a reference should be included in subparagraph (d)(ii) to the costs of operating incidental services. As to subparagraph (d)(iii), it was agreed that the reference to "balance of payments position or foreign exchange reserves" should be changed to "balance of payments position and foreign exchange reserves", as those were two related aspects of a single factor.

158. The Working Group considered again the manner in which the Model Law should treat margins of preference, which were referred to in subparagraph (e). It was noted that the present text reflected the decision reached at the previous session not to include any particular formula in the Model Law, but merely to refer to the application of margins of preference in accordance with the procurement regulations. One suggestion for further refinement was to refer to the solicitation documents as an alternate source of authority for the use of margins of preference. A related suggestion was that subparagraph (e) should refer only to the solicitation documents as a source of authority for the use of margins of preference on the ground that the paramount obligation of the procuring entity was to apprise contractors and suppliers through the solicitation documents of the manner in which tenders would be evaluated and compared. Those suggestions involving the solicitation documents did not prove to be persuasive, however, as the Working Group felt that the authority to use a margin of preference should not stem purely from the solicitation documents, and because the requirement that the solicitation documents should describe the use of a margin of preference was felt to be sufficiently established in articles 17(p) and 28(7)(a).

159. Another idea was to apply to margins of preference terms analogous to those contained in article 11(1), which provided for restriction of tendering proceedings to domestic contractors and suppliers on the grounds of economy and efficiency. Such an approach was seen to be inappropriate, however, since the concept of economy and efficiency was foreign to margins of preference, which were intended to promote development of local production capacity.

160. The Working Group did lend its support to the suggestion that the provision on margins of preference should be tightened somewhat by making it subject to the type of optional approval requirement found in certain other provisions of the Model Law, as well as by including an indication of the consequences of not issuing procurement regulations relating to the margins of preference. Accordingly, it was further agreed to add words to the effect that the margin of preference shall be authorized by and calculated in accordance with the procurement regulations.

#### *Paragraph (8)*

161. The Working Group found paragraph (8) to be generally acceptable.

#### *Paragraph (8 bis)*

162. A proposal was made to align paragraph (8 bis) with article 8 bis(6), in which the Working Group had decided not to limit the procedure of reconfirmation of qualifications only to the successful contractor or supplier. In response, it was observed that the current formulation encompassed cases in which the procuring entity had not actually engaged in prequalification proceedings, and that in such cases the notion of reconfirmation was of limited relevance since the evaluation of qualifications took place at the same time as the examination of tenders. By contrast, paragraph (6) of article 8 bis referred to cases in which the procuring entity had engaged in prequalification proceedings. It was said that were paragraph (8 bis) of article 28 to be expanded as pro-

posed to contractors and suppliers other than the successful contractor or supplier, it would be necessary, in order to ensure even-handedness, to require the procuring entity to request reconfirmation from all contractors and suppliers. In view of those observations, it was agreed to retain the existing formulation of paragraph (8 bis).

### *Article 29*

#### *Rejection of all tenders*

163. The Working Group considered the revised version of article 29 as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

164. A view was expressed that it was inappropriate to permit the procuring entity to reject all tenders remaining after the failure of the successful contractor or supplier to meet a request to reconfirm its qualifications. The prevailing view was that, as had been decided at the previous session, such a right should be recognized, in particular because there might not be any acceptable tenders left after the initially selected tender fell through. A suggestion was made that, in order to guard against abuse, it should be made clear that rejection of all tenders should only be for legitimate reasons. The Working Group considered such an amendment to be unnecessary in view of the second sentence, which required the procuring entity to communicate to contractors and suppliers, upon request, the grounds for rejection of all tenders. The Working Group did agree, however, that it was not necessary to include in article 29 a specific reference to the right of the procuring entity to reject all tenders remaining after a failure to reconfirm, since such a case was covered by the notion of "rejection of all tenders". It was pointed out in that regard that the procuring entity would not issue a notice of acceptance under article 32 until its request for reconfirmation had been honoured.

#### *Paragraphs (2) and (3)*

165. The Working Group found paragraphs (2) and (3) to be generally acceptable.

### *Article 30*

#### *Negotiations with contractors and suppliers*

166. The Working Group considered the text of article 30 as contained in A/CN.9/WG.V/WP.33 and found that article to be generally acceptable.

### *Article 32*

#### *Acceptance of tender and entry into force of procurement contract*

167. The Working Group considered the revised version of article 32 as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

168. The Working Group found paragraph (1) to be generally acceptable.

*Paragraphs (2), (3), (3 bis) and (3 ter)*

169. It was noted that the provisions in article 32 referring to the requirement of the signature of a procurement contract and to the requirement of a final approval for entry into force of the procurement contract would be of varying relevance to enacting States. Accordingly, it was agreed that the Model Law should indicate that enacting States where either of those requirements were not traditional would not have to incorporate them. Enacting States in which such requirements applied only in certain cases could incorporate the text in its present form, with possible further specification in the Model Law or in the procurement regulations of the specific classes of procurement contracts or situations to which the requirements were applicable (e.g., contracts over a certain value). It was further agreed to add in paragraph (3) (a) an optional reference to signature of the procurement contract by the "requesting ministry". Such an alternative to the reference to the procuring entity as a signatory to the procurement contract would be incorporated by enacting States in which the procurement contract was not typically signed by the governmental entity, such as a central tendering board, that conducted procurement proceedings for all government ministries.

170. A question was raised as to the effect of the issuance of the notice of acceptance pursuant to paragraph (1) on the right of a contractor or supplier to withdraw its tender, and as to the sanctions that would be applicable in the event of a withdrawal following issuance of the notice. In particular, the question was raised whether a contractor or supplier that wished to withdraw its tender following the issuance of the notice of acceptance would be exposed to any liability beyond the forfeiture of the tender security. It was observed that the result might vary depending upon whether a procurement contract entered into force pursuant to the issuance under paragraph (2) of a notice of acceptance, or upon the signature of a procurement contract under paragraph (3). It was also observed that it was not precluded by article 32 that, once a procurement contract had entered into force in accordance with the issuance under paragraph (2) of the notice of acceptance, withdrawal of the successful tender would result not only in forfeiture of the tender security, but also in liability under the procurement contract. By contrast, when a procurement contract was to enter into force upon signature of a contract under paragraph (3), withdrawal of a tender following issuance of the notice, but prior to signature, might not result in such extensive liability since a procurement contract had not yet entered into force. It was suggested, however, that a limitation on the right of withdrawal of a tender following issuance of the notice of acceptance, but prior to signature, might be found in the second sentence of paragraph (3) (b), which provided that, between the time of the issuance of the notice and the signature of the procurement contract, neither the procuring entity nor the successful contractor or supplier should take any action interfering with the entry into force or performance of the procurement contract.

171. The Working Group was in agreement that the sanction that the Model Law should provide for in the event of withdrawal of a tender following issuance of the notice of acceptance should be forfeiture of the tender security, in particular because it was considered to be impractical and

not in the interest of the procuring entity to attempt to compel a contractor or supplier that had changed its mind about entering into the procurement contract to perform that contract. At the same time, the Working Group was of the view that the Model Law should not exclude the possibility that in such cases the contractor or supplier would be liable under the applicable contract law, a possibility not excluded by the existing text. Accordingly, it was decided not to modify the relevant portions of article 32. The discussion did reveal, however, a certain lack of clarity in article 25 as to the sanction under the Model Law for a withdrawal of a tender following the deadline for the submission of tenders. Accordingly, it was agreed to replace in article 25(3) the words "but not thereafter" by the words "without forfeiting its tender security". A related suggestion was to add to article 25(3) a statement similar to the one already contained in article 26(1)(d)(i) to the effect that withdrawal of a tender following the deadline for submission of tenders would result in forfeiture of the tender security. A view was also expressed that it should be made clear in article 25(1) that tenders could be withdrawn following the deadline for submission of tenders, albeit subject to forfeiture of the tender security.

*Paragraph (4)*

172. The Working Group found paragraph (4) to be generally acceptable.

*Paragraph (5)*

173. The Working Group found paragraph (5) to be generally acceptable. It was observed, however, that the words "if required" might be misinterpreted as referring to the notice of the procurement contract rather than to the tender security.

*Paragraph (6)*

174. The Working Group found paragraph (6) to be generally acceptable.

*New article 33 bis**Conditions for use of two-stage tendering*

175. The Working Group considered the revised version of new article 33 bis as contained in A/CN.9/WG.V/WP.33.

176. It was suggested that consideration should be given to revising the reference to the solicitation of proposals from "contractors and suppliers" in order to take cognizance of the possibility that, in cases in which a combination of goods and construction was being procured, the procuring entity might be soliciting proposals from both contractors and suppliers. It was noted that similar questions might arise with respect to the appropriateness of the expressions "contractors and suppliers" and "contractors or suppliers" at other points in the Model Law. Accordingly, the Working Group requested the Secretariat to review the entire Model Law in this regard.

177. A suggestion that subparagraph (b) should be deleted on the ground that it concerned matters sufficiently covered in subparagraph (a) did not receive support.

### Article 33 bis

#### *Procedures for two-stage tendering*

178. The Working Group considered the revised version of article 33 bis as contained in A/CN.9/WG.V/WP.33 and found that article to be generally acceptable.

### Article 33 ter

#### *Conditions for use of request for proposals*

179. The Working Group considered the revised version of article 33 ter as contained in A/CN.9/WG.V/WP.33.

180. As it had done at the previous session, the Working Group considered a suggestion that the reference to certain procedural aspects of request-for-proposals proceedings found in the *chapeau* of paragraph (1), in subparagraphs (b) and (c), and in paragraph (2) should be moved to article 33 quater, which concerned the procedures to be followed in such proceedings. The Working Group affirmed, for the most part, its earlier decision. It was decided to retain the texts in the *chapeau* and in subparagraphs (b) and (c) of paragraph (1) in their present position. It was considered that those provisions dealt with the decision on the part of the procuring entity as to the number of contractors and suppliers to be approached and the manner of selection of a proposal and were therefore relevant to the conditions for use. It was also suggested that those elements made the conditions for use of requests for proposals more easily distinguishable from the conditions for use of other methods of procurement. It was agreed, however, that these considerations did not apply to paragraph (2) and that therefore paragraph (2) should be moved to article 33 quater.

181. It was proposed that the final portion of paragraph (2), which indicated that the solicitation by the procuring entity of expressions of interest in submitting proposals did not confer any rights on contractors and suppliers, was unnecessary and should be deleted. However, the Working Group decided to retain that proviso. It was recalled that, when the decision was made at the previous session to require the procuring entity to solicit expressions of interest, it had been considered necessary to make it clear that the liability of the procuring entity to contractors and suppliers was not being expanded by virtue of the addition of the procedure in question.

### Article 33 quater

#### *Procedures for request-for-proposals proceedings*

182. The Working Group considered the revised version of article 33 quater as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

183. The Working Group found paragraph (1) to be generally acceptable.

#### *Paragraph (2)*

184. A proposal was made to add in the *chapeau* of paragraph (2) the requirement that the procuring entity should

send a request for proposals to each contractor or supplier that expressed an interest in participating in response to the notice procedure set forth in article 33 ter (2), unless the procuring entity had decided that it wished only to send the request for proposals to a restricted list. It was noted that the rationale behind such an expanded procedure, which was the practice in certain States, was that, as a general rule, those contractors or suppliers that expressed an interest should be given an opportunity to submit proposals. Objections were raised to the proposal on the ground that it would place an additional burden on the procuring entity at a time when it was already busy. It was also suggested that the additional language involved would unduly complicate the Model Law without actually adding anything, since the procuring entity would remain free to except itself from the requirement.

185. In an attempt to accommodate both the practice reflected in the existing text, as well as the practice reflected by the proposed addition, it was proposed that the two approaches would be incorporated as alternatives. While the Working Group agreed to the need to accommodate both practices, it decided that to expressly provide for the two approaches as alternatives was unnecessary since, under the existing text, the procuring entity remained free to send the request for proposals to whomever it wished, including to any or all of the contractors and suppliers that expressed an interest in the proceedings. Accordingly, it was decided to retain the existing text and to make clear in a commentary the options open to the procuring entity.

#### *Paragraph (3)*

186. It was agreed that specific reference should be made to the communication to contractors and suppliers of modifications of the evaluation criteria. Subject to that refinement, the Working Group found paragraph (3) to be generally acceptable.

#### *Paragraph (4)*

187. The Working Group gave its assent to a suggestion that paragraph (4) should be limited to prohibiting the disclosure of the contents of proposals to competing contractors and suppliers. It was felt that, by referring to the opening of proposals, the current formulation might give the unintended implication that the opening of proposals should be conducted in public. A suggestion for implementing the agreed modification was to replace the word "open" by a word such as "treat" or "review".

#### *Paragraph (5)*

188. The Working Group agreed to a proposal to delete subparagraph (d), which provided that any modification of the evaluation criteria following the commencement of negotiations should not violate the confidentiality of the negotiations. It was recognized that modification of the evaluation criteria would not in itself pose a problem of confidentiality, since those criteria did not contain a summary of or statement concerning proposals. It was also observed that the concern intended to be addressed by subparagraph (d) would be met by the revised version of paragraph (4).

*Paragraph (6)*

189. The Working Group found paragraph (6) to be generally acceptable.

*Paragraph (7)*

190. In response to the observation that the procedures set forth in subparagraphs (b) and (c) concerning the separate evaluation of the price represented one, but not the exclusive, approach to the treatment of price found in practice, it was agreed to treat those subparagraphs as optional or illustrative.

*Additional paragraph*

191. The Working Group was in agreement with a proposal to add a provision to the effect that any award made by the procuring entity should be in accord with the evaluation criteria set forth in the request for proposals.

*New article 34**Conditions for use of competitive negotiation*

192. The Working Group considered the revised version of new article 34 as contained in A/CN.9/WG.V/WP.33.

193. In reviewing new article 34, the Working Group revisited the question of the overlap in the conditions for use of competitive negotiation, two-stage tendering and request for proposals—a problem that had been discussed at the previous session as well as at the current session in connection with the review of article 7 (see paragraphs 45 to 52). In that respect, it was widely felt that the condition in subparagraph (a), which included references to the special nature and particularly complex technical character of the goods or construction, was vague and arguably very similar to conditions applicable to other methods, thus failing to establish a clear and enforceable standard to be used in determining when competitive negotiation, as opposed to those other methods, was appropriate.

194. Several approaches were considered in an attempt to clarify subparagraph (a) and to make the condition contained therein distinguishable from similar conditions for use found in the Model Law for the other methods of procurement. One suggestion was to delete the reference to the "special nature" of the goods, as well as the reference to construction, and to focus on the notion of a "particularly complex technical character", perhaps even referring to specific types of goods such as computers and automatic data processing for which competitive negotiation was used in certain countries. That suggestion encountered opposition on the ground that it would excessively narrow the grounds for the use of competitive negotiation. No strong objections were raised, however, to the proposed deletion of the reference to the scope and volume of goods or construction.

195. The Working Group recalled that one of the reasons why competitive negotiation, as well as two-stage tendering and request for proposals, had been included, a reason which was also a source of the overlap among the conditions for use of those methods, was that those methods

were used in different States to deal with basically the same type of situation, namely, cases in which the procuring entity was unable to bring specifications to the level required for tendering proceedings. It was also noted that this fact was behind the decision in respect of article 7 to give enacting States a choice among the methods of procurement other than tendering (see paragraphs 46 to 48). In that light, it was suggested that, rather than making any further attempt to refine subparagraph (a) so as to make it more distinguishable from similar conditions for use for the other methods, it would be more appropriate, at least with regard to certain types of overlapping conditions for use, to treat those methods as equal options.

196. A specific proposal was made as to the extent to which competitive negotiation, two-stage tendering and request for proposals should be treated as equal options. That proposal involved establishing as a common condition for the use of each of those methods the inability of the procuring entity to draw up specifications. The inclusion of that common condition for each of those methods would not exclude the inclusion of other, divergent conditions for use for the different methods (e.g., urgency, for competitive negotiation, and, for request for proposals, the decision of the procuring entity to use an evaluation and selection scheme characteristic of that method of procurement). A variant of that proposal was to delete subparagraph (a), thereby limiting to two-stage tendering and request for proposals the common condition of the inability of the procuring entity to draw up specifications. There was considerable support for the latter approach, on the ground that those two methods were adequate to deal with the type of procurement situations contemplated for competitive negotiation, while at the same time being more disciplined, transparent and competitive than competitive negotiation.

197. However, an objection was raised to precluding the availability of competitive negotiation in cases in which the procuring entity was unable to draw up specifications on the ground that it was precisely in such cases that competitive negotiation was traditionally regarded in some States as the appropriate procurement method. The suggestion was made that those States might wish to deal with such special cases, which might include, for example, the procurement of very complex technology or of specially commissioned artistic works, by excluding those categories of procurement from the Model Law. In support of that suggestion, the view was expressed that such exclusions would have minimal impact since, at any rate, the application of competitive negotiation procedures provided a very limited degree of restraint on the procuring entity. However, the Working Group was unable to form a consensus behind an approach that would foster exclusions from the Model Law or exclude the use of competitive negotiation in cases in which the procuring entity was unable to formulate complete specifications.

198. After deliberation, the Working Group decided to request the Secretariat to implement the proposal that the three methods in procurement should be treated as equal options as regards cases in which the procuring entity was unable to formulate complete specifications. It was noted that such a solution did not completely resolve the problem of overlap in the admittedly unlikely event that an enacting

State would incorporate both two-stage tendering and competitive negotiation. In such a State, a procuring entity that wished to use competitive negotiation on the ground of inability to formulate specifications, would be precluded from doing so by virtue of the order of preference established in article 7 (new 3) governing cases of overlap in conditions for use. Accordingly, the Working Group decided to review again at the next session the question of the overlap in the conditions for use of the methods of procurement, including the question of the order of preference established in article 7 (new 3).

199. The Working Group affirmed the decision made at the last session to limit urgency as a ground for the use of competitive negotiation to cases in which the circumstances giving rise to the urgency were not foreseeable by, or a result of dilatory conduct on the part of, the procuring entity.

200. It was proposed that subparagraph (e) should be expanded to cover the case in which a contractor or supplier defaulted in the performance of a procurement contract already in force and the procuring entity did not have time to engage in new tendering proceedings because of urgent needs. It was generally felt that such a case was adequately covered by subparagraph (b) and that it was therefore unnecessary to expand subparagraph (e) as suggested. A concern was also voiced that such an expansion of subparagraph (e) might have the unintended effect of fostering unjustified resort to competitive negotiation. The Working Group did, however, request the Secretariat to ensure that all language versions of subparagraph (b) would clearly cover a case of the type in question.

#### *Article 34*

##### *Procedures for competitive negotiation*

201. The Working Group considered the revised version of article 34 as contained in A/CN.9/WG.V/WP.33.

202. The Working Group agreed to replace the word "may" in paragraph 3 *bis* by the word "shall" so as to make the "best and final offer" procedure mandatory. Article 34 was otherwise found to be generally acceptable.

#### *New article 34 bis*

##### *Conditions for use of request for quotations*

203. The Working Group considered the revised version of new article 34 *bis* as contained in A/CN.9/WG.V/WP.33.

##### *Paragraph (1)*

204. Questions were raised as to the appropriateness of the use of the word "standardized" to refer to the type of goods that were the subject of request-for-quotations proceedings. It was said to be unclear whether that word was intended to refer merely to goods that were ready made as opposed to being manufactured to a particular customer's specifications, or whether the word was intended to refer to

the conformity of the goods with national or international technical standards. The Working Group expressed its understanding that it was the former meaning that should be conveyed. At the same time, a view was expressed that the language chosen should take account of the concern of importing countries that goods meet the required quality standard. It was suggested that, in place of the word "standardized", words or expressions such as "standard" or "commercially available" should be used instead. However, those words also were considered to be insufficiently clear. The Working Group requested the Secretariat to consider the matter further in the light of the observations that had been made.

##### *Paragraph (2)*

205. The Working Group found paragraph (2) to be generally acceptable.

#### *Article 34 bis*

##### *Procedures for request for quotations*

206. The Working Group considered the revised version of article 34 *bis* as contained in A/CN.9/WG.V/WP.33.

##### *Paragraph (3)*

207. As had been agreed in the context of article 17(2)(i) with respect to the composition of the price in tendering proceedings, it was agreed to add a reference to duties and taxes as additional examples of elements that would form part of the price quotation.

208. A concern was expressed that the reference to the "cost" of the goods might have the unintended effect of suggesting that procuring entities should request a complete breakdown of the basis on which contractors and suppliers arrived at a price for the goods themselves (e.g., calculation of overhead and level of profit). It was said that the difficulty was compounded by the use later in the paragraph of the word "price", and that it would be preferable to use the word "price" in both locations. While some support was expressed for the present formulation and misgivings were voiced as to the double use of the word price, the Working Group recognized the concern over the use of the word "cost" and requested the Secretariat to attempt to find an appropriate formulation.

##### *Paragraphs (3 bis) and (4)*

209. The Working Group found paragraphs (3 *bis*) and (4) to be generally acceptable.

#### *Article 35*

##### *Single source procurement*

210. The Working Group considered the revised version of article 35 as contained in A/CN.9/WG.V/WP.33.

##### *Paragraph (new 1)*

211. A number of interventions were made aimed at loosening somewhat the restrictions that had been placed on

subparagraph (c), which provided for urgency as a grounds for the use of single source procurement. One proposal was to delete the reference to catastrophic events, with the result that resort could be had to single source procurement on the grounds of urgency as long as the condition giving rise to the urgency was neither foreseeable nor due to the dilatory conduct of the procuring entity. It was further suggested that, with the removal of the reference to catastrophic events, the subparagraph should be cast in terms of a *force majeure* clause, namely, a clause permitting the use of single source procurement when the use of such a procurement method was dictated by events that were beyond the control of the procuring entity. Another proposal was to provide simply that the use of single source procurement would be permitted when the use of any other method was impossible. Those proposals failed to attract general support, however, as the Working Group affirmed its view that the use of single source procurement on the grounds of urgency should be limited to catastrophic cases. At the same time, it was agreed that the commentary should indicate that, in such cases, the procuring entity should limit its procurement to the quantity required to deal with the emergency situation, thus leaving the procurement of its general needs to the more competitive procurement methods.

212. The Working Group also considered a proposal to delete the restriction that had been added at the previous session limiting the urgency grounds to cases in which the condition giving rise to the urgency was unforeseeable and not due to the dilatory conduct of the procuring entity. It was pointed out that, given the basic premise of a catastrophic situation, the retention of that restriction would lead to anomalous results. In particular, a combination of catastrophic circumstances and the restrictive formulation of subparagraph (c) might leave a procuring entity unable to resort to single source procurement or, for that matter, to any other method of procurement, thus resulting in serious harm to the public interest. In view of such a possibility, the Working Group agreed that it was necessary to delete the restriction in question. It was felt that, with the remaining restriction to catastrophic events and the proviso that no other method of procurement must be available, there were sufficient safeguards in place to limit abusive resort to single source procurement on the grounds of urgency.

213. In subparagraph (d), the Working Group agreed to replace the words "the size of the proposed procurement" by the words "the limited size of the proposed procurement". In subparagraph (e), it was decided to replace the word "development" by the words "development leading to the procurement of a prototype" in order to achieve alignment with similar language in new article 34 (c).

#### Article 36

##### Right to review

214. The Working Group considered the revised version of article 36 as contained in A/CN.9/WG.V/WP.33.

215. A proposal was made to add to article 36 the requirement that, in order to obtain review, a complaint must state that the procuring entity was "*prima facie* in breach of a duty set forth in the Model Law", i.e., that it should be

apparent from the face of the complaint that what the procuring entity was alleged to have done was in fact a violation of a duty imposed by the Model Law. It was suggested that the addition of such a requirement would help to preclude frivolous complaints, thereby limiting disruption of procurement proceedings. That proposal failed to generate significant support, in particular because of a concern that any such language in article 36 seeming to restrict the right to review would create uncertainty and might jeopardize the effectiveness of the review procedures as a tool for enforcement of the Model Law. It was also observed that such a restriction was implicit in the review process as was evidenced by the reference in article 38(2) to dismissal of complaints. It was further observed that, while the proposed limitation might have some relevance to court proceedings, article 36 was not geared only to judicial review.

216. The Working Group then turned its attention to the alternatives that had been included for indicating the provisions that imposed duties the breach of which would give rise to a cause of action. Upon review of those alternatives, the Working Group agreed that variant 1, which referred simply to the breach of a duty imposed by "this law", was preferable to variant 2, which involved a listing of a large number of provisions of the Model Law intended to be subject to the review procedures. It was felt that the simpler approach would be easier to implement and would avoid the possible pitfall inherent in variant 2 that the listing might somehow be incomplete. At the same time, it was agreed that the commentary should indicate, on the basis of the provisions found in variant 2 and including the additional paragraph agreed for article 33 *quater*, which provisions should give rise to private remedies. It was also agreed that, as a consequence of the decision to use the variant 1 approach, it would be necessary to indicate, either in article 36 or at relevant points in the Model Law, that certain provisions involving the exercise of discretion by the procuring entity would not give rise to private remedies.

217. The Working Group gave its assent to a proposal to delete the words "at any stage of the procurement proceedings or after the procurement proceedings have terminated" found at the end of article 36. It was felt that the notion addressed in that language was adequately and more precisely covered in the subsequent provisions on review.

#### Article 37

##### Review by procuring entity or by approving authority

218. The Working Group considered the revised version of article 37 as contained in A/CN.9/WG.V/WP.33.

##### Paragraph (1)

219. A question was raised as to the appropriateness of the reference in paragraph (1) to an "authority", which was the first reference of its kind in the Model Law. In response, it was pointed out that that reference needed to be understood in the context of the optional approval requirement referred to at various points in the Model Law. At the same time, note was made of the fact that the reference to approval in paragraph (1) might have to be aligned with the

optional character of the approval requirement in the Model law. The Working Group found paragraph (1) to be otherwise generally acceptable.

#### *Paragraph (2)*

220. It was agreed that the reference in the second sentence of paragraph (2) to complaints seeking only compensation for tender or proposal preparation costs should be deleted since that matter was addressed, and more appropriately so, in article 38(2)(g). It was also noted that the reference to the "person" submitting a complaint needed to be changed to a reference to a "contractor or supplier" in line with the decision at the previous session in connection with article 36 to limit the availability of review to contractors and suppliers. An additional drafting suggestion was that, for the purposes of clarity, the words "the earlier of the time when" should be replaced by a formulation along the lines of "whichever is earlier".

#### *Paragraph (3)*

221. The Working Group found paragraph (3) to be generally acceptable.

#### *Paragraph (4)*

222. It was noted that the reference to the "person" submitting the complaint would be modified to refer to the "contractor or supplier" submitting the complaint. Paragraph (4) was found to be otherwise generally acceptable.

#### *Paragraph (5)*

223. A suggestion was made to eliminate paragraph (5) by redistributing its contents to other provisions. According to that suggestion, the first sentence, which referred to the institution of proceedings under article 38 or 40, would be incorporated in article 38(1)(b), and the second sentence, which dealt with the cessation of the competence of the procuring entity and of the approving authority under article 37 upon the institution of such proceedings, would be incorporated in paragraph (6) of the present article. However, the suggestion was regarded as unworkable since paragraph (5) referred not only to administrative review under article 38, but also to judicial review under article 40.

#### *Paragraph (6)*

224. The Working Group found paragraph (6) to be generally acceptable.

### *Article 38*

#### *Administrative review*

225. The Working Group considered the revised version of article 38 as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

226. It was observed that, while paragraph (1) established certain time limits for the commencement of administrative review actions with reference to the point of time that the complainant became aware of the circumstances in question, the Model Law did not provide any absolute limitation period for the commencement of review. It was agreed that this was a matter better left to be addressed by other national law and that the commentary should address the

point. It was observed that the present case was a good illustration of the usefulness of the commentary in pointing out to legislatures in enacting States the potential relationship between the review provisions in the Model Law and other provisions of national law.

227. It was noted that the reference in subparagraph (c) to the "person" claiming to be adversely affected would be modified to refer to a "contractor or supplier".

#### *Paragraph (1 bis)*

228. The Working Group found paragraph (1 bis) to be generally acceptable.

#### *Paragraph (2)*

229. The Working Group noted that subparagraph (d), and perhaps subparagraph (e), which referred to the annulment or revision of actions and decisions of the procuring entity, would have to be clarified in order to make it clear that they stopped short of authorizing the annulment of a procurement contract that had entered into force. This would be in line with the decision of the Working Group at the previous session that the Model Law should not itself authorize the annulment of procurement contracts. Any such annulment would be left to other national law, for example, criminal or administrative law. In order to clarify the point in subparagraph (d), it was suggested that words should be added along the lines of "other than any act or decision by which the procurement contract is constituted". Were it to be considered necessary to clarify the same point in subparagraph (e), it was suggested that words should be added there along the lines of "other than any decision bringing the procurement contract into force". An alternative drafting suggestion was to limit the applicability of subparagraphs (d) and (e) to the period of time prior to the entry into force of the procurement contract.

230. It was noted that the question in subparagraph (g) as to the types of loss to be compensable in administrative review proceedings remained outstanding from the previous session. Differing views were expressed as to the two variants before the Working Group, one of which provided for compensation only of costs associated with participation in the procurement proceedings, and the other one for broader losses suffered. One view was that limiting recovery merely to tender or proposal preparation costs would result in insufficient compensation. At the same time, it was acknowledged that exposing the procuring entity also to liability for other losses suffered, in particular lost profit, was excessive given the fact the compensation would come from the public purse. It was therefore suggested that compensation should be set somewhere between the mere costs associated with participating in the procurement proceedings and lost profit. The prevailing view, however, was that the Model Law should not recommend as necessary the adoption of a standard of compensation beyond costs associated with the procurement proceedings. In particular, the concern was voiced that the Model Law should not add to the burdens borne by procuring entities in the developing world. At the same time, it was agreed that the Model Law should not exclude the possibility of compensation of costs beyond those associated with the procurement proceedings.

231. Several suggestions were considered for leaving open the possibility of compensation beyond the costs associated with the procurement proceedings. One suggestion was to indicate that the administrative body may require the payment of compensation "at least" for costs associated with the procurement proceedings. Another suggestion was that the possibility of additional compensation would remain open without the addition of any such language because a complainant might obtain further compensation from a court. The Working Group finally decided that it would be best to present both approaches to compensation currently embodied in subparagraph (g) as options for the enacting State and to discuss in the commentary the choice to be made in this regard by legislatures.

#### *Paragraphs (3) and (4)*

232. The Working Group found paragraphs (3) and (4) to be generally acceptable.

#### *Article 39*

##### *Certain rules applicable to review proceedings under article 37 [and article 38]*

233. The Working Group considered the revised version of article 39 as contained in A/CN.9/WG.V/WP.33.

#### *Paragraph (1)*

234. The Working Group found paragraph (1) to be generally acceptable.

#### *Paragraph (2)*

235. The view was expressed that paragraph (2) was not clear as to two facets of the question of participation in review proceedings of contractors and suppliers other than the contractor or supplier submitting the complaint. The first facet was the standard in paragraph (2) to be used to determine which contractors and suppliers would be admitted. A view was expressed that the current standard, which referred to any contractor or supplier whose interests were or could be affected, was too vague and should be replaced by a reference to "direct and material" interest. It was suggested that such a limitation would help to ensure that review proceedings did not assume unmanageable proportions. The prevailing view, however, was that the existing formulation was adequate, particularly in view of the discretion remaining in the hands of the review body to determine whether a given contractor or supplier met the admission test. It was also felt that the possibility of broader participation should not be unduly restricted since it was in the interest of the procuring entity to have complaints aired and information brought to its attention as early as possible. The other facet of paragraph (2) addressed by the Working Group was whether paragraph (2) provided sufficient guidance as to the extent of the participation that would be allowed to those third-party contractors and suppliers that had been admitted to the proceedings. It was suggested in this regard that the mere reference to a "right to participate" might not provide an adequate indication of whether the participation of such third parties was to be at a full level (e.g., including the right to submit briefs) or whether it could be restricted in some way. On this ques-

tion also, the Working Group was of the view that it would be preferable to retain the general formulation in the existing text. It was agreed, however, that the commentary should alert legislatures that there might be a need in their jurisdictions for establishing rules to govern issues not dealt with in article 39(2).

#### *Paragraph (3)*

236. The Working Group noted that the first reference in paragraph (3) to the "person" submitting the complaint would be modified to refer to a "contractor or supplier". As to the second such reference, it was agreed that it should be similarly replaced, and that reference should also be made at that point to the furnishing of the decision to any governmental authority (e.g., an approving authority) that may have participated in the review proceedings. It was also agreed that the formulation of the reference at the end of paragraph (3) to confidentiality should be aligned with provisions at other points of the Model Law restricting disclosure of information that would prejudice legitimate commercial interests.

#### *Article 40*

##### *Judicial review*

237. The Working Group considered the revised version of article 40 as contained in A/CN.9/WG.V/WP.33.

238. It was agreed that the drafting of article 40 should be refined in order to avoid giving rise to the interpretation that procuring entities were precluded from seeking judicial review of decisions reached at lower levels of the review process. One suggestion for doing so was to replace the words "jurisdiction over an action commenced by a contractor or supplier" by the words "jurisdiction over, or in connection with, an action commenced by a contractor or supplier". The Working Group found article 40 to be otherwise generally acceptable.

#### *Article 41*

##### *Suspension of procurement proceedings [and of performance of procurement contract]*

239. The Working Group considered the text of article 41 as contained in A/CN.9/WG.V/WP.33, as well as the note by the Secretariat on the question of suspension contained in A/CN.9/WG.V/WP.34.

240. The Working Group resumed its consideration of the question of suspension of the procurement proceedings and of the performance of the procurement contract, a question that had been left unresolved at the last session. Differing views were expressed as to the threshold question of whether it was at all necessary to include in the Model Law a provision on suspension. One view was that article 41 should be deleted because adequate provision existed for suspension without an article specifically on that point. In particular, it was suggested that suspension was available from the procuring entity itself by virtue of article 37(4), from an administrative review body under article 38(2)(b), and from the courts under the applicable rules of civil procedure. It was also suggested that a provision such as article 41

would intrude into those existing rules governing court procedure and that those rules should not fall within the domain of the Model Law. It was further suggested that the availability in many countries of provisional court measures, which would encompass a measure such as suspension, obviated the need for any mention of the possibility of suspension at lower levels of the review process. The prevailing view, however, was that the Model Law, in particular because of the need to establish uniformity of law, should contain a provision on suspension. At the same, it was generally agreed that article 41 should be restricted to dealing with the availability of suspension in review proceedings under articles 37 and 38 and that it should not venture into the question of the power of courts to order suspension. Neither, it was agreed, should article 41 provide for suspension of the performance of the procurement contract. It was agreed that that question should be left to other national laws.

241. Having decided that article 41 should be retained in some form, the Working Group turned its attention to the two variants that remained on the table from the previous session, with variant A providing for automatic suspension and variant B providing for discretionary suspension. Differing views and considerations were expressed with regard to the advantages and disadvantages possessed by those two variants. It was noted that the automatic suspension feature of variant A had the advantage of freezing the status quo and thereby preserving the rights of the complainant. Particular reference was made to the value of such an approach for complaints filed shortly before the issuance of the notice of acceptance, i.e., shortly before the entry into force of the procurement contract. It was recalled that, with the decision of the Working Group not to provide in the Model Law for suspension of the procurement contract, an automatic suspension would be more likely than a discretionary approach to ensure the availability of a meaningful remedy for complaints filed shortly before the entry into force of a procurement contract. It was also suggested that an approach involving an automatic suspension would be more likely to result in the settlement of complaints at a lower level, short of judicial intervention, thus fostering more economical and efficient dispute settlement and judicial economy. At the same time, it was recognized that the discretionary approach embodied in variant B had the advantage of avoiding the degree of disruption of procurement proceedings likely to result under an automatic-suspension regime because the reviewing body would be in a position to ferret out the type of frivolous complaints that would create problems under variant A.

242. In view of the fact that both variants displayed important advantages and disadvantages, there was broad support for attempting to craft a provision on suspension that would combine the desirable elements of both variants. In that light, the Working Group was able to achieve broad agreement that article 41 should provide for a mandatory suspension, but that that suspension would be applicable only if the reviewing body determined that the complaint met certain criteria specified in the Model Law. It was further agreed that another crucial feature of article 41 should be that the procuring entity would be able to override the suspension requirement on the basis of urgent public interest considerations. In order to ensure that such an override was not used capriciously or arbitrarily, it was agreed that a procuring

entity wishing to override should certify the ground for the override, thus providing a record for later judicial review. At the same time, with a view to limiting disruption of the proceedings in such critical cases, it was agreed that the procuring entity's certification should be conclusive with respect to all levels of review except judicial review.

243. The Working Group considered the question of the length of time of the suspension. A proposal that the overall length of time be set at thirty days failed to gain support as it was felt that such a length of time was too long and disruptive. Another proposal was to set a very short preliminary period of suspension during which a determination could be made as to whether a longer suspension was necessary. While some misgivings were expressed as to the meaningfulness of a short period of time, it was generally agreed that the initial period of suspension should be short, for example, five days or one week. It was felt that such a short period, which would be in line with the attempt to find a middle ground between variants A and B, would limit disruption, while at the same time accomplishing the essential purpose of freezing the status quo while the review body obtained an impression of the complaint and thereby determined the extent of the suspension, if any, that would be merited. It was also noted that, in cases in which the issuance of the notice of acceptance itself triggered entry into force of the procurement contract, a complainant filing a protest following the issuance of a notice should be permitted to request a suspension. A further point that was noted was that the application of a suspension may affect time limits in the procurement proceedings, for example, the deadline for the submission of tenders.

244. The Working Group considered a number of suggested criteria to be met by a complaint in order to obtain a suspension. One proposal was that the complainant should be required to provide an affidavit or some other form of a sworn statement on the face of which would be apparent the allegation of injury and probability of success. Questions were raised as to the meaningfulness of such a requirement, its low evidentiary value and the unfamiliar nature of affidavits in some legal systems. In response to those questions, it was pointed out that the purpose of the statement was not, at this stage, to initiate an adversarial hearing or an evidentiary examination, but merely to require the complainant to make its *ex parte* allegations under oath. It was also suggested that, while the particular form of an affidavit might not be familiar in all legal systems, the possibility of issuing a sworn statement of some sort existed widely. Another proposed criterion was that the complainant should be required to make a statement concerning the effect of a granting or of a denial of the suspension on the balance of interests between the complainant and the procuring entity, and between the complainant and other contractors and suppliers. Similar points were made in favour and in opposition to this criterion as had been made with regard to the sworn statement. A final suggestion was that the complainant should be required to post a security to cover losses that might result from the suspension in the event that the complaint proved to be unjustified. While there was some support for such a requirement, the prevailing view was that it would raise difficulties related to the time required to obtain a security and to the narrowing effect that it might have on the availability of the suspension.

245. The Working Group requested the Secretariat to re-draft article 41 in light of the above discussion.

\* \* \*

*Footnote for review provisions*

246. It was recalled that at the thirteenth session the Working Group had deferred a final decision on the treatment in the Model Law of the question of review proceedings. Having considered the articles on review again at the present session, the Working Group decided to retain those articles as a part of the Model Law that States might enact without change or with only such minimal changes as were necessary to meet particular important needs of the enacting State. However, in view of the fact that the provisions on review were more likely than other parts of the Model Law to affect constitutional and administrative systems in place in the enacting State, the Working Group considered that it would be necessary to indicate, by way of a footnote at the beginning of chapter IV, that an enacting State might not see fit to incorporate, to one degree or another, the provisions on review. The footnote would, at the same time, indicate that those provisions might nevertheless be used to measure the adequacy of review procedures available in the enacting State.

### III. Future work

247. At the conclusion of the Working Group's deliberations on the draft articles of the Model Law, the Working Group requested the Secretariat to revise the Model Law to take into account the decisions taken at the present session.

248. The Working Group discussed its future plan of work, in particular, the finalization of the draft Model Law for presentation to the Commission, and the possible func-

tions, structure, and schedule of preparation of the commentary. In regard to the preparation of the draft Model Law for presentation to the Commission, the Working Group noted the urgency of the need for the Model Law and expressed its intention of completing its preparation of the Model Law at the next session in order to be able to present the Model Law to the Commission at its twenty-sixth session.

249. As it had done at the previous session, the Working Group affirmed the importance of having a commentary to accompany the Model Law. As regards the nature of the commentary, the Working Group noted that the content of the commentary would differ depending upon its function. Three possible functions were identified, including guidance to legislatures considering enactment of the Model Law, practical guidance to procuring entities applying the Model Law, and, lastly, a guide to judicial interpretation of the Model Law. It was agreed that, at least at the initial stage, priority should be given to the preparation of a commentary aimed at giving guidance to legislatures, without precluding the possibility that at a later stage the decision would be made to prepare commentaries with other functions. As to the timing and method of preparation of the commentary, it was agreed that, although it may have been desirable for the legislative commentary to be reviewed by the Working Group at the time of its final review of the draft Model Law, completion of the Working Group's consideration of the Model Law should not be delayed until the preparation by the Secretariat of a draft commentary. At the same time, the Working Group decided that, upon the preparation of the draft commentary by the Secretariat, it would convene a small and informal ad hoc working party of the Working Group to review the draft commentary.

250. The Working Group noted that the fifteenth session, subject to approval by the Commission, would be held from 22 June to 2 July 1992 in New York.

## D. Working papers submitted to the Working Group on the New International Economic Order at its fourteenth session

### 1. Procurement: draft articles 1 to 35 of Model Law on Procurement: report of the Secretary-General (A/CN.9/WG.V/WP.30) [Original: English]

[Text reproduced in chapter III, B, 1, pp. 221 to 243.]

### 2. Procurement: draft articles 28 to 42 of Model Law on Procurement: note by the Secretariat (A/CN.9/WG.V/WP.33) [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 Working Group agreed that the commentary would not be revised until after the text of the Model Law had been settled and requested the Secretariat to revise the first draft of articles 1 through 35 to take account of the discussion and decisions at its eleventh session (A/CN.9/331, para. 222). At the twelfth session, the Working Group had before it the second draft of articles 1 through 35 (A/CN.9/WG.V/WP.28) as well as draft provisions on review of acts and decisions of, and procedures followed by, the procuring entity (draft articles 36 through 42, contained in A/CN.9/WG.V/WP.27). At that session, the Working Group reviewed the second draft of articles 1 through 27. At the thirteenth session, the Working Group reviewed the second draft of articles 28 to 35, and the provisions on review (article 36 to 42). It did not have sufficient time to again review draft articles 1 to 27, which had been revised to take account of the decisions at the twelfth session, and decided to consider those articles at its fourteenth session. It also requested the Secretariat to revise articles 28 to 42, taking into account the discussions and decisions at the thirteenth session (A/CN.9/356, para. 196).

3. At the fourteenth session, the Working Group will have before it the text of articles 1 to 27 as revised following the twelfth session (contained in document A/CN.9/WG.V/WP.30), as well as, in the present document, articles 28 to 42, revised to reflect the decisions taken at the thirteenth session. The present document also contains, in its annex, the text of several new provisions that have been added either as a result of decisions taken at the thirteenth session or at the initiative of the Secretariat. In addition, the annex contains a number of changes to the first portion of the Model Law (articles 1 to 27) that flow from the Working Group's decisions at the twelfth session with regard to articles 28 to 42. The Working Group may wish to consider the contents of that annex at appropriate points in its consideration of articles 1 to 27.

4. In revising articles 28 through 42, the Secretariat implemented all changes, additions and deletions agreed upon by the Working Group at its eleventh session. A limited number of proposals and suggestions with respect to which decisions were not taken at the thirteenth session, and which the Secretariat believes the Working Group may wish to consider further, have been incorporated within square brackets.

5. The draft articles contained in the present document set forth the provisions governing the use of the methods of procurement other than tendering available under the Model Law. Those methods have been included to accommodate the wide variety of circumstances and procurement needs that procuring entities might encounter. In agreeing to include three of those methods, namely, two-stage tendering, request for proposals and competitive negotiation, the Working Group recognized that in certain situations the conditions for use of those methods might present a degree of overlap. In order to deal with such situations of overlap, it was decided to include in article 7(2) an order of preference to be used in selecting a method of procurement when the circumstances fit the conditions for use of more than one of the methods of procurement other than tendering. However, it may be considered that the overlap in the conditions for use of those three methods results not only from the general character of the conditions for use of the three methods, but also from the fact that the exceptional types of procurement situations in question have been dealt with differently from country to country. In view of this diversity in practice, the Working Group may wish to consider further whether the Model Law as presently formulated would give adequate guidance as to the particular method of procurement to be used in procurement circumstances intended to be covered by the three methods in question.

6. The Working Group may also wish to consider whether it is desirable to recommend that each enacting State should incorporate each of the procurement methods in question. It might be considered preferable for the Model Law to provide enacting States that did not wish to incorporate the full array of methods of procurement other than tendering with the option of not incorporating certain of those methods. Such an approach would recognize the distinct character of the three methods, while recognizing that for certain types of procurement situations enacting States might differ as to their choice of procurement methods.

7. Throughout the present document, changes of and additions to wording that appeared in earlier drafts are underlined, except in the case of headings to articles, all of which are underlined as a matter of style. Deletions from earlier drafts are indicated in the notes following each article.

8. At the thirteenth session, the Secretariat was requested to prepare a note for the fourteenth session on the subject of suspension of procurement proceedings in response to claims seeking redress against the procuring entity for its conduct of procurement proceedings (A/CN.9/356, para. 190). That note is contained in document A/CN.9/WG.V/WP.34.

## CHAPTER II. TENDERING PROCEEDINGS

## Section VII. Opening, examination, evaluation and comparison of tenders

## Article 27. Opening of tenders

[For the text of articles 1 to 27, including sections I to VI of chapter II, see A/CN.9/WG.V/WP.30.]

\* \* \*

## Article 28. Examination, evaluation and comparison of tenders

(1) (a) The procuring entity may ask contractors and suppliers for clarifications of their tenders in order to assist in the examination, evaluation and comparison of tenders.<sup>1</sup> *No change in a matter of substance in the tender, including changes in price and changes aimed at making an unresponsive tender responsive, shall be sought, offered or permitted.*<sup>2</sup>

[(b) Notwithstanding subparagraph (a), the procuring entity shall correct purely arithmetical errors apparent on the face of a tender.]<sup>3</sup>

(2) The procuring entity shall reject a tender:<sup>4</sup>

(a) if the contractor or supplier that submitted the tender is not qualified, subject to article 8(3);

(b) if the contractor or supplier that 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.

(d) [deleted]<sup>5</sup>

(3) [incorporated in article 10 quater]<sup>6</sup>

(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. *Any such deviations shall be quantified, to the extent possible,*<sup>7</sup> and appropriately taken account of in the evaluation and comparison of tenders.

(5) [deleted]<sup>8</sup>

(6) [deleted]<sup>9</sup>

(7) (a) The procuring entity shall evaluate and compare the tenders that have not been rejected pursuant to paragraph (2) or to article 10 quater in order to ascertain the successful tender,<sup>10</sup> as defined in subparagraph (c), 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.

(b) [deleted]<sup>11</sup>

(c) The successful tender shall be:<sup>12</sup>

(i) the tender with the lowest tender price, subject to any margin of preference applied pursuant to subparagraph (e); or

(ii) if the procuring entity has so stipulated in the solicitation documents, the lowest evaluated tender ascertained on the basis of factors specified in the solicitation documents, which factors shall, to the extent practicable, be objective and quantifiable, and shall be given a relative weight in the evaluation procedure or be expressed in monetary terms wherever practicable.<sup>13</sup>

(d) In determining the lowest evaluated tender in accordance with subparagraph (c)(ii), the procuring entity may consider only the following:

(i) the tender price, subject to any margin of preference applied pursuant to subparagraph (e);

(ii) the cost of operating, maintaining and repairing the goods or construction, the time for delivery of the goods or completion of construction, the functional characteristics of the goods or construction, the terms of payment and of guarantees in respect of the goods or construction;

(iii) the balance of payments position or foreign exchange reserves of [this State], countertrade arrangements, local content, including manufacture, labour and materials, economic development, encouragement of domestic investment or activity, encouragement of employment equity, reservation of certain production for domestic suppliers, transfer of technology and the development of managerial, scientific and operational skills [ . . . (the enacting State may expand subparagraph (iii) by including additional factors)]<sup>14</sup> and

(iv) national defence and security considerations.<sup>14</sup>

(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 calculated in accordance with the procurement regulations.*<sup>15</sup>

(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.

(8 bis) *Whether or not it has engaged in prequalification proceedings pursuant to article 8 bis, the procuring entity may require the contractor or supplier submitting the tender that has been found to be the successful 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.*<sup>16</sup>

(8 ter) *If the contractor or supplier submitting the successful tender is requested to reconfirm its qualifications in accordance with paragraph (8 bis), but fails to do so, the*

*procuring entity shall reject that tender and shall select a successful tender, in accordance with paragraph (7), from among the remaining tenders, subject to the right of the procuring entity, in accordance with article 29(1), to reject all remaining tenders.*<sup>17</sup>

(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 involved officially in the examination, evaluation or comparison of tenders or in the decision of which tender should be accepted, except as provided in article 10 *ter*.<sup>18</sup>

(10) [deleted]

<sup>17</sup>The formal requirements formerly set forth in the second and third sentences have been incorporated in article 10 *bis* (see note 1 under that article).

<sup>18</sup>See A/CN.9/356, para. 15.

<sup>19</sup>Square brackets around subparagraph (b) have been retained in accordance with the decision in A/CN.9/356, para. 16, to defer a final decision on the subparagraph pending further consideration of other articles of the Model Law.

<sup>20</sup>At the thirteenth session, the question was raised whether the use of the words "shall reject a tender" implied a duty on the part of the procuring entity to take some formal action of rejection (see A/CN.9/343, para. 17). It was suggested that if the intent of the provision was not to impose such a duty, words such as "shall not accept a tender" might be more appropriate. It was also recognized that the question of whether to require a formal act of rejection should be considered in the context of the discussion of the draft articles on review, something which the Working Group did not have an opportunity to do at the thirteenth session during its consideration of the articles on review.

<sup>21</sup>See A/CN.9/356, para. 18.

<sup>22</sup>See note 1 under article 10 *quater*.

<sup>23</sup>See A/CN.9/356, para. 21.

<sup>24</sup>See A/CN.9/331, para. 159.

<sup>25</sup>See A/CN.9/331, para. 164.

<sup>26</sup>Pursuant to A/CN.9/356, paras. 22 and 27, the term "successful tender" provisionally replaces the term "most economic tender".

<sup>27</sup>See A/CN.9/331, para. 167.

<sup>28</sup>Subparagraphs (c) and (d) have been reformulated pursuant to A/CN.9/356, paras. 25 to 35.

<sup>29</sup>See A/CN.9/356, para. 31; see also article 17(2)(e *bis*), and its accompanying note (set forth in the annex to the present document), with regard to the decision of the Working Group in A/CN.9/356, para. 31, that the solicitation documents should indicate the manner of quantification of non-price factors. The Working Group may wish to consider the use of the term "most favourable tender" in place of the term "lowest evaluated tender".

<sup>30</sup>See A/CN.9/356, para. 34.

<sup>31</sup>Pursuant to A/CN.9/356, para. 25, the second sentence, which dealt with detailed aspects of the application of a margin of preference, has been deleted and replaced by the reference to the procurement regulations. The Working Group may wish to consider further the desirability of this modification in view of the potential impact of margins of preference on tendering proceedings and in light of the fact that the issuance of procurement regulations is optional under article 4.

<sup>32</sup>In accordance with A/CN.9/356, para. 38, paragraph (8 *bis*) has been reformulated to leave to the discretion of the procuring entity reconfirmation of qualifications when prequalification proceedings have been engaged in.

<sup>33</sup>Paragraph (8 *ter*) has been added to implement the decision of the Working Group in A/CN.9/356, para. 39, that the Model Law should indicate how the procuring entity should proceed when the contractor or supplier submitting the successful tender fails to reconfirm its qualifications.

<sup>34</sup>At the thirteenth session it was suggested that there was an apparent inconsistency between paragraph (9), which restricted the disclosure of information concerning examination, clarification, evaluation and com-

parison of tenders, and article 33(2), concerning public disclosure of the record of the procurement proceedings, as the latter provision was formulated in A/CN.9/WG.V/WP.30 (see A/CN.9/356, para. 41). It was decided to defer a final decision on paragraph (9) until consideration by the Working Group of article 33(2). In view of the decision of the Working Group in A/CN.9/356, para. 80, to limit disclosure of such information as contained in the record, it would appear that the apparent inconsistency between paragraph (9) and article 33(2) has been alleviated. (The substance of article 33(2) has been moved to article 10 *ter*, a consolidated provision on records requirements for all procurement proceedings in accordance with A/CN.9/356, para. 77.)

\* \* \*

## Article 29. *Rejection of all tenders*

(1) *(Subject to approval by . . . (each State designates an organ to issue the approval), and) if so specified in the solicitation documents, the procuring entity may reject all tenders at any time prior to the acceptance of a tender, or after a contractor or supplier submitting a successful tender fails to reconfirm its qualifications when requested to do so in accordance with article 28(8 bis).<sup>1</sup> 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 is not required to justify those grounds.*<sup>2</sup>

(1 *bis*) [deleted]<sup>3</sup>

(2) The procuring entity shall incur no liability, solely by virtue of its invoking paragraph (1), towards contractors and suppliers that have submitted tenders.

(3) Notice of the rejection of all tenders shall be given promptly to all contractors and suppliers that submitted tenders.<sup>4</sup>

<sup>1</sup>See A/CN.9/356, para. 42. The reference to impermissible grounds for rejection of all tenders has been deleted pursuant to A/CN.9/356, para. 46.

<sup>2</sup>The preceding sentence, which formerly appeared in paragraph (2), has been moved to paragraph (1) for the purposes of clarity.

<sup>3</sup>See A/CN.9/356, para. 46.

<sup>4</sup>The formal requirements for the notice, formerly set forth in paragraph (3), to have been incorporated in article 10 *bis* (for the text of the article, see the annex to the present document).

\* \* \*

## 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.<sup>1</sup>

<sup>1</sup>The references to articles 29(1 *bis*) and 31(4) have been deleted in accordance with A/CN.9/356, para. 52.

\* \* \*

## Section VIII. [moved to chapter III, section I]<sup>1</sup>

### Article 31. [moved to articles new 33 *bis* and 33 *bis*]<sup>1</sup>

<sup>1</sup>In accordance with A/CN.9/343, para. 80, the provisions on two-stage tendering proceedings have been moved to section I of chapter III.

\* \* \*

## Section IX. Acceptance of tender and entry into force of procurement contract<sup>1</sup>

<sup>1</sup>The reference in the title of section IX to the record of the tendering proceedings has been deleted consequent to the addition to chapter I of article 10 *ter*, containing a consolidated provision on record requirements for all procurement proceedings available under the Model Law (for the text of the article, see the annex to the present document).

\* \* \*

### Article 32. Acceptance of tender and entry into force of procurement contract

(1) Subject to articles 28(8 *ter*) and 29,<sup>1</sup> the tender that has been ascertained to be the *successful* tender pursuant to article 28(7)(c) shall be accepted. Notice of acceptance of the tender shall be given promptly to the contractor or supplier submitting the tender.<sup>2</sup>

(2) (Except as provided in paragraphs (3)(b) and (3 bis),)<sup>3</sup> 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.

[(3) (a) (Notwithstanding the provisions of paragraph (2), the *solicitation documents* may require the contractor or supplier whose tender has been accepted to sign a written procurement contract conforming to the tender. In such cases,)<sup>4</sup> the procuring entity<sup>5</sup> and the contractor or supplier shall sign the procurement contract within a reasonable period of time after the notice referred to in paragraph (1) is dispatched to the contractor or supplier.<sup>6</sup>

(b) (Where a written procurement contract is required to be signed pursuant to paragraph (3)(a),)<sup>4</sup> subject to paragraph (3 bis), 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, neither the procuring entity nor the contractor or supplier shall take any action which interferes with the entry into force of the procurement contract or with its performance.<sup>7</sup>

(3 bis) *Where the procurement contract is required to be approved by a higher authority or the Government, the decision on whether to grant the approval shall be made within a reasonable time after the notice referred to in paragraph (1) is dispatched to the contractor or supplier. The procurement contract shall not enter into force or, as the case may be, be executed before the approval is given.*<sup>8</sup>

(3 *ter*) *(Where an approval referred to in paragraph (3 bis) is required, the) solicitation documents shall specify the amount of time following the dispatch of the notice of acceptance of the tender that will be required to obtain the approval. A failure to obtain the approval within the time specified in the solicitation documents shall not extend the period of effectiveness of tenders specified in the solicitation documents pursuant to article 25(1) or the period of effectiveness of tender securities that may be required pursuant to article 26(1).*<sup>9</sup>

(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 procuring entity shall select a successful tender, in accordance with article 28(7), from among the remaining tenders that are in force, subject to the right of the procuring entity, in accordance with article 29(1), to reject all remaining tenders.* The notice provided for in paragraph (1) shall be given to the contractor or supplier that submitted that tender.<sup>10</sup>

(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) [incorporated in article 10 bis]<sup>11</sup>

(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).

<sup>1</sup>See A/CN.9/356, para. 60.

<sup>2</sup>In accordance with A/CN.9/356, para. 61, and by way of the reference to articles 28(8 *ter*) and 29, reference is made to the obligation of the procuring entity to select a successful tender in accordance with article 28(7)(c) from among the tenders remaining when the contractor or supplier submitting the first selected tender fails to meet a request to reconfirm its qualifications, subject to the right of the procuring entity under article 29(1) to reject all the remaining tenders.

<sup>3</sup>The reference to paragraph (3 bis) has been added as a result of the inclusion, pursuant to A/CN.9/356, paras. 68 and 69, of the additional exception contained in that paragraph to the entry-into-force rule set forth in paragraph (2) (see note 9). The present formulation of paragraphs (2) and (3) reflects the decision at the thirteenth session as to the manner in which the Model Law should accommodate the two basic ways in which procurement contracts enter into force, i.e., upon dispatch of the notice of acceptance and upon signature of a procurement contract (see A/CN.9/356, paras. 62-65). However, the opening words of paragraph (2) have been placed within parentheses in order to invite the Working Group to consider whether the Model Law should further indicate that those words, as well as the entirety of paragraph 3 would not have to be incorporated by those enacting States that wished to provide for entry into force of the procurement contract solely upon dispatch of the notice of acceptance. Such an approach would be in line with the decision that the Model Law should provide for both methods of entry into force, without suggesting that each enacting State had to incorporate both methods.

<sup>4</sup>The preceding text has been placed within parentheses in order to invite the Working Group to consider whether the Model Law should indicate that that text, as well as the entirety of paragraph 2, would not be incorporated by those enacting States that wished to provide for entry into force of the procurement contract solely upon the signature of a contract (see also note 4).

<sup>5</sup>The Working Group may wish to consider whether the present reference to the procuring entity as the signatory of the procurement contract should be accompanied by an alternative formulation to be used by enacting States in which the procurement contract is typically not signed by the governmental entity, such as a central tendering board, that conducts the procurement proceedings for all government ministries, but is signed by the particular governmental ministry in whose behalf those proceedings are conducted. Under such an approach, the words "[requesting ministry]" might be added at this and other relevant parts of article 32, following, and as an alternative to, the words "procuring entity".

<sup>6</sup>In accordance with A/CN.9/356, para. 65, subparagraph (a) refers to the solicitation documents, rather than to the notice of acceptance of the tender, as the source of the requirement of a signed procurement contract, and the reference to the applicable law has been deleted.

<sup>7</sup>In accordance with A/CN.9/356, para. 72, the statement of the rule governing the conduct of the procuring entity and of the contractor and supplier has been modified to revert to the earlier version, contained in A/CN.9/WG.V/WP.24. The reference to paragraph (3 *bis*) has been added pursuant to A/CN.9/356, para. 72.

<sup>8</sup>Paragraph (3 *bis*) has been added pursuant to the decision in A/CN.9/356, para. 68, to accommodate the practice in some States which requires the procuring entity, after notifying acceptance of a tender, to obtain a final approval of the procurement contract as a condition for entry into force of that contract. The new provision has not been added to paragraph (3), as suggested in A/CN.9/356, para. 68, since such final approval requirements may be applicable to entry-into-force procedures covered both by paragraphs (2) and (3). It is suggested that the Model Law indicate that the incorporation of paragraph (3 *bis*), as well as of the reference to paragraph (3 *bis*) found in paragraph (3)(b), would be optional, in order to accommodate those enacting States in which it was not the practice to require such final approvals. As the second sentence in the form agreed upon by the Working Group envisages both methods of entry into force provided for under article 32, that sentence would have to be adjusted in those enacting States that uniformly required the signature of a procurement contract as well as in those that uniformly did not. It may be noted that the text agreed upon by the Working Group does not provide for final approval requirements after the signature of a procurement contract.

<sup>9</sup>Paragraph (3 *ter*) has been added pursuant to A/CN.9/356, para. 69. The portion of the text within parentheses at the beginning of the paragraph would not have to be incorporated by States that applied a final approval requirement uniformly. Similarly, it could be indicated that the entirety of the paragraph would not be incorporated by States that uniformly did not apply such a requirement.

<sup>10</sup>See A/CN.9/356, para. 73.

<sup>11</sup>See note 1 under article 10 *bis* (see annex to present document).

\* \* \*

### Article 33. *Record of tendering proceedings* [incorporated in article 10 *ter*]<sup>1</sup>

<sup>1</sup>See A/CN.9/356, para. 77, as well as article 10 *ter*, and its accompanying note, in the annex to the present document.

\* \* \*

## CHAPTER III. PROCUREMENT OTHER THAN BY MEANS OF TENDERING PROCEEDINGS

### Section 1. *Two-stage-tendering proceedings*<sup>1</sup>

#### New article 33 *bis*. *Conditions for use of two-stage tendering*<sup>1</sup>

(Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may employ the procedures provided for in this article where:

(a) instead of formulating detailed specifications for the goods or construction, the procuring entity seeks proposals from contractors and suppliers as to those specifications in order to obtain the most advanced or the most appropriate technology or otherwise to obtain the most satisfactory solution to its procurement needs; or

(b) due to the nature of the goods or construction, the procuring entity is unable to formulate detailed technical specifications.<sup>2</sup>

<sup>1</sup>Pursuant to A/CN.9/356, para. 59, the conditions for use of two-stage tendering (formerly scheduled to appear in article 33 *bis*(1)), and the pro-

visions dealing with procedures, have been set forth in separate articles. The title of article 33 *bis* has been modified accordingly.

<sup>2</sup>The Working Group may wish to consider deletion of the foregoing provision as it would appear to be adequately covered by subparagraph (a).

\* \* \*

### Article 33 *bis*. *Procedures for two-stage-tendering proceedings*<sup>1</sup>

(1) [moved to new article 33 *bis*]<sup>1</sup>

(2) The provisions of chapter II of this Law shall apply to two-stage-tendering proceedings except to the extent those provisions are derogated from in the present section.

(3) The solicitation documents<sup>2</sup> shall call upon contractors and suppliers to submit, in the first stage of the two-stage-tendering proceedings,<sup>3</sup> 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 or construction as well as to contractual terms and conditions of their supply.

(4) The procuring entity may engage in negotiations with any contractor or supplier whose tender has not been rejected pursuant to articles 10 *quater*, 28(2), or 29 concerning any aspect of its tender.

(5) In the second stage of the two-stage-tendering proceedings,<sup>3</sup> 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 or construction to be procured, and any criterion set forth in those documents for evaluating and comparing tenders and for ascertaining the successful 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. A contractor or supplier not wishing to submit a final tender may withdraw from the tendering proceedings without forfeiting any tender security that the contractor or supplier may have been required to provide.<sup>4</sup> The final tenders shall be evaluated and compared in order to ascertain the successful tender as defined in article 28(7)(c).

(6) [deleted]<sup>5</sup>

<sup>1</sup>See note 1 under new article 33 *bis*.

<sup>2</sup>The reference to articles 17 and 20 in regard to the preparation of the solicitation documents has been deleted as the point appeared to be adequately covered by paragraph (2).

<sup>3</sup>Added at the initiative of the Secretariat for the purposes of clarity.

<sup>4</sup>See A/CN.9/356, para. 55.

<sup>5</sup>Paragraph 6, which referred to the requirement in article 7(5) that the record of the procurement proceedings should contain a statement of the circumstances on which the procuring entity relied in invoking new article 33 *bis*, has been deleted in view of the mention in article 10 *ter* (1)(g) of the article 7(5) requirement.

\* \* \*

## Section II. Request-for-proposals proceedings

### Article 33 *ter*. Conditions for use of request for proposals<sup>1</sup>

(1) (Subject to approval by . . . (each State designates an organ to issue the approval)) a procuring entity may engage in procurement by means of requests for proposals, which shall be addressed to as many contractors or suppliers as practicable, but to at least three, if possible, provided that the following conditions are satisfied:<sup>2</sup>

(a) the procuring entity has been unable to fully decide upon the particular nature or specifications of the goods or construction to be procured and seeks proposals as to various possible means of meeting its needs;<sup>3</sup>

(b) the selection of the successful contractor or supplier is to be based on both the effectiveness of the proposal and on the price of the proposal;<sup>4</sup> and

(c) the procuring entity has established the factors for evaluating the proposals and has determined the relative weight to be accorded to each such factor and the manner in which they are to be applied in the evaluation of the proposals.<sup>4</sup>

(2) The procuring entity shall publish in a widely circulated trade journal a notice seeking expression of interest in submitting a proposal, unless for reasons of economy or efficiency the procuring entity considers it undesirable to publish such a notice; the publication of the notice shall not confer any rights on contractors or suppliers, including any right to have a proposal evaluated.<sup>5</sup>

<sup>1</sup>At the thirteenth session, the Working Group agreed to replace the provisions on request-for-proposals proceedings set forth in articles 33 *ter* to 33 *sexies* in A/CN.9/WG.V/WP.30 by the proposed text set forth in A/CN.9/356, para. 82, as modified in A/CN.9/356, paras. 85 to 105. In line with A/CN.9/356, para. 59, the procedures for request-for-proposals proceedings, contained in paragraphs (2) to (7) of the text agreed upon by the Working Group, have been set forth in paragraphs (1) to (6) of a separate provision, article 33 *quater*. The titles of articles 33 *ter* and 33 *quater* have been modified accordingly.

<sup>2</sup>See A/CN.9/356, para. 85. The Working Group may wish to consider, for the purposes of achieving a clear distinction between the provisions on conditions for use of request-for-proposals proceedings and the provisions setting forth the procedures to be followed in such proceedings, to move to article 33 *quater* the reference in the *chapeau* to the circulation of the request for proposals, as well as subparagraphs (b) and (c), and paragraph (2), since all of those provisions deal with procedures to be followed when the procuring entity engages in request-for-proposals proceedings.

<sup>3</sup>See A/CN.9/356, para. 89.

<sup>4</sup>See A/CN.9/356, para. 90, as well as note 2, concerning the appropriateness of retaining subparagraphs (b) and (c) in their current position.

<sup>5</sup>See A/CN.9/356, paras. 87 and 88.

\* \* \*

### Article 33 *quater*. Procedures for request-for-proposals proceedings<sup>1</sup>

(1) The factors referred to in article 33 *ter* (1)(c) shall concern:<sup>2</sup>

(a) the relative managerial and technical competence of the contractor or supplier;<sup>3</sup>

(b) the effectiveness of the proposal submitted by the contractor or supplier; and

(c) the price submitted by the contractor or supplier for carrying out its proposal and the cost of operating, maintaining and repairing the proposed goods or construction.

(2) A request for proposals issued by a procuring entity shall include at least the following information:

(a) the name and address of the procuring entity;

(b) a description of the procurement need including the technical and other parameters to which the proposal must conform, as well as the location of any construction to be effected;

(c) the factors for evaluating the proposal, expressed in monetary terms to the extent practicable, the relative weight to be given to each such factor, and the manner in which they will be applied in the evaluation of the proposal; and

(d) the desired format and any instructions, including any relevant time-frames, applicable in respect of the proposal.

(3) Any modification or clarification of the request for proposals shall be communicated to all contractors and suppliers participating in the request-for-proposals proceedings.<sup>4</sup>

(4) The procuring entity shall open all proposals in such a manner as to avoid the disclosure of their contents to competing contractors and suppliers.<sup>5</sup>

(5) The procuring entity may engage in negotiations with contractors or suppliers with respect to their proposals and may seek or permit revisions of such proposals, provided that the following conditions are satisfied:

(a) any negotiations between the procuring entity and a contractor or supplier shall be confidential;

(b) subject to article 10 *ter*, one party to the negotiations shall not reveal to any other person any technical, price or other market information relating to the negotiations without the consent of the other party;

(c) the opportunity to participate in negotiations is extended to all contractors and suppliers that have submitted proposals and whose proposals have not been rejected; and

(d) any modification of the evaluation criteria set forth in the request for proposals following the commencement of negotiations is carried out in a way that preserves the confidentiality of the negotiations.<sup>6</sup>

(6) Following completion of negotiations, the procuring entity shall request all contractors or suppliers remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals.<sup>7</sup>

(7) The procuring entity shall employ the following procedures in the evaluation of proposals:

(a) only the factors referred to in paragraph (1) and set forth in the request for proposals and in any modification thereof shall be considered;<sup>8</sup>

(b) the effectiveness of a proposal in meeting the needs of the procuring entity shall be evaluated separately from the price;<sup>9</sup>

(c) *the price of a proposal shall only be considered by the procuring entity after completion of the technical evaluation;*<sup>9</sup>

(d) *the procuring entity may refuse to evaluate proposals submitted by contractors or suppliers it considers unreliable or incompetent.*<sup>10</sup>

<sup>9</sup>See note 1 under article 33 *ter*.

<sup>10</sup>See A/CN.9/356, para. 93.

<sup>11</sup>See A/CN.9/356, para. 94.

<sup>12</sup>In its discussion of paragraph (5), the Working Group agreed that the procuring entity should be permitted to modify the evaluation criteria set forth in the request for proposals, provided that any such modification would be communicated to all participating contractors and suppliers (see A/CN.9/356, para. 102), and that a provision to that effect should be included in paragraph (5). Paragraph (3) has been added in order to reflect that decision, but it does so in a general manner, so as to cover not only modifications of the evaluation criteria, but also modifications of any of the information set forth in the request for proposals.

<sup>13</sup>The Working Group may wish to consider limiting paragraph (4) to prohibiting the disclosure of the contents of proposals to competing contractors and suppliers. In its present form, the provision might suggest that proposals are to be opened publicly, a procedure which there may not be any particular reason to follow in request-for-proposals proceedings.

<sup>14</sup>Subparagraph (d) has been added to reflect the decision in A/CN.9/356, para. 102, that modifications of evaluation criteria carried out after commencement of negotiations should not compromise the confidentiality of negotiations. The Working Group may wish to consider the desirability of retaining such a provision, which may be difficult to interpret and apply. It might be considered that the concern addressed in subparagraph (d) is sufficiently met in subparagraphs (a) and (b).

<sup>15</sup>See A/CN.9/356, para. 104.

<sup>16</sup>See A/CN.9/356, para. 105.

<sup>17</sup>The Working Group may wish to consider whether it is unnecessarily restrictive for the Model Law to require that the evaluation of proposals should be carried out using the procedures set forth in subparagraphs (b) and (c) since alternative methods appear to exist in practice. Accordingly, the issues raised in these subparagraphs might be more appropriately left to the procurement regulations.

<sup>18</sup>Subparagraph (d) has been added to reflect the decision in A/CN.9/356, para. 94, that the Model Law should authorize the procuring entity to exclude contractors or suppliers deemed unreliable or incompetent.

\* \* \*

#### Articles 33 *quinquies* and *sexies*. [deleted]<sup>1</sup>

<sup>1</sup>See note 1 under article 33 *ter*.

\* \* \*

### Section III. Competitive-negotiation proceedings

#### New article 34. *Conditions for use of competitive negotiation*<sup>1</sup>

(Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may engage in procurement by means of competitive negotiation in the following circumstances:

(a) when, due to the *special nature or particularly complex technical character, or scope or volume of goods or construction to be procured*, it is necessary to negotiate with contractors or suppliers in order to enable the procuring entity to obtain the solution which represents the best value;<sup>2</sup>

(b) when there is an urgent need for the goods or construction and engaging in tendering proceedings would

therefore be impossible or imprudent, *provided that the circumstances giving rise to the urgency were not foreseeable by, or a result of dilatory conduct on the part of, the procuring entity;*<sup>3</sup>

(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 in quantities sufficient to establish their commercial viability or to recover research and development costs;

(d) *when the procuring entity applies this Law, pursuant to article 1(2), to procurement involving national defence or national security and determines that competitive negotiation is the most appropriate method of procurement;*<sup>4</sup> or

(e) when tendering proceedings have been engaged in but no tenders were submitted or all tenders were rejected by the procuring entity pursuant to articles 10 *quater*, 28(2) or 29, and when engaging in new tendering proceedings would be unlikely to result in a procurement contract;<sup>5</sup>

(f) [deleted]<sup>6</sup>

<sup>1</sup>Pursuant to the request in A/CN.9/356, para. 59, the conditions for use of competitive negotiation and the provisions dealing with procedures have been set forth in separate articles.

<sup>2</sup>See A/CN.9/356, para. 110.

<sup>3</sup>See A/CN.9/356, para. 111. The Working Group may wish to consider further the desirability of including such a limitation on the availability of urgency as a condition for use of competitive negotiation. It might be considered that the limitation, while effective in restricting resort to competitive negotiation through negligence or intentional circumvention of tendering requirements on the part of the procuring entity, could itself result in serious detriment to the public interest by delaying urgently needed procurement. A review of a similar restriction with respect to urgency as a condition for use of single source procurement might also be considered (see article 35 (new 1)(c)).

<sup>4</sup>See A/CN.9/356, para. 114.

<sup>5</sup>The reference to article 10 *quater* replaces the reference to article 28(3) in view of the incorporation of the latter provision in article 10 *quater*. As to whether any changes to subparagraph (e) are necessary to reflect the right of the procuring entity to reject all tenders when a selected contractor or supplier fails to reconfirm its qualifications, it would appear that the point is adequately covered by the reference to article 29, particularly in view of the reformulation of paragraph (1) of article 29.

<sup>6</sup>See A/CN.9/356, paras. 116 and 117.

\* \* \*

#### Article 34. *Procedures for competitive negotiation*<sup>1</sup>

(1) In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of contractors and suppliers to ensure effective competition.

(2) Any requirements, guidelines, documents, *clarifications* 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.<sup>2</sup>

(3) Negotiations between the procuring entity and a contractor or supplier shall be confidential, and, except as provided in article 10 *ter*, one party to those negotiations shall not reveal to any other person any *technical, price or other*

market information relating to the negotiations without the consent of the other party.<sup>3</sup>

(3 bis) Following completion of negotiations, the procuring entity may request all contractors or suppliers remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals.<sup>4</sup>

(4) [incorporated in article 10 *ter*].<sup>5</sup>

<sup>3</sup>The title of article 34 has been modified to reflect the presentation of the conditions for use and procedures for competitive negotiation in separate articles (see note 1 under new article 34).

<sup>4</sup>See A/CN.9/356, para. 119.

<sup>5</sup>The reference to paragraph (4) has been replaced by the reference to article 10 *ter*, which contains a consolidated provision on record requirements for procurement proceedings. Concerning the other modifications, see A/CN.9/356, paras. 120-122.

<sup>6</sup>Paragraph (3 bis) has been added pursuant to A/CN.9/356, para. 118. The Working Group may wish to consider further the desirability or necessity of including paragraph (3 bis) in view of its discretionary nature and of the aim of this method of procurement to give the procuring entity a generally unrestricted power to negotiate. Reference to such a procedure might be left to the procurement regulations.

<sup>7</sup>Paragraph (4) has been incorporated in article 10 *ter* (see note 1 under that article).

\* \* \*

#### Section IV. Request-for-quotations proceedings

New article 34 *bis*. *Conditions for use of request for quotations*<sup>1</sup>

(1) (Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may engage in procurement by means of a request for quotations for the procurement of standardized goods that are readily available and for which there is an established market, provided that the estimated value of the procurement contract is less than the amount set forth in the procurement regulations.<sup>2</sup>

(2) The procuring entity shall not divide its procurement into separate contracts for the purpose of invoking paragraph (1).

<sup>1</sup>Pursuant to A/CN.9/356, para. 59, the conditions for use of request for quotations (formerly appearing in article 34 *bis* (1) and (2)), and the provisions dealing with procedures, have been set forth in separate articles. The title of article 34 *bis* has been modified accordingly.

<sup>2</sup>See A/CN.9/356, para. 124.

\* \* \*

Article 34 *bis*. *Procedures for request for quotations*

(1) [moved to new article 34 *bis*]<sup>1</sup>

(2) [moved to new article 34 *bis*]<sup>1</sup>

(3) The procuring entity shall request quotations from as many contractors or suppliers as practicable, but from at least three, if possible.<sup>2</sup> Each contractor or supplier from whom a quotation is requested shall be informed whether any elements other than the cost of the goods themselves, such as transportation and insurance, are to be included in the price.<sup>3</sup>

(3 bis) Each contractor or supplier is permitted to give only one price quotation and is not permitted to change its quotation. No negotiations shall take place between the procuring entity and a contractor or supplier with respect to a quotation submitted by the contractor or supplier.<sup>4</sup>

(4) The procurement contract shall be awarded to the contractor or supplier that gave the lowest priced responsive quotation and is considered reliable by the procuring entity.<sup>5</sup>

(5) [incorporated in article 10 *ter*]<sup>6</sup>

<sup>1</sup>See note 1 under new article 34 *bis*.

<sup>2</sup>See A/CN.9/356, para. 128.

<sup>3</sup>At the thirteenth session the question was raised whether the reference to price included elements other than the cost of the goods themselves, such as transportation and insurance charges (see A/CN.9/356, para. 132). It was also suggested that, if the composition of the price was also an issue relevant to other methods of procurement, consideration might be given to including a definition of "price" in article 2. It would appear that the inclusion of such a definition would be of limited value since the components of the price would vary from case to case. However, it would seem that the objectives of the Model Law would be furthered by requiring the procuring entity, at least in procurement proceedings that do not involve negotiation, to inform participating contractors and suppliers beforehand of the elements to be covered by the price that they quote. Such a requirement has therefore been added to paragraph (3). In this vein, the Working Group may wish to consider whether the composition of the price should be expressly mentioned in article 17(2)(i) (see the annex to the present document, under article 17(2)(i)).

<sup>4</sup>The contents of paragraph (3 bis), which were formerly a part of paragraph (3), have been moved to a separate paragraph for the purposes of clarity.

<sup>5</sup>See A/CN.9/356, paras. 130 and 131.

<sup>6</sup>Paragraph (5) has been incorporated into article 10 *ter*, which contains a consolidated provision on record requirements for all procurement proceedings under the Model Law (for the text of the article, see the annex to the present document).

\* \* \*

#### Section V. Single source procurement

Article 35. *Single source procurement*<sup>1</sup>

(new 1) (Subject to approval by . . . (each State designates an organ to issue the approval),) the procuring entity may procure the goods or construction by soliciting a proposal or price quotation from a single contractor or supplier when:

(a) [deleted];<sup>2</sup>

(b) the goods or construction are available only from a particular contractor or supplier, or a particular contractor or supplier has exclusive rights in respect of the goods or construction, and no reasonable alternative or substitute exists;

(c) due to a catastrophic event, there is an urgent need for the goods or construction, making it impossible or imprudent to use other methods of procurement because of the amount of time involved in using those methods, provided that the condition resulting in the urgency was unforeseeable and unavoidable and was not due to the dilatory conduct of the procuring entity;<sup>3</sup>

(d) for reasons of standardization, or the need for compatibility with existing goods, equipment or technology, the

procuring entity, taking into account the effectiveness of the original procurement in meeting the needs of the procuring entity, the size of the proposed procurement in relation to the original procurement, the reasonableness of the price and the suitability of alternatives to the goods in question, determines that additional supplies must be procured from the contractor or supplier that supplied the existing goods, equipment or technology;<sup>4</sup>

(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;<sup>5</sup>

(f) the procuring entity applies this law, pursuant to article 1(2), to procurement involving national defence or national security and determines that single source procurement is the most appropriate method of procurement;<sup>6</sup>

(g) procurement from a particular contractor or supplier is necessary in order to promote a policy specified in article 28(7)(d)(iii) and approval is obtained following public notice and adequate opportunity to comment, provided that procurement from no other contractor or supplier is capable of promoting that policy;<sup>7</sup>

(h) [deleted];<sup>8</sup>

(i) [deleted].<sup>9</sup>

(new 1 bis) [deleted]<sup>10</sup>

(1) [deleted]<sup>11</sup>

(2) [deleted]<sup>11</sup>

<sup>4</sup>See A/CN.9/356, para. 134.

<sup>5</sup>Subparagraph (a), which authorized resort to single source procurement for low-value procurement, has been deleted pursuant to A/CN.9/356, para. 136.

<sup>6</sup>See A/CN.9/356, para. 138. See also note 3 under new article 34.

<sup>7</sup>See A/CN.9/356, para. 139.

<sup>8</sup>The Working Group may wish to note that the analogous provision in subparagraph (c) of new article 34 makes reference to development of prototypes, while the present provision does not.

<sup>9</sup>See A/CN.9/356, para. 141.

<sup>10</sup>See A/CN.9/356, paras. 142 and 143.

<sup>11</sup>See A/CN.9/356, para. 144.

<sup>12</sup>See A/CN.9/356, para. 145.

<sup>13</sup>See A/CN.9/356, para. 146.

<sup>14</sup>Paragraphs (1) and (2) have been incorporated in article 10 *ter*, which contains a consolidated provision concerning record requirements for procurement proceedings under the Model Law (for the text of the article, see the annex to the present document).

\* \* \*

## CHAPTER IV. REVIEW

### Article 36. Right to review

Any contractor or supplier<sup>1</sup> that has an interest in obtaining a procurement contract resulting or anticipated to result from procurement proceedings covered by this Law and that claims to suffer, to risk suffering or to have suffered loss<sup>2</sup> due to an act or decision of, or procedure fol-

lowed by, the procuring entity, that is in breach of a duty imposed by

[Variant 1]<sup>3</sup>

this law

[Variant 2]

article 8(2), (2 bis), (3), article 8 bis (2), (3), (3 bis), (3 ter), (4) and (5), article 10, article 10 bis, article 10 ter (1) and (2), article 10 quater, article 11(1), article 12 (1), (1 bis), and (2)(a), article 14, article 17, article 19, article 20, article 22, article 24, article 25(2)(a), article 27, article 28, article 29(2) and (3), article 30, article 32(1), (3), (3 ter), and (4), article 33 bis (5), 33 ter (1) and (2), 33 quater (2), (3), (4), (5), (6) and (7), article 34(1), (2), and (3), and article 34 bis (3) and (4)<sup>4</sup>

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.

<sup>3</sup>See A/CN.9/356, para. 151.

<sup>4</sup>See A/CN.9/356, para. 156.

<sup>5</sup>Pursuant to A/CN.9/356, paras. 154 and 158, article 36 has been reformulated to reflect the decision of the Working Group that the Model Law should present two alternatives for indicating in the Model Law the provisions that imposed duties the breach of which would give rise to a cause of action. Variant I, based on the approach used in some States, contains a simple reference to the breach by the procuring entity of duties imposed by the Model Law. Variant II, based on the approach used in some other States, sets forth a list of the articles which impose duties the violation of which would give rise to a cause of action. As indicated in A/CN.9/356, para. 154, in place of listing the relevant articles within the text of the Model Law as is presently done in variant II, article 36 could be left with only the simple rule stated in variant I, and the relevant articles listed in the commentary, with an indication that enacting States that wished to do so could incorporate the list of articles into article 36. It would appear that the reformulation of article 36, irrespective of which variant an enacting State would select, meets the concern expressed in A/CN.9/356, para. 157, that it should be made clear that article 36 was intended to refer only to aspects of procurement proceedings addressed in the Model Law.

<sup>6</sup>The list of articles in variant II has been drawn up in accordance with the decision of the Working Group in A/CN.9/356, para. 153, that articles that imposed a duty on the procuring entity relating to the qualification and selection of contractors and suppliers should give rise to remedies under the Model Law and that certain articles providing for the exercise of discretion by the procuring entity should give rise to remedies only if the procuring entity failed to exercise the discretion at all or exercised it in an arbitrary fashion. According to that decision, articles imposing duties, or providing for exercise of discretion, aimed at the general public interest should not be regarded as establishing any private rights. Provisions not appearing on the list would be considered as not giving rise to remedies.

\* \* \*

### 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 des-

igned by the head of the procuring entity or by head of the approving authority, as the case may be.

(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 that person should have become aware of those circumstances. [The foregoing time limit does not apply to complaints seeking only compensation for costs incurred in preparing a tender or proposal.]<sup>1</sup>

(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 working days<sup>2</sup> 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.<sup>3</sup>

(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 is 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 ceases.

(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].<sup>4</sup>

<sup>1</sup>The text within square brackets has been added pursuant to a proposal in A/CN.9/356, para. 162. The Working Group may wish to consider whether determining the time limitation for entertainment of complaints on the basis of the relief being sought would unnecessarily complicate the Model Law. On another point, it will be recalled that the Working Group agreed in A/CN.9/356, para. 78, that consideration should be given to providing an exception to time limitations for seeking review to the extent that an aggrieved contractor or supplier was prevented from exercising its right to seek review as a result of a breach by the procuring entity of record requirements set forth in article 10 *ter*. In this regard, consideration might be given to the fact that the time limitation in article 37 runs from the time of discovery of the alleged misconduct, rather than from the actual date of the misconduct. This permits, for example, a complainant that would have discovered the procuring entity's misconduct through an accurate record of the procurement proceedings to seek review upon discovery of the misconduct, despite any delay in discovery caused by the inaccurate record, as long as the petition for review was filed within the 10 day period following discovery of the misconduct.

<sup>2</sup>See A/CN.9/356, para. 164.

<sup>3</sup>The reference to payment of compensation has been deleted pursuant to A/CN.9/356, para. 167.

<sup>4</sup>The Working Group may wish to consider adding a reference to the time limitations for instituting proceedings under article 38 or 40.

\* \* \*

#### Article 38. Administrative review\*

(1) A contractor or supplier entitled under article 36 to seek review<sup>1</sup> may submit a complaint, which shall be in writing, to [insert name of administrative body]:

(a) if the complaint cannot be submitted or entertained under article 37 because of the entry into force of the procurement contract, and provided that the complaint is submitted within 10 days after the earlier of the time when the contractor or supplier submitting it became aware of the circumstances giving rise to the complaint or the time when that contractor or supplier should have become aware of those circumstances;<sup>2</sup>

(b) pursuant to paragraph (5) of article 37, provided that the complaint is submitted within 10 days after the expiry of the period referred to in article 37(4);<sup>3</sup> 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, provided that the complaint is submitted within 10 days after the issuance of the decision;<sup>4</sup>

(1 bis) Upon receipt of a complaint, the [insert name of administrative body] shall give notice of the complaint promptly to the procuring entity or to the approving authority.<sup>5</sup>

(2) The [insert name of administrative body] may [grant/recommend]<sup>6</sup> one or more of the following remedies, unless it dismisses the complaint:<sup>7</sup>

(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) [deleted];<sup>8</sup>

(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]<sup>9</sup> 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.<sup>10</sup>

\*States where hierarchical administrative review of administrative actions, decisions and procedures is not a feature of the legal system may omit article 38 and provide only for judicial review (article 40). [The foregoing note has been added pursuant to A/CN.9/356, para. 170.]

<sup>1</sup>See A/CN.9/356, para. 171.

<sup>2</sup>The time limit for filing for administrative review under subparagraph (a) has been added pursuant to A/CN.9/356, para. 172. This time limit is aligned with the one in article 37(2), so as to ensure that contractors and suppliers that intend to file complaints do so promptly after discovery of

the circumstances giving rise to the complaint, either pursuant to article 37 or, if the procurement contract has entered into force, pursuant to article 38(1)(a). Concerning the question of whether the effect on the time limit of a violation by the procuring entity of record requirements should be addressed, see note 1 under article 37.

<sup>2</sup>The time limit for filing for administrative review under subparagraph (b) has been added pursuant to A/CN.9/356, para. 172.

<sup>3</sup>The time limit for filing for administrative review under subparagraph (c) has been added pursuant to A/CN.9/356, para. 172.

<sup>4</sup>Paragraph (1 *bis*) has been added pursuant to A/CN.9/356, para. 172.

<sup>5</sup>Pursuant to A/CN.9/356, para. 173, the words "may grant" have been supplemented by the indicated language in order to accommodate those States where review bodies do not have the power to grant the remedies listed below but could make recommendations.

<sup>6</sup>See A/CN.9/356, para. 174.

<sup>7</sup>The reference to annulment of the procurement contract has been deleted pursuant to A/CN.9/356, para. 174. The Working Group may wish to consider further the question of annulment in conjunction with its consideration of article 41.

<sup>8</sup>No decision was reached at the thirteenth session regarding the types of losses to be compensated (see paragraph 7 of the commentary on article 38, and paragraph 3 of the commentary on article 37, in A/CN.9/WG.V/WP.27).

<sup>9</sup>The Working Group may wish to consider whether it would be appropriate to add a reference to the time limits applicable for commencing an action under article 40.

\* \* \*

#### 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) Any such contractor or supplier *whose* interests are or could be affected by the review proceedings *has a right* to participate in the review proceedings.<sup>1</sup>

(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.

<sup>1</sup>The Working Group decided in A/CN.9/356, para. 180, to retain only the second sentence of variant B, with the indicated modifications.

\* \* \*

#### Article 40. *Judicial review*

The [insert name(s) of court(s)] has jurisdiction over an action commenced by a contractor or supplier<sup>1</sup> referred to in article 36 to review an act or decision of, or a procedure followed by, the procuring entity.<sup>2</sup>

<sup>1</sup>See A/CN.9/356, para. 182.

<sup>2</sup>The second sentence, including subparagraphs (a) through (d), which specified circumstances in which the commencement of judicial review would be permitted, has been deleted pursuant to A/CN.9/356, para. 187.

\* \* \*

#### Article 41. *Suspension of procurement proceedings [and of performance of procurement contract]*<sup>1</sup>

[[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.]

<sup>1</sup>Article 41 has been placed within square brackets in view of the Working Group's decision in A/CN.9/356, para. 190, to defer a decision on the article pending further consideration (see paragraph 8 in the introduction to the present document, as well as A/CN.9/WG.V/WP.34).

\* \* \*

#### Article 42. [deleted]<sup>1</sup>

<sup>1</sup>Article 42, which referred to disciplinary, administrative or criminal responsibility of the procuring entity, has been deleted pursuant to A/CN.9/356, para. 192.

\* \* \*

### ANNEX

#### Additional provisions and changes to other draft articles of Model Law on Procurement

Add the following provision:

Article 10 *bis*. *Communications between procuring entity and contractors and suppliers*<sup>1</sup>

*Communications between contractors and suppliers and the procuring entity referred to in articles 8 bis(3 bis), 22(3),*

*25(2)(a), 28(1), 29(3) and 32(1) shall be made in a form which provides a record of the communication. However, those communications may be made by telephone provided that, immediately thereafter, confirmation of the communication is given to the recipient of the communication in a form which provides a record of the confirmation.*

<sup>1</sup>Article 10 *bis* has been added in line with a request by the Working Group at the thirteenth session (see A/CN.9/356, paras. 14, 50 and 76) that the Secretariat consider the replacement by a consolidated provision of a number of similar provisions on telephone communications between the procuring entity and contractors and suppliers found in articles 8 *bis*, 22(3), 25(2)(a), 28(1), 29(3) and 32(6)(a). Further consolidation has been achieved by also encompassing in article 10 *bis* the writing requirement found in those provisions, thereby making it possible to avoid in their entirety the repeated references to identical formal requirements contained in those provisions. The formulation used to describe the permissible means of communication, which is based on article 1(e) of the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade, encompasses, but avoids express mention of, writing.

\* \* \*

Add the following provision:

Article 10 *ter*. *Record of procurement proceedings*<sup>1</sup>

(1) The procuring entity shall prepare a record of the *procurement proceedings containing the following information*:

(a) a brief description of the goods or construction to be procured, or of the *procurement need for which the procuring entity requested proposals*;

(b) the names and addresses of contractors and suppliers that submitted tenders, *proposals or quotations*;

(c) information relative to the qualifications, or lack thereof, of contractors and suppliers that submitted tenders, *proposals or quotations*;

(d) the price and a summary of the other principal terms and conditions of each tender, *proposal or quotation* and of the procurement contract;

(e) a summary of the evaluation and comparison of tenders, *proposals or quotations*;

(f) the information required by article 10 *quater*, if a tender, *proposal or quotation* was rejected pursuant to that provision; if all tenders were rejected pursuant to article 29, a statement to that effect [and the grounds therefore, in accordance with article 29(2)]; if, in *procurement proceedings involving methods of procurement other than tendering*, those proceedings did not result in a procurement contract, a statement to that effect and the grounds therefor;

(g) in *procurement proceedings involving methods of procurement other than tendering*, the statement required under article 7(5) of the grounds and circumstances on which the *procuring entity relied to justify the selection of the method of procurement used*.

(2) The portion of the record referred to in subparagraphs (1)(a) and (b) shall be made available for inspection by any person 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, *proposal or quotation*, as the case may be, has been accepted] or after procurement proceedings have been terminated without resulting in a procurement contract.<sup>2</sup>

(2 *bis*) The portion of the record referred to in subparagraphs (1)(c) to (f) shall be made available for inspection by contractors or suppliers that submitted tenders, *proposals or quotations*, or applied for prequalification, 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, *proposal or quotation* has been accepted] or after *procurement proceedings have been terminated without resulting in a procurement contract*.<sup>3</sup> However, except when ordered to do so by a competent court, and subject to the conditions of such an order, the procuring entity shall not disclose:

(a) information if its disclosure would be contrary to law, would impede law enforcement, would not be in the public inter-

est, would prejudice legitimate commercial interests of the parties or would inhibit fair competition;

(b) information relating to the examination, evaluation and comparison of tenders, *proposals or quotations*, and tender, *proposal or quotation* prices.<sup>4</sup>

(3) The portion of the record referred to in subparagraph (1)(g) shall be made available to governmental bodies exercising an audit or control function over the procuring entity in accordance with the laws of [this State].<sup>5</sup>

(4) The procuring entity shall not be liable to contractors and suppliers solely as result of a failure to prepare a record of the procurement proceedings in accordance with the present article.<sup>6</sup>

<sup>1</sup>Article 10 *ter* has been added to implement the decision of the Working Group in A/CN.9/356, para. 77, to replace the provisions in articles 33, 33 *series*, 34(4), 34 *bis*(4) and 35(1) and (2) with a consolidated provision concerning the record requirements for all procurement methods available under the Model Law. Article 10 *ter* is based on article 33, with additions and changes indicated by underscoring.

<sup>2</sup>In line with the expansion of the rule on improper inducements to all methods of procurement (see article 10 *quater* in the present annex), subparagraph (f) requires that the record of proceedings involving any type of procurement method note the rejection of a contractor or supplier offering a gratuity or other type of improper inducement. It is suggested that the procuring entity also be required to record the grounds for rejection of all tenders. This would align record requirements for tendering proceedings with the requirement that, when procurement proceedings involving other methods of procurement do not result in a procurement contract, the record should state the reasons therefor. Under article 29(2), the procuring entity is required to provide information concerning the grounds for rejection of all tenders, upon request, to contractors and suppliers that submitted tenders.

<sup>3</sup>Subparagraphs (a) and (b) of paragraph (2) have been placed in a separate paragraph, paragraph (2 *bis*).

<sup>4</sup>In accordance with A/CN.9/356, paras. 79 and 80, paragraphs (2), (2 *bis*) and (3) provide that the extent of disclosure of the record obligatory under the Model Law varies according to the type of information and user in question. The Working Group may wish to consider whether disclosure of any additional portions of the record to the general public would be desirable or whether paragraph (2), as presently formulated, leaves sufficient scope for such additional disclosure to be governed by general laws of the enacting State concerning access to information. As to the point of time when the record should be made available to the various categories of users, the present text reflects the decision of the Working Group in A/CN.9/356, para. 81, to retain both alternatives contained in square brackets that had appeared in article 33(2), pending further revision of the provision. The second of those alternatives has been modified to reflect its incorporation into a provision applicable to all methods of procurement.

<sup>5</sup>Pursuant to A/CN.9/356, para. 80, the restrictions on disclosure set forth in subparagraphs (a) and (b) have been retained, along with the provision allowing court-ordered disclosure of restricted information.

<sup>6</sup>See A/CN.9/356, para. 80.

<sup>7</sup>See A/CN.9/356, para. 78.

\* \* \*

Add the following provision:

[Article 10 *quater*. *Inducements from contractors and suppliers*

(Subject to approval by . . . (each State designates an organ to issue the approval).) the procuring entity shall reject a tender, *proposal or quotation* 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 *procurement proceedings*. The rejection of the tender, *proposal or quotation* and the reasons therefor shall be recorded in the record of the *procurement proceedings*.]

\* \* \*

*Article 8 bis (6)*

At the thirteenth session, the Working Group agreed that the use of the word "re-evaluating" in paragraph (6) needed to be reviewed (see A/CN.9/356, para. 37). In that connection, the Working Group might wish to consider replacing the words "re-evaluating at a later stage of the procurement proceedings the qualifications of contractors and suppliers that have been prequalified" by the words "requesting, at a later stage of the procurement proceedings, contractors and suppliers that have been prequalified to re-confirm their qualifications".

\* \* \*

*Article 17(2)(c bis)*

It is suggested to add the text below, as subparagraph (*e bis*), to reflect the requirement in article 28(7)(a) and (c)(ii) that the solicitation documents specify the factors, including non-price factors, that are to be used by the procuring entity in determining the successful tender, as well as to implement the decision of the Working Group in A/CN.9/356, para. 31, that the method of quantification of non-price factors should be indicated in the solicitation documents:

"(*e bis*) the factors to be used by the procuring entity in determining the successful tender, including any non-price

factors to be used pursuant to article 28(7)(c) and (d) and the manner in which any such non-price factors are to be quantified".

\* \* \*

*Article 17(2)(i)*

As discussed in A/CN.9/356, para. 132, as well as in note 3 under article 34 *bis*, the Working Group may wish to consider whether further specificity is desirable in the Model Law as to the composition of the price of tenders. One possibility would be to make a more specific reference in article 17(2)(i) to the elements that are to make up the price by adding the following language:

"... including whether the price is to cover elements other than the cost of the goods or construction themselves, such as transportation and insurance charges".

\* \* \*

*Article 17(2)(y)*

It was decided in A/CN.9/356, para. 69, that reference should be made in solicitation documents to any final approval requirement and to the amount of time expected to be needed to obtain any such final approval. This might be done by adding the following language at the end of subparagraph (y):

"and approval by a higher authority or the Government and the amount of time following the dispatch of the notice of acceptance that will be required to obtain the approval".

**3. Procurement: suspension of procurement proceedings and of performance of procurement contract: note by the Secretariat**  
(A/CN.9/WG.V/WP.34) [Original: English]

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**INTRODUCTION**

1. As reported to the eleventh session of the Working Group, the procurement laws of a number of countries contain provisions on whether the commencement of recourse proceedings by a contractor or supplier is to have an interruptive effect on the procurement proceedings. It was also reported that provisions are found concerning the effect on the performance of the procurement contract when recourse proceedings are commenced after the award of the procure-

ment contract.<sup>1</sup> At that session, differing views were expressed as to the approach to be taken in the Model Law on the question of interruption of procurement proceedings.<sup>2</sup>

2. At the thirteenth session, the Working Group had before it draft article 41 of the Model Law, which presented alternative approaches to the question of suspension

<sup>1</sup>A/CN.9/WG.V/WP.22, paras. 224 and 225.

<sup>2</sup>A/CN.9/315, paras. 117 and 118.

of the procurement proceedings, as well as of the performance of a procurement contract, in response to the commencement of recourse proceedings.<sup>3</sup> Variant A of draft article 41 provided for automatic suspension of the procurement proceedings upon the commencement of review proceedings, unless the entity conducting the review determined that such a suspension was not in the public interest. Variant B left the question of suspension of the procurement proceedings to the discretion of the entity conducting the review. Both variants invited the Working Group to consider whether or not the Model Law should provide for suspension of the performance of the procurement contract in those cases in which the review proceedings were commenced after the entry into force of the procurement contract. Variant A provided for automatic suspension of performance, in line with the automatic-suspension approach taken in that variant with regard to pre-award protests; variant B left suspension of performance to the discretion of the entity conducting the review. At the same time, it was pointed out that 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 would be suspended only if it was so decided by the entity conducting the review.<sup>4</sup> At the thirteenth session, a preference was expressed for variant B. However, a number of suggestions were made with regard to the exercise of the power of suspension, and the Working Group decided that the issue of suspension needed further consideration. The Secretariat was requested to prepare a note on the subject of suspension for the fourteenth session.<sup>5</sup> That note is contained in the present document.

## I. GENERAL REMARKS

3. Provisions on suspension, that are found in the procurement codes of a number of countries, share a number of basic, sometimes competing objectives. These include, in addition to giving meaning to the review process, ensuring that procurement is conducted on terms optimal for the procuring entity by protecting competition in and the integrity of the procurement process, avoiding undue delay in the procurement process, protecting the interests of contractors and suppliers, and minimizing wastage of the time and financial resources of the procuring entity as well as of contractors and suppliers. However, a survey of those procurement laws reveals that they differ on a number of issues that affect the exact manner in which a balance is struck between the public interest in effective expenditure of public funds, the needs of the procuring entity, and the interests of contractors and suppliers participating in the procurement. Those issues, which are discussed below, centre around, in particular, the stage of the procurement process that is subject to suspension and the degree of discretion left to the entity conducting the review as to whether to apply a suspension.

4. Suspension of procurement proceedings or of performance of the procurement contract may be available in a

number of countries under the general rules of the legal system governing interim judicial relief, in addition to, or in place of, being available pursuant to specific provisions in procurement laws. The requirements found in such general rules include, for example, that the claimant show that without the interim measure it would suffer irreparable harm, that the imposition of the interim measure will not cause irreparable harm, and that there is a reasonable probability that the claim will succeed. The present note focuses on provisions on suspension found in procurement laws; it does not focus on provisions governing interim measures generally, since such provisions are not specific to procurement and would not be altered by the Model Law.

5. A distinction should also be drawn between provisions for suspension of procurement proceedings in response to the commencement of review proceedings and provisions inserting periods of delay into the procurement proceedings, or providing for annulment of the procurement contract, as part of a requirement that the decision of the procuring entity as to the selection of a contractor or supplier receive the approval of a higher authority. The present note does not discuss the latter type of provisions since they do not concern suspensions resulting from the commencement of review proceedings.

## II. STAGE OF PROCUREMENT PROCESS SUBJECT TO SUSPENSION

6. The procurement laws of some countries provide not only for suspension of the procurement proceedings when review proceedings are commenced prior to the award of a procurement contract, but also for suspension of the performance of the procurement contract when review proceedings are commenced following the award of the procurement contract. The procurement laws of some other countries limit the availability of suspension to the pre-award stage of the procurement process, with relief in post-award review proceedings limited to damages.

7. The provisions of a procurement code governing the precise stage at which the review proceedings themselves may be commenced are relevant in determining the particular point in the procurement proceedings at which a suspension could be applied. This is particularly evident in the procurement laws of a number of countries that require the signature of a contract for the entry into force of the procurement contract. The laws of some of those countries limit the commencement of review proceedings to a specified period of time following notification or publication of the procuring entity's selection of a contractor or supplier, and prior to the signature of the procurement contract. Thus, in those countries, the suspension would be applied only at a relatively advanced stage of the procurement proceedings. By contrast, in some other countries the review proceedings may be commenced, and the resulting suspension applied, at any point in the procurement proceedings. Procurement laws which limit the commencement of review proceedings to a period of time between the publication of the procuring entity's decision and the signature of the procurement contract typically make no provision for the commencement of review proceedings following the conclusion of the procurement contract.

<sup>3</sup> A/CN.9/WG.V/WP.27.

<sup>4</sup> See the Working Group note in the commentary to draft article 41 in A/CN.9/WG.V/WP.27.

<sup>5</sup> A/CN.9/356, paras. 188-190.

8. The generally accepted rationale for suspension at the pre-award stage is that such a measure makes it possible to maintain the status quo at an early stage of the procurement process, thereby enhancing the possibility of applying a meaningful remedy should the complaint turn out to be justified and limiting wasteful expenditures by the procuring entity and by contractors and suppliers. The key rationale for not providing for suspension of the performance of the procurement contract is the potential for disruption and uncertainty that such suspension would bring to the procurement process. In those countries in which the procurement laws provide for it, the availability of suspension of the performance of the procurement contract, and ultimately annulment of that contract, is considered as enhancing competition and promoting compliance with procurement laws. Such an approach is also considered desirable in order to avoid placing the procuring entity in a situation in which it would remain bound to a procurement contract that was less favourable than it could have obtained under the circumstances, while at the same time being required to pay damages to an aggrieved contractor or supplier. Furthermore, suspension of performance is regarded as a way of keeping costs associated with a possible termination of the procurement contract at a minimum.

9. In order to minimize the extent of the disruption that might result from suspension of performance of a procurement contract, some procurement laws limit the availability of the suspension to review proceedings commenced within a limited period of time (e.g., ten days) following the award of the procurement contract.

### III. DEGREE OF DISCRETION IN APPLICATION OF SUSPENSION

10. Differing approaches are found with respect to the degree of discretion given to the entity conducting the review proceedings to determine whether to apply a suspension. The procurement laws of some countries provide for the automatic application of suspension provisions upon the commencement of review proceedings, while the laws of some other countries provide that suspension is discretionary. The laws of yet other countries have a mixture of the two approaches, with automatic suspension upon the commencement of review proceedings prior to the award and, when review proceedings are commenced following award, discretionary suspension of performance of the procurement contract. It may also be noted that the inclusion in a procurement law of a provision mandating suspension of the performance of the procurement contract does not mean that that procurement law necessarily requires annulment of the procurement contract in the event that the complaint is found to be justified. It may be further noted that in a certain number of countries, suspension of the contract-award procedure is mandatory when a regional supranational authority with oversight responsibilities makes a finding that a clear and manifest infringement of the laws applicable to that procedure has taken place.

11. A key rationale behind automatic suspension is that such an approach is more effective in preserving the status quo pending the outcome of the review proceeding. The rationale behind discretionary suspension is that the increased flexibility offered by a case-by-case determination

minimizes disruption of the procurement process, avoids disproportionate inconvenience for the procuring entity and lessens the harm that might result to all parties and interests involved, including the public interest.

12. Procurement laws that mandate automatic suspension usually permit the procuring entity to obtain a waiver of suspension requirements in certain specified types of circumstances. Such provisions typically require that the procuring entity cite urgent and compelling circumstances in order to obtain the waiver, for example, that the suspension would cause grave detriment to the procuring entity or to the public interest by delaying or precluding the procurement of indispensable, urgently needed goods or construction.

13. In a number of countries, procuring entities seeking to override suspension requirements must take certain formal or procedural steps. Such steps are, for example, that the procuring entity present to the entity conducting the review proceedings a written statement of the circumstances justifying the waiver, that the waiver must be claimed within a certain period of time following the commencement of the review proceedings, and that the procuring entity notify the complainant of the waiver of the normally applicable suspension provisions.

14. The laws of some countries also provide for an exception to the application of automatic suspension requirements in cases in which a petition seeking review is dismissed at the outset due to formal defects in that petition (e.g., lack of signature by complainant).

15. Under a discretionary suspension regime, the determination of whether to grant a request for a suspension typically involves deciding whether the negative consequences of a suspension for all the interests involved outweigh the benefits. As is the case with provisions concerning waiver of automatic suspension, provisions governing discretionary suspension usually permit a procuring entity to cite urgent and compelling circumstances and prejudice to the public interest as grounds for avoiding a suspension. Specific factors considered relevant in deciding on suspension might include whether alternatives, not involving a new procurement, exist to meet the procuring entity's needs pending completion of the review proceedings and whether suspension would, due to statutory deadlines for the expenditure of funds, jeopardize the availability of public funds budgeted for the procurement.

16. Another approach to the exercise of discretion in suspension of procurement proceedings that is found in practice is one in which the entity conducting the review is permitted to determine that something less than a total suspension of the procurement proceedings is warranted. Under such an approach, which may be referred to as "partial suspension", certain aspects of the procurement proceedings, such as the opening of tenders, or the making of an award, may be suspended, while other aspects, such as the reception of tenders, may be permitted to continue. The notion of partial suspension may also be applied to the performance of the procurement contract. For example, under the procurement laws of some countries the procuring entity may be required, upon the commencement of a review proceeding, to request the contractor or supplier that

has begun performance to continue with performance in a reduced manner so as to minimize the costs of a possible termination of the procurement contract.

#### IV. OTHER FEATURES OF SUSPENSION PROVISIONS

17. In procurement laws providing for suspension, it is common to find time periods and deadlines for the carrying out and completion of the review proceedings. Such time limits have the effect of setting a maximum duration for the suspension, so as to limit the extent of disruption caused by the suspension. In some cases, such time periods and deadlines may also have the effect of setting a minimum duration for the suspension, with a view to providing sufficient time for a thorough review.

18. The procurement laws of a limited number of countries make reference to the effect of a suspension on the validity of tenders and tender securities submitted by contractors and suppliers. For example, the procurement laws of some countries make reference, in the context of a challenge to the procuring entity's selection of a winning contractor or supplier, to an obligation on the part of that winning contractor or supplier to ensure that the validity periods of its tender and tender security cover the duration of the review proceeding. References are also found in some laws to similar obligations on the part of the contractor or supplier initiating the review and on the part of other contractors or suppliers, as well as to an obligation on the part of the procuring entity to pay heed to the question of the continued validity of tenders and tender securities during the suspension.

## IV. GUARANTEES AND STAND-BY LETTERS OF CREDIT

### A. Report of the Working Group on International Contract Practices on the work of its sixteenth session

(Vienna, 4-15 November 1991) (A/CN.9/358) [Original: English]

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#### INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,<sup>1</sup> 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.<sup>2</sup>

3. At its thirteenth session (A/CN.9/330), 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

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 22.

<sup>2</sup>Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

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. At its fifteenth session (A/CN.9/345), 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 Working Group then considered the issues discussed in a 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 Working Group also considered the issues discussed in a note by the Secretariat relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft set of articles on the issues discussed.

6. The Working Group, which was composed of all States members of the Commission, held its sixteenth session at Vienna, from 4 to 15 November 1991. The session was attended by representatives of the following States members of the Working Group: Argentina, Canada, Chile, China, Costa Rica, Cyprus, Czechoslovakia, France, Germany, Iran (Islamic Republic of), Japan, Mexico, Morocco, Netherlands, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland and United States of America.

7. The session was attended by observers from the following States: Austria, Colombia, Finland, Gabon, Indonesia, Lebanon, Peru, Philippines, Poland, Sweden, Switzerland, Thailand, Turkey, Ukraine, Yemen and Zaire.

8. The session was attended by observers from the following international organizations: Hague Conference on Private International Law, International Monetary Fund (IMF), Banking Federation of the European Community, Federación Latinoamericana de Bancos (FELABAN).

9. The Working Group elected the following officers:

*Chairman:* Mr. J. Gauthier (Canada)

*Rapporteur:* Mr. R. Sandoval (Chile)

10. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.72) and a note by the Secretariat containing tentative draft articles of a uniform law on international guaranty letters (A/CN.9/WG.II/WP.73 and Add.1).

11. 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.

## 1. DELIBERATIONS AND DECISIONS

12. The Working Group examined draft articles 1 to 13 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.73 and Add.1). 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 13 of the uniform law.

## II. CONSIDERATION OF DRAFT ARTICLES OF A UNIFORM LAW ON INTERNATIONAL GUARANTY LETTERS

### Chapter I. Sphere of application

#### *Article 1. Substantive scope of application*

13. The text of draft article 1 as considered by the Working Group was as follows:

"This Law applies to international guaranty letters."

14. A suggestion was made to include the term "independent" so that the uniform law would apply to "international independent guaranty letters". A concern was expressed that the term "guaranty letter" was inappropriate since it did not embrace stand-by letters of credit. While the term "guaranty letter of credit" might do so, neither term was used in practice and the use of either of the terms might lead to the misconception that the uniform law created a new type of instrument. It was also stated that, while the uniform law attempted to regulate in an amalgamated manner independent guarantees and stand-by letters of credit, there was a need to address some issues separately for independent guarantees and for stand-by letters of credit, so as to take full account of the different origin and unique features of the two instruments. In response, it was recalled that the Working Group at its previous sessions had always treated jointly the two kinds of instruments in view of their functional equivalence and common or similar operational legal character; the term "guaranty letter"

had been chosen as a novel term embracing both kinds of instruments.

15. After deliberation, the Working Group concluded that it would be premature to take a final decision on the nominal issue of a common name and on the substantive issue of whether stand-by letters of credit and independent guarantees could be treated jointly in all respects or whether for some issues separate rules were necessary.

#### *Article 2. Guaranty letter*

16. The text of draft article 2 as considered by the Working Group was as follows:

"A guaranty letter [, however named or described,] is an [express] undertaking of independent [and essentially documentary] character, given by a bank or other institution or person ["guarantor"] ["issuer"]

*Variant A:* at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of that instructing party's customer ("principal"),

*Variant B:* , whether or not so requested or instructed by another bank, institution or person to pay to another person ("beneficiary") a certain or determinable amount of a specified currency or unit of account [or other item of value] [or to accept or negotiate without recourse a bill of exchange for a specified amount] in conformity with the terms of the undertaking upon receipt of a demand

*Variant X:* made in the manner prescribed in the undertaking, provided that the undertaking [indicates that it] is given for the purpose of [indemnifying the beneficiary for the consequences of a specified contingency] [securing the beneficiary against the non-fulfilment of certain financial or other obligations by the principal or against another specified risk].

*Variant Y:* stating or, if so required in the undertaking, certifying or otherwise establishing that payment is due."

#### *Opening words*

17. The Working Group noted that the definition of guaranty letter would also apply to a counter-guaranty letter and a confirming guaranty letter and that special definitions of those two terms might later have to be included in the uniform law, in particular, if those terms would be used in operative rules in the uniform law (see A/CN.9/WG.II/WP.73, remark 1 on article 2). It was observed that the terminology concerning the confirmation of a guaranty letter would need to be carefully considered.

18. As regards the words "however named or described" between square brackets, it was recalled that this wording was drawn from the wording of the draft Uniform Rules on Demand Guarantees (URDG) currently under consideration by the International Chamber of Commerce (ICC). It was noted that the wording was used to make it abundantly clear that no specific title or description was needed for making the uniform law applicable to an undertaking that met the requirements contained in the definition of guaranty letter. The prevailing view was that the article defining

the guaranty letter should be streamlined to the greatest possible extent and that the wording should be deleted as unnecessary.

19. As regards the mention of the "express" nature of the undertaking, it was stated that the word between square brackets should be deleted, since the rest of the provision made it sufficiently clear that the uniform law did not encompass implied undertakings. The Working Group decided to delete the word "express".

20. As regards the reference to the "essentially documentary" character of the undertaking, it was stated that a reference to documents was not appropriately located in the definition of the undertaking, since the documentary nature became relevant at the stage of execution when the beneficiary made a demand for payment. In response, it was stated that the reference to the essentially documentary character of the undertaking was intended to serve as a reminder of the unresolved problem of the treatment of non-documentary conditions (A/CN.9/342, paras. 111-118) and to indicate a possible location for a restriction of the scope of application to undertakings that were not only independent but also essentially documentary in nature (see A/CN.9/WG.II/WP.73, remark 2 on article 2).

21. The view was expressed that the term "essentially" would be inappropriate in the case of stand-by letters of credit, which were not "essentially" but "invariably" documentary by their very nature. As regards the admissibility of non-documentary conditions, it was recalled that the Working Group, at earlier sessions, had considered various options of treatment without having reached a general consensus. It was also recalled that the Working Group had regarded the reference to the "essentially documentary" undertaking as a way to maintain within the scope of application of the uniform law an intermediate situation where an undertaking inadvertently included a non-documentary condition and yet was so drafted as to be essentially documentary. It was stated that the most difficult part of the problem would be to ascertain what non-documentary conditions that did not have the effect of rendering the undertaking to be accessory were found in practice and how that limited category of conditions should be clearly defined. After discussion, the Working Group decided to maintain the words between square brackets as a reminder and to reconsider the issue at a later stage, after having reviewed the problem of non-documentary conditions in the context of relevant operational provisions.

22. As regards the reference to the "guarantor" or "issuer" between square brackets, it was stated that the term "guarantor" would more appropriately cover the situation where the undertaking was in the form of an independent guarantee, while the term "issuer" would be more suitable in the case of a stand-by letter of credit. A suggestion was made to combine the two words and use the term "guarantor/issuer". Another suggestion was to use only the word "guarantor" and to provide a definition of the guarantor in article 6 indicating that the term "guarantor" encompassed the issuer of a stand-by letter of credit. After discussion, the Working Group decided to leave the matter for consideration by the drafting group that would be set up at a later session.

### *Variants A and B*

23. The Working Group next considered different approaches to requests or instructions by another person for the issuance of the guaranty letter, as embodied in variants A and B as well as in the proposed paragraph (2) contained in remark 4 on article 2. A number of criticisms of a drafting nature were made of variant A. One was that the term "customer" was too narrow since, for example, a parent company instructing its subsidiary to issue a guaranty letter could not be considered a customer of the subsidiary. It was suggested that a more appropriate term would be "debtor" or "obligor"; that substitution was objected to on the ground that it might connote the existence of certain contractual relationships foreign to the guaranty letter. Another suggestion was to refer to the "applicant" for the guaranty letter as this would reflect practice associated with stand-by letters of credit. It was also suggested that additional clarity was needed as to the antecedent of the words "acting at the request of that instructing party's customer". It was further suggested that reference should be made not only to a request, but also to an instruction, since a guarantor may only act upon an instruction.

24. It was noted that variant A would not cover the issuance by the guarantor of a guaranty letter in support of the guarantor's own obligation, while such undertakings would be covered, implicitly, under variant B and, explicitly, under paragraph (2) as proposed in remark 4 on article 2. Differing views were expressed as to which approach to follow. One view was that the traditional understanding of a guarantee involved the guarantor answering for the debt of another and that therefore an undertaking issued by a guarantor in support of its own primary obligation could not properly be regarded as a guaranty letter. The prevailing view was that, because such undertakings, though not particularly common, occurred in practice, they needed to be covered by the uniform law. It was also felt that such undertakings could properly fall within the scope of the uniform law because they involved, as in any guaranty letter, a commitment that was of a documentary character, abstracted from the underlying transaction. A suggestion that the extent to which such undertakings might be covered by the uniform law could be limited somewhat by requiring that issuance should be by entities that engaged in issuance of guaranty letters in the ordinary course of their business did not receive support.

25. The Working Group then considered the exact manner in which guarantees on behalf of the guarantor should be accommodated. One approach was to be silent on such guarantees, an approach that could be implemented by selecting variant B or by deleting, as was proposed, both variants A and B, and thereby eliminating any reference in article 2 to a need for a request or instruction for the issuance of a guaranty letter. The other approach was to include an express reference to guaranty letters issued on behalf and on the account of the guarantor, as contained in subparagraph (c) of the proposed paragraph (2). It was stated in support that, absent an express recognition of guaranty letters on behalf of the guarantor, some operative rules (e.g., requirements that the guarantor notify the principal of a demand for payment or obtain the principal's consent to an amendment) might be read as an indication

of non-recognition of such instruments. It was also pointed out that silence raised the danger of divergent treatment by implementing States. In particular, the danger would exist that in States which were unfamiliar with the practice, such guarantees might not be recognized. In view of the foregoing, it was decided to add the proposed paragraph (2) as a replacement for both variants A and B. The proposed paragraph (2) was as follows:

"(2) The undertaking may be given

(a) at the request of the customer ('principal') of the guarantor ('direct guaranty letter');

(b) on the instruction of another bank, institution or person ('instructing party') acting at the request of the customer ('principal') of that instructing party ('indirect guaranty letter'); or

(c) on behalf of the guarantor itself ('guaranty letter on guarantor's own behalf')."

### *To pay to another person ("beneficiary")*

26. A concern was expressed that the requirement that payment be to "another person" would preclude the application of the uniform law to certain financial stand-by letters of credit in which the issuer itself was designated as beneficiary acting as trustee for a large number of final recipients of the sum owed under the stand-by letter of credit. It was suggested that the problem might be solved by deleting the requirement that payment be to another person, while possibly adding to the uniform law a definition of the "beneficiary" as the person designated in the guaranty letter. An alternate suggestion was to retain in article 2 the requirement of payment to another person, but to include somewhere in the uniform law a provision excluding financial stand-by letters of credit from that requirement. Those proposals were objected to on the ground that issuances in which the issuer was, in effect, also acting as the beneficiary, would raise insurmountable conflict-of-interest concerns in some jurisdictions, and that it was therefore preferable, in a uniform law of international scope, to retain the requirement of payment to another person. Another suggestion was that the problem was one to be properly solved by the issuer through the establishment of a separate corporate entity for the purpose of acting on behalf of the true beneficiaries. In response, it was stated that financial stand-by letters of credit were a practical necessity and therefore widely used, particularly in cases in which there were very large numbers of holders of public bonds, the repayment of the principal and interest of which was secured through stand-by letters of credit. It was reported that such issuances had obtained clearance from regulatory authorities in a number of countries and represented a large volume worldwide. It was further stated that the effects of the practice could not be confined purely to a national arena since in many cases foreigners were the holders of public debt and thereby ultimate beneficiaries of the types of arrangements in question.

27. In order to attempt to meet the concern about coverage of such "direct pay financial stand-by letters of credit", without at the same time deleting the requirement that payment be to another person, it was proposed to add a reference to payment to the issuer when the issuer was acting in

a capacity different from that of issuer. That approach was found to be deficient because such financial stand-by letters of credit typically did not on their face refer to any special capacity in which the beneficiary/issuer was acting. It was also suggested that the problem might simply be solved through interpretation, by considering that an issuer acting in such a capacity could be considered as being "another person". After discussion, the Working Group decided to retain the reference in article 2 to payment to another person, but to include at an appropriate place in the uniform law the language needed to accommodate such stand-by letters of credit.

#### *Object of payment obligation*

28. A proposal was made to delete the words "of a specified currency or unit of account" on the ground that it was sufficient to refer simply to the obligation of the guarantor to pay "a certain or determinable amount". That proposal failed to receive sufficient support, in particular because it was felt that reference to a specified currency or unit of account was necessary in order to provide certainty.

29. Differing views were expressed as to the desirability of retaining the words "or other item of value", which would place within the scope of the uniform law guaranty letters in which payment was in a form other than money. A proposal was made to delete those words on the ground that, in the interests of harmonization, the uniform law should concentrate on the types of instruments most commonly used. Even if some instruments were not covered by the law, parties would retain the contractual freedom to agree on alternate forms. In support of retention, it was stated that stand-by letters of credit in which payment was made in a form other than money, typically in precious metals, were used and that their use was likely to increase. The uniform law should therefore include such instruments within its scope so as to avoid restricting the options of the parties, as well as to stay abreast of new forms of payment that might develop in the coming years. It was also suggested that a broad reading of the term "units of account" would not be sufficient to secure coverage of such instruments.

30. A concern was raised that payment through commodities might necessitate investigations to ascertain quality, thus detracting from the independence of the guarantor's undertaking. A related concern was that fluctuating prices of commodities might make it difficult for the parties to determine the actual amount of the guaranty letter, in addition to raising the risk of abusive calls when the value of the commodity escalated sharply. In response to those concerns, it was stated that any such determination of the quality of the commodity used for payment would not involve the underlying obligation secured by the guaranty letter and that the problem of price fluctuation was one that the parties could assess and deal with through appropriate language in the guaranty letter.

31. A further concern was that payment through commodities might implicate various national regulatory laws which might, for example, prohibit certain transfers of commodities and that such instruments should therefore be left to those other laws. In response, it was stated that in-

clusion of such instruments within the scope of the uniform law would not affect the continued applicability of regulatory laws in question.

32. After discussion, the Working Group decided to defer a final decision on the language in question to a later stage of its deliberations.

33. As to the words "or to accept or negotiate without recourse a bill of exchange for a specified amount", it was observed that the use of the term "negotiate" needed to be reconsidered since the commitment of the guarantor or issuer of an instrument in which payment was to be through a bill of exchange could only be to accept and later honour the bill of exchange. It was also suggested that the words "and to pay at maturity" should be added after the words "to accept". The advisability of the latter modification was questioned from the standpoint of legislative drafting, since the introduction of an element of the law on bills of exchange presented the risk that other relevant elements might be omitted. Another suggestion was that acceptable modes of payment, including, if it were so decided, acceptance of bills of exchange, could be defined in article 6, thus simplifying the definition of the guaranty letter.

34. Beyond those comments of an essentially drafting nature, concerns were expressed as to the desirability of mentioning in article 2 instruments in which the commitment of the issuer was to accept a bill of exchange. The view was expressed that the types of instruments in question were unfamiliar in some parts of the world, particularly where guarantees were traditionally regarded as vehicles for speedy payment to the beneficiary. According to that view, only instruments that fit within that traditional category should fall within the scope of the uniform law. A further ground cited in favour of deletion was that introduction into the guaranty letter of payment through acceptance would result in uncertainty as to the applicable law since the obligations of the guarantor would also become subject to the laws governing bills of exchange.

35. In response to those views, it was stated that, since the uniform law was intended to codify existing practice, it was necessary to cover the presentation of bills of exchange, in particular in order to encompass stand-by letters of credit, which were used extensively and which at times provided for payment through acceptance of bills of exchange. It was suggested that acceptance or payment of a bill of exchange needed to be mentioned in article 2 because it raised not merely the subsidiary question of the object of payment, but concerned the very nature of the guarantor's commitment under the guaranty letter. It was also stated that the possibility of ambiguity as to the applicable law was negligible because the law on guaranty letters and the law on bills of exchange would apply to distinct facets of the transaction. After discussion, the Working Group decided to defer a decision to a later stage of its deliberations.

#### *In conformity with the terms of the undertaking upon receipt of a demand*

36. A proposal was made to modify the reference to "the terms of the undertaking" to read "the terms and documentary conditions of the undertaking". Such a change was

said to be necessary to reflect the practice in jurisdictions in which the use of stand-by letters of credit was prevalent. In those legal systems the word "term" connoted items, such as the expiry date of a letter of credit, the occurrence of which were not uncertain, therefore not requiring the presentation of documents, whereas the word "condition" was used to refer to events the occurrence of which was uncertain, thereby necessitating the presentation of documentary evidence of occurrence. The characterization of the conditions as "documentary" was said to be necessary in order to affirm, in the definition of the guaranty letter, that the undertaking was of a documentary nature, thereby minimizing the need to deal with non-documentary conditions in the operative rules.

37. While it was pointed out that in many legal systems the word "term" was sufficient, since what was referred to above as a "condition" would be included as a term in the guaranty letter, it was agreed to add the word "condition" in order to accommodate divergent understandings of the word "term". It was noted that with such a change the uniform law would reflect the language used in the Uniform Customs and Practice for Documentary Credits (UCP). The Working Group did not agree to the suggested addition of the word "documentary", in particular because of a concern that the addition of that word might lead to the exclusion from the uniform law of any instrument with a potential non-documentary condition. Many representatives expressed the view that it was therefore preferable to treat non-documentary conditions in the operative, rather than in the definitional, provisions of the uniform law (see, however, the later decision reflected below, paragraph 61).

38. A view was expressed that the words "upon receipt of a demand" should be deleted or modified so as to avoid giving rise to an interpretation that payment under stand-by letters of credit required the presentation of a distinct document labelled as demand for payment, in addition to any other documents required under the guaranty letter.

#### *Variants X and Y*

39. As regards variant X, the view was expressed that the use of the words "indemnifying the beneficiary for the consequences of a specified contingency" between square brackets might unduly suggest a need to measure the damage suffered by the beneficiary. Such measurement of the damage might require a review of the underlying contract and therefore contradict the independent nature of the undertaking. Support was expressed in favour of the second wording between square brackets, which read: "securing the beneficiary against the non-fulfilment of certain financial or other obligations by the principal or against another specified risk". That wording was said to respond to the need of defining the purpose of the undertaking by reference to the potential risk of the beneficiary.

40. It was stated that a reference to the purpose of the undertaking would help to exclude from the definition the commercial letter of credit and other facilities without guaranteeing purpose. It was also stated that an indication of the purpose of the undertaking in the uniform law, not necessarily in the guaranty letter, was needed to identify the common ground between the bank guarantee and the

stand-by letter of credit by reference to the guaranteeing function of both instruments. Furthermore, an indication of the purpose of the guaranty letter might also be relevant in the context of an improper demand under article 19.

41. A contrary view was that, although a similar economical function was performed by bank guarantees and stand-by letters of credit, that functional similarity was not specific to those two instruments and could be extended to accessory guarantees and even to insurance contracts. It was suggested that such a broad indication of the purpose of the instruments as that contained in variant X might be of little operative significance.

42. A suggestion was made that, when presenting a demand for payment under the guaranty letter, the beneficiary should be under an obligation to produce a statement that payment of the guaranty letter was justified. In response, it was stated that the creation of the suggested obligation would not be consistent with the current practice of stand-by letters of credit and bank guarantees payable on simple demand.

43. A concern was expressed that the wording of variant X, unlike that of variant Y, would not be fully compatible with the practice of stand-by letters of credit. It was stated that, should variant X be retained, a special rule would need to be devised for certain stand-by letters of credit that were classified as stand-by letters of credit by bank regulatory authorities for capital adequacy reasons but were in effect used as ordinary instruments of payment. Such instruments were not intended to secure the beneficiary against any risk but were used like normal commercial letters of credit.

44. It was also suggested that the wording of the variants, particularly that of variant Y referring to a demand certifying or otherwise establishing that payment is due under the guaranty letter, might not be fully consistent with the description of the independent undertaking provided in draft article 3(2)(b). It was therefore suggested that both variants be deleted and replaced by the words "made in the manner prescribed in the undertaking". It was stated in response that that suggestion would unduly widen the scope of application of the uniform law by covering commercial letters of credit and other independent payment undertakings such as bills of exchange and promissory notes.

45. In this connection the Working Group recalled that it had decided at its twelfth and fourteenth sessions "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, and A/CN.9/342, para. 18). The Working Group decided to consider at a later stage the question of the inclusion of commercial letters of credit.

46. While the discussion on variants X and Y revealed a certain preference for variant X, the Working Group decided to retain for later reconsideration both variants, to be redrafted by the Secretariat in the light of the above comments.

### Article 3. Independence of undertaking

47. The text of draft article 3 as considered by the Working Group was as follows:

"(1) An undertaking is independent if [, according to its terms,] the payment obligation [does not depend on] [is not subject to, or qualified by,] the existence or validity of an underlying transaction [,whether or not referred to in the undertaking,] [between the principal and the beneficiary or between an instructing party and the guarantor] or of any other relationship, and the guarantor may [therefore] not invoke any defence arising from a relationship other than its relationship with the beneficiary. [The independent character of an undertaking is not affected by the fact that the guarantor, as provided in article 17(1)(c), may raise certain objections to payment that might be based on facts relating to any such other relationship.]

"(2) (a) An undertaking is [irrebuttably] deemed to be independent when it contains the heading '[Independent guaranty letter]' [Independent documentary promise] [First demand guaranty letter]' and contains the same words also in its text. [Where an undertaking is deemed to be independent, any term or condition that would have the effect of rendering the undertaking to be accessory shall be treated as void.]

(b) [Otherwise] [Subject to the provisions of subparagraph (a) of this paragraph], any characterization or a single term found in the text of the undertaking shall not be deemed conclusive [of whether or not the undertaking is independent] if other terms clearly weigh in favour of the opposite result. In evaluating the terms in their totality, the following factors may be regarded as points weighing in favour of independence:

- (i) The undertaking to pay is expressed to be 'on simple demand', 'on first demand', 'on demand', 'upon receipt of a written request', 'unconditional', 'irrespective of the validity or existence of X-Contract', 'waiving all rights of objection and defences arising from said contract', 'without proof of default' or is qualified by any other words of similar import;
- (ii) Payment is due upon receipt of a statement by the beneficiary or any document by a third party, and the guarantor is not required to verify any fact outside its purview;
- (iii) Any underlying transaction is referred to in the undertaking only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses [, provided that the text of the undertaking is divided in that manner];
- (iv) The undertaking is stated to be subject to the Uniform Customs and Practice for Documentary Credits or the Uniform Rules for Demand Guarantees of the International Chamber of Commerce."

#### Paragraph (1)

48. The Working Group considered, on the basis of the definition of an independent undertaking as suggested in

paragraph (1), the concept of independence as an appropriate element delimiting the scope of application of the uniform law. It was agreed that, as a general matter of principle, the relationship between the guarantor and the beneficiary created by the guaranty letter was separate and independent from any other relationship, in particular, from any underlying transaction between the principal and the beneficiary. That independence, which distinguished the guaranty letter from an accessory undertaking such as a suretyship, led to the result that the rights and obligations of the parties to the guaranty letter were exclusively determined by the terms and conditions of the guaranty letter. It was realized, however, that the concept of independence was a complex matter that needed clarification and refinement in various respects.

49. One concern was that a strict interpretation of the rule that the undertaking did not depend on the existence or validity of an underlying transaction would necessarily lead to the conclusion that any illegality of the underlying transaction or its violation of public policy would under no circumstances have any effect on the guarantor's payment obligation. In this connection, a question was raised as to whether the terms of the guaranty letter might refer to the possible illegality of an underlying transaction without compromising the independent character of the undertaking. A related concern was that a strict interpretation of the rule of independence might lead to the conclusion that fraud or manifest abuse of rights by the beneficiary could not constitute an objection to payment; in that connection, a view was expressed that inserting the words "unless otherwise provided in this Law" in the first sentence of the paragraph would be more adequate than retaining the second sentence. It was stated in response to that concern that the so-called "fraud exception", as addressed in draft articles 17(1)(c) and 19, was conceptually not an exception to independence but rather a defence against an (independently) existing claim under the guaranty letter and that, at any rate, the concern was met by the second sentence of paragraph (1), which made it clear that the definition of independence did not preclude reliance on fraud or abuse as an objection to payment.

50. As regards the definition of independence suggested in the first sentence of paragraph (1), it was stated that the reference to "the existence or validity of an underlying transaction" was too narrow in that it did not encompass the fulfilment or non-fulfilment of the principal's obligations under an existing and valid underlying transaction. That element was said not to be covered with sufficient clarity by the additional wording that "the guarantor may not invoke any defence arising from a relationship other than its relationship with the beneficiary" created by the undertaking. The Working Group adopted the suggestion to delete the specific reference to existence and validity and instead to include a general reference to the underlying transaction.

#### Various approaches to independence

51. It was realized that the guarantor's undertaking was truly independent only if it was in no way linked to the actual fulfilment or non-fulfilment of the principal's obligations under the underlying transaction; at the same time,

the non-fulfilment of the principal's obligations often constituted the contingency against which the beneficiary was intended to be secured by the guaranty letter. It was felt that this seemingly paradoxical situation illustrated the gist of the problem of defining the concept of independence as an appropriate criterion for delimiting the scope of the uniform law. The ensuing discussion in the Working Group revealed somewhat different approaches to that crucial matter, particularly as regards the treatment of non-documentary conditions.

52. One approach was to rely primarily, if not exclusively, on the use of expressions in the undertaking revealing the intent of the parties to make the payment obligation independent from other relationships. Under that approach, any stipulation by the parties that the guarantor, upon presentation of a demand, needs to do more than merely verifying the conformity of documents presented by the beneficiary would not necessarily destroy the independent character of the undertaking.

53. Another, similar approach was to regard as autonomous an undertaking that did not have any direct connection with the underlying transaction; any contingency forming the object of the undertaking (e.g., non-fulfilment of principal's obligations) would be dealt with in an indirect manner by focusing on the evidence of its occurrence. Under that approach, the inclusion of a condition of effectiveness (e.g., receipt of advance payment in the context of a repayment guarantee) or of a payment condition stated as an objective fact or result without reference to any underlying transaction (e.g., non-arrival of named ship in specified port at certain date) would not necessarily negate the independent nature of the undertaking. However, in the rare case of inclusion of such a condition without stipulation of the required proof, it was very likely that the guarantor would request evidence of the occurrence of the contingency and that a court would confirm the appropriateness of such request.

54. Yet another approach was to require the undertaking to be of a purely documentary character, thus excluding any undertakings where the guarantor would have to verify any acts or events outside its purview. Any contingency or risk against which the beneficiary was to be secured was relevant only as "notional or representational default" to be determined exclusively on the basis of documents specified in the undertaking. The presentation of documents in conformity with the terms and conditions of the undertaking triggered the payment obligation irrespective of any ultimate determination of the facts evidenced in those documents. The purely documentary approach was orientated at the traditional function of banks to "deal in documents and not in goods or services" and designed to ensure prompt payment (a feature labelled as "moneyness").

#### *Non-documentary conditions in independent undertakings*

55. In considering the above approaches, it was realized that their main difference related to the treatment of non-documentary conditions. While the purely documentary approach excluded any undertakings containing, intentionally or inadvertently, a non-documentary condition of effectiveness or of payment, the two other approaches covered those

non-documentary conditions that would not render the undertaking to be accessory. It was stated that a result similar to that of the purely documentary approach could be reached by converting any such non-documentary conditions into documentary ones. It was also observed that the more rigid documentary approach might be more appropriate in a legal system where the determination of an undertaking given by certain institutions as being accessory would entail nullity of the undertaking than in legal systems where such determination would merely lead to the application of a different body of law (i.e., law of suretyship).

56. With a view to quantifying the problem by getting a clearer picture of the practical dimension of non-documentary conditions in independent undertakings, the Working Group engaged in an overview of the kinds of non-documentary conditions encountered in the practice of bank guarantees and stand-by letters of credit.

57. It was reported that, in addition to factors having to do with time and calendar dates, a number of categories of non-documentary conditions were found. One category related to the establishment of the guarantee. For example, the establishment of a substitute guarantee might be conditioned on the return of the original guarantee instrument. A second category concerned pre-conditions for the effectiveness of the undertaking, for example, in an advance payment guarantee, that the advance payment had been made. A third category encompassed conditions in connection with the demand for payment that were mentioned in a guarantee without a stipulation as to how the fulfilment of the condition was to be evidenced. For example, a tender guarantee might be conditioned on the fact that the contract had been awarded, or a guarantee might state that payment was due if a certain event occurred that was or was not stated to be linked to an underlying transaction, or a counter-guarantee might be payable when the ultimate beneficiary demands payment from the beneficiary of the counter-guarantee. A fourth category concerned increases and reductions in the guarantee amount. For example, a guarantee might provide that the amount was to be increased in accordance with the opening of letters of credit by an importer or as the volume of goods delivered increased. Such automatic provisions were also associated with the reduction of the guarantee amount, for example, as deliveries or works progressed. A final category of non-documentary conditions had to do with expiry clauses. For example, a guarantee might make reference to the completion of works or deliveries as the point of expiry. It was pointed out that such indefinite expiry terms were often accompanied by fixed, ultimate expiry dates.

58. Examples of non-documentary conditions in stand-by letters of credit included that the demand for payment be signed by a duly authorized officer, non-calendar time periods for demands such as bond-maturity periods, deadlines for submission of a demand in order to obtain same-day payment, restriction of presentation of documents and of payment to a particular location, and indefinite expiry terms (accompanied by fixed, ultimate expiry dates) such as those mentioned above in relation to guarantees.

59. Various observations were made as a result of the overview. One observation was that the manner in which

non-documentary conditions came about varied, being in some instances due to oversight or poor drafting, and in other instances due to the intention of the parties. An example of the former case would be an undertaking that failed to specify the manner in which the fulfilment of only one of a number of demand-related conditions was to be evidenced. An example of intentional insertion might be the repayment guarantee where the guarantor was in many cases willing to establish for itself that the advance payment had indeed been made.

60. It was also observed that, as to the acceptability from the operational point of view, there was a spectrum of non-documentary conditions. On one end of the spectrum there were those factors that were not truly conditions defined as uncertain future events. Those factors related to time, calendar date, and any other event the occurrence of which was certain. Also at this end of the spectrum were conditions that related to events which fell within the guarantor's purview or sphere of influence. For example, as regards the case cited above of a non-documentary condition for the establishment of a substitute guarantee, the guarantor was in a position to determine, without investigation beyond its own purview, whether it had received the original guarantee instrument. Similarly, when an advance payment guarantee conditioned its effectiveness or a demand for payment upon the deposit of the advance payment into an account held by the guarantor, the determination of whether that condition was fulfilled fell within the guarantor's purview as a banker. It was doubtful, however, whether it fell within the purview of the issuer of a standby letter of credit to determine whether a requirement that the demand for payment be signed by a duly authorized officer had been met. At the other end of the spectrum lay conditions that involved facts or events the occurrence of which was uncertain and the determination of which lay outside the purview of the guarantor.

#### Conclusions

61. In view of the foregoing, in particular the impression that the vast majority of instruments being contemplated for coverage by the uniform law were of a documentary character, it was agreed that the provisions in the uniform law should focus on instruments containing only documentary conditions. It was understood that the independent nature of the undertaking and the documentary nature of the conditions in a guaranty letter, while not equivalent concepts, were closely intertwined. It was therefore agreed that terms should be added elsewhere in the uniform law relating to the documentary nature of the conditions in a guaranty letter that reflected the deliberations of the Working Group concerning non-documentary conditions. It was further agreed to consider, after having completed the current review of the tentative draft text of a uniform law, whether independent undertakings containing non-documentary conditions should be covered by the uniform law and, if so, how such conditions should be treated.

#### Paragraph (2)

62. While some expressions of support and of reservations were made concerning paragraph (2), it was generally agreed that the Working Group should defer consideration of paragraph (2) since its deliberations and decisions with

respect to paragraph (1) would result in significant revisions of the latter paragraph, which in turn might affect the function and content of paragraph (2).

#### Article 4. *Internationality of guaranty letter*

63. The text of draft article 4 as considered by the Working Group was as follows:

"(1) A guaranty letter is international if:

*Variant A:* (a) the places of business specified in the guaranty letter of any two of the following parties are in different States: guarantor, beneficiary, principal [instructing party, confirming guarantor]

*Variant B:* (a) any two of the guarantor, beneficiary and principal have their place of business in different States, provided that this fact is apparent to the guarantor and the beneficiary either from the undertaking or from information disclosed no later than the time of receipt of the guaranty letter by the beneficiary.

l, or

(b) if the guaranty letter expressly so states].

"(2) For the purposes of the preceding paragraph:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the guaranty letter;

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

#### Paragraph (1)

64. The Working Group expressed a preference for variant A on the ground that it would provide significantly more certainty than variant B in determining whether a given instrument met the test of internationality so as to trigger application of the uniform law. This greater degree of certainty resulted from the fact that variant A, unlike variant B, permitted internationality to be determined from an examination of the face of the instrument, without the necessity of any further investigation, an approach that was considered more consistent with the independent nature of the undertaking. At the same time, however, the view was expressed that an approach such as that in variant B might provide, in some cases, a more accurate determination of internationality, for example, when the place of business of a party situated in a foreign country was not specified in the guaranty letter.

65. Despite the agreement with the thrust of variant A, there was a general concern that, under the present formulation of variant A, certain instruments that were closely tied to international commerce, though perhaps not meeting a literal test of internationality, would be excluded from the scope of the uniform law. As an example, it was pointed out that, under variant A, a wholly domestic counter-guarantee backing an international guarantee or a domestic guarantee securing an international commercial transaction would not meet the internationality requirement of the uniform law. It was suggested that such a limitation on the scope of the uniform law would detract from its effectiveness in achieving harmonization.

66. In connection with the discussion of a possible need to broaden the scope of the definition of internationality, it was recalled that the Working Group had previously discussed, and left open the final decision on, whether the uniform law should extend to domestic transactions. At the same time, a note of caution was struck about going too far in the direction of regulating domestic transactions since this might affect the acceptability of the uniform law; States would anyway remain free to adopt the uniform law to govern their domestic transactions. In this regard, it was suggested that the uniform law might be accompanied by a recommendation that enacting States might consider the option of dispensing with article 4 in its entirety.

67. Various approaches were suggested to broadening the scope of the definition of internationality. One suggestion was to add a statement to paragraph (1) that instruments that involved the interests of international commerce or in which the underlying transaction was international would meet the internationality requirement. Reservations were expressed as to such an approach on the ground that it would not be apparent on the face of an instrument whether such a requirement had been met, thus injecting an unacceptable degree of uncertainty.

68. There was considerable support for expanding the definition of internationality by retaining the terms "instructing party" and "confirming guarantor" in the list of parties in variant A whose places of business, if appearing on the instrument, would be relevant to determining internationality. As to the confirming guarantor, it was suggested that a more appropriate term might be "confirmer" since it could be considered that a confirmation of a guaranty letter did not involve the issuance of a separate guaranty letter. There was also support for referring to the counter-guarantor, as there were occasionally cases in which the counter-guaranty letter was issued by someone other than the instructing party. A view was expressed, however, that the relationship between a counter-guarantor and a guarantor was one of indemnity and therefore should not be mentioned in the same breath with the other parties being listed. It was further suggested that the terms "applicant" and "issuer" be added in order to reflect stand-by letter of credit practice.

69. Another proposal was to provide that stand-by letters of credit that referred to the UCP would be considered international under the uniform law. It was stated that such a technique would promote application of the uniform law and at the same time fill a vacuum left by the fact that the UCP did not regulate all important aspects of stand-by letters of credit. It was also pointed out that some jurisdictions had used a comparable technique in passing statutory enactments that permitted the applicable law to be supplanted by the UCP when the parties so chose. The reservations that were expressed about that proposal involved concerns over the propriety of referring in the uniform law to a set of contractual rules, rules that undoubtedly would be modified, the appropriateness of providing a technique resulting in the characterization of wholly domestic transactions as international, the danger of defeating the expectations of unsuspecting parties as to the applicable law, and the possibility of conflicts between the provisions of the UCP and of the uniform law. The necessity of such a pro-

vision was also questioned in view of the fact that parties were free to use subparagraph (b) to obtain applicability of the uniform law. Because of these considerations, the proposal in its present form failed to gain support. There was, however, a greater degree of sympathy for somewhat modified versions of the proposal. For example, it was proposed that any possibility of fulfilling the internationality requirement through a reference to the UCP should be limited to relationships between professionals. Such a limitation would be intended, in particular, to protect the interests and expectations of consumers attempting to obtain the issuance of suretyships rather than simple-demand instruments. It was also proposed to provide that the requirement of internationality could be met by a reference to internationally accepted rules or usages, which could be interpreted as including the UCP.

70. The Working Group next considered the merits of retaining subparagraph (b), which provided that an instrument could meet the internationality requirement by merely calling itself international. The effect of this provision in broadening the scope of application of the uniform law was cited in support of retention. At the same time, the appropriateness of retaining the provision was questioned, in particular because it was felt to be inappropriate to describe a domestic instrument as international. There was also a concern that such a device for application of the uniform law to wholly domestic instruments might be regarded as an intrusion into the sphere of domestic legislation. However, there was substantial support for inclusion in the uniform law of a provision permitting parties to opt for the application of the uniform law, and this should be done in a straightforward manner, rather than through a provision on internationality. It was observed that such an "opting-in" provision might go some of the way in meeting the objectives of the proposal that application of the uniform law be triggered by a reference to internationally accepted rules.

#### *Paragraph (2)*

71. A question was raised as to whether paragraph (2) would have any continuing relevance following the selection of variant A in paragraph (1). It was noted that paragraph (2) had been included with a view primarily to the possibility that the Working Group would select variant B in paragraph (1), necessitating the inclusion of the guidelines in paragraph (2) for the determination of the relevant place of business or habitual residence of a party. While it was agreed that much of the rationale for the inclusion of paragraph (2) had fallen away with the disappearance of variant B, it was recognized that there might nevertheless be situations arising under variant A which would warrant the retention of the substance of paragraph (2). It was pointed out that the continued relevance of paragraph (2) might be assured because of the possibility that a guaranty letter might list two places of business for a party, for example, when a guarantor with multiple places of business issued a guaranty letter with its letterhead listing more than one place of business. Another observation was that, if paragraph (2) were to be retained, its formulation should remain essentially the same, since it was based on similar provisions that had successfully been incorporated in a number of international conventions and that were therefore widely accepted and understood.

72. In view of the foregoing, it was agreed that a final determination on paragraph (2) would have to be deferred to a later stage. The Secretariat was requested to prepare an alternative draft version that was geared to the future text of paragraph (1) based on variant A.

## Chapter II. Interpretation

### Article 5. Interpretation of this [Law] [Convention]

73. The text of draft article 5 as considered by the Working Group was as follows:

*"Version for Model Law:* In the interpretation of this Law, regard is to be had to its international origin and to the need to promote the observance of good faith in international guaranty and credit practice.

*"Version for Convention:* In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international guaranty and stand-by letter of credit practice."

74. It was noted that this article presented two versions, pending the decision of the Working Group on whether the uniform law should take the form of a model law or of a convention, and that a decision on which version to select would therefore have to be deferred until the decision on the form of the uniform law had been reached. It was agreed that the reference to "stand-by letter of credit practice", found in the convention version, was preferable to the reference simply to "credit practice", found in the model law version, and should be retained in both versions. It was suggested that a definition should be added to the uniform law of the term "stand-by letter of credit", the first mention of which appeared in the present article. That suggestion was accepted by the Working Group, which noted that a clearer picture of the terms that needed definition would emerge as work on the uniform law progressed.

### Article 6. Definitions and rules of interpretation

75. The text of draft article 6 as considered by the Working Group was as follows:

"[For the purposes of this Law and unless otherwise indicated in a provision of this Law or required by the context:

(a) 'guaranty letter' includes 'counter-guaranty letter' and 'confirming guaranty letter,' and 'guarantor' includes 'counter-guarantor' and 'confirming guarantor';

(b) any reference to the terms of the guaranty letter or the undertaking of the guarantor is to the text as originally established in accordance with article 7 or, if later amended in accordance with article 8, to the text in its last amended version;

(c) where a provision of this Law refers to a possible agreement of the parties, the parties meant are the guarantor and the beneficiary of the guaranty letter in question and the reference is to any term of the guaranty

letter or its amendment or to any separate agreement between the guarantor and the beneficiary.]"

76. Support was expressed for the rule of interpretation concerning the term "guaranty letter" in subparagraph (a). It was suggested, however, that the provision should be expanded to include stand-by letter of credit terminology.

77. A view was expressed that the necessity and purpose of subparagraphs (b) and (c) was unclear. As to the content of subparagraph (c), it was suggested that the use of the word "agreement" be reconsidered, since that term might unnecessarily raise the question of the contractual nature of the undertaking. A suggestion was made that subparagraph (c) might need to be reformulated in order to take account of the transferability of stand-by letters of credit and the resultant presence of more than one beneficiary. An observation was made that subparagraph (c) did not adequately reflect the complications that might arise when the confirmer of a stand-by letter of credit refused to agree to an amendment thereof.

78. It was proposed that a definition of "counter-guaranty letter" should be added, and that it should take into account the independence of the counter-guaranty letter not only from the underlying commercial transaction, but also from the guaranty letter issued by the beneficiary of the counter-guaranty letter. Suggestions for additional terms to be defined included "counter-guarantor" and "confirmation of guaranty letter".

## Chapter III. Effectiveness of guaranty letter

### Article 7. Establishment of guaranty letter

79. The text of draft article 7 as considered by the Working Group was as follows:

"(1) *Variant A:* A guaranty letter may be established by any means of communication that [itself] provides a record of the text of the guaranty letter.

*Variant B:* A guaranty letter may be issued in any form which preserves a complete record of the information contained therein [and is authenticated as to its source by generally accepted means or by a procedure agreed upon by the parties].

*Variant C:* The guaranty letter shall be issued by a means of communication that provides a record thereof, including by an authenticated teletransmission or equivalent electronic data interchange message.

"(2) *Variant X:* The guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt]. The guaranty letter becomes effective at that time, unless it states a different time of effectiveness [, by reference to a fixed date or to a determinable period of time,] or [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor on the basis of a document specified in the guaranty letter] [it makes its effectiveness depend on the

occurrence of a specified, uncertain future event, in which case the guarantor may require the beneficiary to certify that occurrence, unless the parties have agreed on another means of establishing that occurrence or its verification is within the purview of the guarantor].

*Variant Y:* Unless otherwise stated therein, a guaranty letter becomes effective and irrevocable when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt]."

80. The view was expressed that it would be preferable, from the standpoint of clarity, to place into separate articles the provisions on the form of establishment of a guaranty letter, presently contained in paragraph (1), and the provisions governing the time of establishment of the guaranty letter, which were presently in paragraph (2).

#### *Paragraph (1)*

81. As to the three variants of paragraph (1), one view favoured variant C because it specifically mentioned electronic and other paperless means of communication that were currently used in the issuance of guaranty letters. However, the widely prevailing view was that variant B should be selected. The primary ground for that choice was a perception that variant B contained the formulation that not only covered the currently used means of communication but also accommodated possible future developments. variant B was also said to be preferable because, unlike variant A, it required authentication and because it was clearer than variant C as to the required record. Particular reference was made to the need to make it clear that the uniform law did not embrace purely oral forms of issuance. Another observation was that additional clarity might be achieved by including in the uniform law a definition of "issuance".

#### *Paragraph (2)*

82. The Working Group next considered the two variants of a rule on the time of establishment and effectiveness of the undertaking embodied in the guaranty letter. It was noted that paragraph (2) contained three distinct terms addressing discrete issues relating to the existence and effect of the undertaking. The term "binding" was designed to refer to the existence of a commitment that could not be withdrawn and would, for example, entitle the guarantor to the agreed fee or charges. The term "irrevocability" referred to the firm character of an existing undertaking that could not be revoked; that term was not to be equated with the term "binding", since the notion revocation presupposed a binding undertaking. Finally, the term "effective" was designed to refer to the fact that the guaranty letter, either at the time of establishment or at a point subsequent thereto, is available for draw, i.e., open for making a demand for payment in conformity with the payment requirements.

83. As to the content of a rule on time, one view was that the guaranty letter would be established at the time of receipt by the beneficiary. Such a rule was said to have the benefit of giving guarantors the opportunity to withdraw or amend guaranty letters prior to receipt. The prevailing view, however, was in favour of the time of issuance, that

is, when the guaranty letter leaves the guarantor's sphere of control.

84. In support of a rule based on issuance, reference was made to the inter-bank practice of sending guarantee and stand-by letter of credit messages through the S.W.I.F.T. network. It was pointed out that in such inter-bank practice establishment was deemed to take place upon release of the message. The certainty provided by a rule based on issuance, with no question of proof of receipt, was said to be necessary in order for banks to be able to carry out instructions for the issuance of guaranty letters without the risk that, after those instructions had been carried out, the original instructions would be withdrawn. Some hesitation was expressed as to the extent to which such a closed inter-bank network could shed light on the issues to be dealt with in the uniform law. It was suggested that different considerations might be relevant to a decision on establishment with respect to the beneficiary than those at play in inter-bank dealings, and that the resulting rules for the two sets of relationships might have to be different. Such a dual approach failed to generate substantial support in the Working Group, because of the concern that a dual rule would create considerable uncertainty. As had been the case at previous sessions of the Working Group, the prevailing view was that the establishment of the guaranty letter should be linked to issuance and not to receipt, and that there should only be one rule in this respect.

85. Having affirmed the rule of establishment upon issuance, the Working Group decided that the formulation of that rule in variant Y, in particular because of its relative simplicity, was preferable to that contained in variant X. As to the specific formulation of variant Y, it was proposed that the words "unless otherwise stated therein" should be deleted on the ground that such language was generally applicable to all non-mandatory portions of the uniform law. However, support was expressed for the retention of those words on the ground that they served not only an educational function but also constituted an essential reference to the possibility that the guaranty letter might contain conditions relating to the commencement of effectiveness and irrevocability at some point subsequent to establishment. It was noted that such a possibility had been set forth more explicitly in variant X and should be included in variant Y since stipulations on effectiveness were often found in practice.

86. Differing views were expressed as to the language between square brackets that provided that the guaranty letter would not take effect if the beneficiary rejected it promptly upon receipt. One view was that the language should be retained because it would permit the guarantor, in the event of a rejection, to have a clearer picture of its obligations than would be the case without the language. In particular, a guarantor would be able to remove a rejected guaranty letter from its books. It was suggested that the word "promptly" needed to be reconsidered in view of the variations in communications and other circumstances encountered from country to country. It was also suggested that reference should be made to "complete rejection" since it might otherwise be uncertain whether a beneficiary that protested the exact duration or amount of a guaranty letter was rejecting it in its entirety.

87. The prevailing view was that the language within square brackets should be deleted. One reason advanced in support of deletion was that the proviso injected an unacceptable degree of uncertainty in the determination of the time of effectiveness. Another reason was that the establishment of a guaranty letter was generally to the benefit of the beneficiary and that any objections on the part of the beneficiary would in all likelihood relate only to individual terms, in which case the beneficiary would request an amendment rather than reject the entire guaranty letter. In the unlikely case that the beneficiary indeed wanted to reject the entire guaranty letter, draft article 10 (a) or (b) would provide an appropriate way to achieve that result.

#### *Article 8. Amendment*

88. The text of draft article 8 as considered by the Working Group was as follows:

"(1) A guaranty letter may be amended in the form agreed upon by the parties or, failing such agreement, [in the form in which the guaranty letter was established] [in any form referred to in paragraph (1) of article 7]. [A party may be precluded by its conduct from asserting non-compliance with such form requirement to the extent that the other party has relied on that conduct.]

"(2) The amendment becomes effective, unless it states a different time of effectiveness,

*Variant A:* when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt].

*Variant B:* when it is issued by the guarantor, provided that the guarantor receives notice of the acceptance by the beneficiary within [ten] business days.

*Variant C:* when the guarantor receives notice of the acceptance by the beneficiary.

"(3) *Variant X:* The provisions of paragraphs (1) and (2) of this article do not excuse the failure of the guarantor to obtain the consent of the principal as may be required by the instructions of the principal or an agreement with the principal.

*Variant Y:* The provisions of paragraphs (1) and (2) of this article do not entitle the guarantor to invoke the amendment in support of any claim for reimbursement against the principal if the guarantor failed to obtain the consent of the principal as required by instructions of the principal or an agreement between the principal and the guarantor.

*Variant Z:* When issuing an amendment, the guarantor shall promptly dispatch a copy thereof to the principal."

#### *Paragraph (1): Form of the amendment*

##### *First sentence*

89. The Working Group considered the two alternative wordings placed between square brackets. It was recalled that a possible reason for requiring that the amendment be established in the form in which the given guaranty letter was established might be the consideration that the amendment modified in part that guaranty letter. However, the

Working Group was agreed that such a requirement would be too restrictive in practice. The Working Group adopted the second wording that allowed any form referred to in article 7(1) and, in effect, only excluded purely oral communications unless otherwise agreed by the parties.

##### *Second sentence*

90. It was recalled that the sentence between square brackets was modelled on article 29 of the United Nations Sales Convention, pursuant to a proposal made at the fourteenth session (A/CN.9/342, para. 85). The view was expressed that the sentence might be useful in the situation where the parties had agreed on a specific form for amendments but later not complied with that requirement; subsequent conduct of a party might then preclude reliance on the non-compliance.

91. In response, it was stated that such a situation was more likely to arise in the context of a relationship between buyer and seller than in the context of a more limited and more formalistic guaranty operation. It was also stated that the provision of article 7(1) relied on a formalistic approach of the guaranty letter by requiring a record thereof. There might therefore be some contradiction in focusing on the conduct of the parties as regards the amendment of the guaranty letter. The view was also expressed that the principle contained in the sentence would most probably be applied by courts in all legal systems even in the absence of a specific provision.

92. After discussion, the Working Group decided to delete the sentence between square brackets.

##### *Paragraph (2): Time of effectiveness*

93. As regards the opening words, the view was expressed that it might be useful to distinguish clearly between an agreement of the parties in the amendment concerning the postponement of the time of its effectiveness and a previous agreement, probably contained in the guaranty letter, concerning the time of effectiveness of any future amendment.

94. As regards the proposed variants, the Working Group noted that while variant A embodied the concept of implied or silent acceptance, variants B and C required express acceptance. Variant B differed from variant C in that it did not use the time of receipt of the notice of acceptance as the point determining the time of effectiveness, as did variant C, but used for that purpose the earlier point of time of the issuance of the amendment, subject to timely receipt of the notice of acceptance.

95. The view was expressed that the rule on amendment should be parallel to the rule retained for the time of effectiveness of the guaranty letter itself. Another view was that the rule of variant A should be accompanied by the proviso that "the beneficiary, as long as it has not accepted the amendment, may rely on the terms of the unamended guaranty letter". That view was based on the consideration that a beneficiary should not be bound without acceptance.

96. Yet another view, based on the same consideration, was to require in each case an express acknowledgement

by the beneficiary, as provided for in variant C. Consideration should be given to including in the uniform law the principle, as found in draft article 10(e) of the proposed revision of the UCP, that an amendment would become effective only with the agreement of all parties bound by the undertaking, namely the issuer, the beneficiary and any confirmer. As regards the confirmer, it was, however, questioned whether its acceptance should be a condition of the effectiveness of an amendment as between the guarantor and the beneficiary.

97. Yet another view was that it might not be appropriate to include a general provision to the effect that notice of acceptance would need to be given by the beneficiary. It was observed that in practice the vast majority of amendments were made at the request of the beneficiary and very often consisted of an extension of the period of validity. Some other amendments related, for example, to the place or the currency of payment and were also often made at the request of the beneficiary. Where an amendment was based on a request by the beneficiary presented to the guarantor either directly or indirectly through the principal, the consent of the beneficiary should be presumed. It was stated in response that the time of effectiveness should not be made dependent on such uncertain and not easily verifiable criteria as whether the amendment originated from a request by the beneficiary and whether the amendment was in full conformity with that request.

98. Yet another view was that the rule expressed in variant A should apply to those situations where the amendment was in favour of the beneficiary while variant C should be retained only for the very few cases where the amendment was detrimental to the beneficiary. In response, it was recalled that the Working Group at a previous session had examined a proposal to prepare a dual set of rules depending on whether a given amendment was beneficial or detrimental to the beneficiary. As had been felt then, rules that involved subjective judgements were not easy to administer and did not provide the certainty required in practice. As an example, it was stated that it might be difficult to decide whether a change in the place or currency of payment would be favourable to the beneficiary.

99. In the light of the foregoing considerations, the Working Group searched for a solution that would provide certainty without compromising the beneficiary's interests, taking into account the fact that beneficiaries tended to remain silent in cases where amendments had been initiated by them or were otherwise in their favour. The Working Group focused its attention on the following two proposals.

100. The first proposal was to take variant B with the following modified proviso: "unless the guarantor receives a notice of rejection by the beneficiary within [10] business days". The second proposal was to take variant A for all those amendments that concerned an extension of the validity period of the guaranty letter and to take variant C for all other amendments.

101. In support of the first proposal, it was stated that it constituted a uniform rule for all types of amendment and provided a clear answer, for example, in the mixed case of an amendment that provided for an extension of the valid-

ity period and contained another modification as well. In support of the second proposal, it was stated that, unlike the first proposal, it implied or presumed acceptance by the beneficiary only in cases where the amendment was without doubt to its advantage. As to the query concerning the case of a mixed amendment, a clear answer could be obtained by refining the proposal so as to apply variant A to those cases where the amendment consisted solely of an extension of the validity period.

102. After discussion, the Working Group requested the Secretariat to prepare alternative draft provisions corresponding to the two proposals for further consideration at a later session.

#### *Paragraph (3)*

103. Divergent views were expressed as to the appropriateness of retaining paragraph (3), which addressed the relationship between the guarantor and the principal that was independent from the relationship established between the guarantor and the beneficiary. Doubts were expressed as to the need for including a provision in the uniform law to the sole effect of reminding the guarantor of its obligations to the principal in the context of an amendment of the guaranty letter. It was also noted that the provision did not provide for any sanction for failure to give notice under variant Z. It was further stated that it would not be appropriate for the uniform law to cover only a limited aspect of the relationship between the guarantor and the principal.

104. A contrary view was that the indirect link between the two relationships needed to be reflected in the uniform law. Support was expressed in favour of variant Y since it accurately reflected the indirect link between the two relationships and the fact that the amendment might affect the final obligation of reimbursement owed by the principal to the guarantor. Support was also expressed in favour of variant Z, as it would add an element of certainty to the practice of amendments. The view was also expressed that both variants should be combined.

105. After discussion, the Working Group was agreed that variants Y and Z would be retained between square brackets for further consideration at a later session, when it would be clearer to what extent the uniform law would contain provisions concerning the relationship between the guarantor and the principal.

#### *Article 9. Transfer of rights; assignment of proceeds*

106. The text of draft article 9 as considered by the Working Group was as follows:

"(1) The beneficiary may not transfer its right to make a demand for payment under the guaranty letter,

*Variant A:* unless so authorized by the guarantor [, either in the guaranty letter or by separate consent in any form referred to in paragraph (1) of article 7].

*Variant B:* except where the guaranty letter was given for the purpose of securing the beneficiary against the non-performance of certain obligations by the principal and the right to claim performance from the principal has passed from the beneficiary to the intended transferee.

"(2) However, the beneficiary may assign to another person any proceeds to which it may be entitled under the guaranty letter. If the guarantor has notice of the assignment, only payment to the assignee discharges the guarantor from its liability towards the beneficiary."

107. It was noted that the draft article drew a distinction between the transfer of the rights to demand payment under the guaranty letter and the assignment of any proceeds that might be forthcoming by way of payment of the guaranty letter. It was recalled that that distinction had been agreed upon by the Working Group at an earlier session and that it was also drawn in the UCP and the draft URDG.

#### *Paragraph (1)*

108. It was noted that variant A limited the transferability of the right to demand payment under the guaranty letter to the case where the guarantor authorized such transfer, while variant B limited the right of transfer to those cases where the secured creditor under the underlying relationship changed, whether by assignment of the underlying contract or by operation of law. While variant B was said to have the advantage of providing certainty about the effect of such a change on the relationship between the beneficiary and the guarantor (by indirectly rejecting the notion of an automatic termination of the guaranty letter or of an automatic transfer of the beneficiary's rights), it was generally viewed as undermining the independent nature of the guaranty letter and as being contrary to the interest of the guarantor who did not want to be faced with an unknown and possibly unreliable beneficiary.

109. The Working Group thus agreed with the idea underlying variant A that a transfer of the right to demand payment under the guaranty letter should not be binding on the guarantor unless the guarantor had consented to the transfer. Various questions were raised as regards the concept of transfer and its authorization as embodied in variant A.

110. It was asked, for example, what sanction would apply in the case where a transfer had taken place without prior authorization by the guarantor and whether an unauthorized transfer might affect the validity of the undertaking. In response, it was stated that, for the purpose of the uniform law, an unauthorized transfer would be deemed not to have taken place and would not have any impact on the validity of the undertaking under the uniform law.

111. Another question was whether the necessary authorization had to be given before the transfer or whether it might be given at a later time, for example, until payment would be demanded from the guarantor. In the latter case, the guarantor would in effect have an option, by deciding on whether or not to consent to the transfer, to select between the (original) beneficiary and the (intended) transferee as the person entitled to demand and receive payment. It was agreed that the question should be clearly answered in the uniform law, probably in favour of a consent to be given prior to transfer.

112. In this connection, it was stated that while the current wording of variant A suggested that the transfer would be authorized by the guarantor and effected by the beneficiary,

the practice of stand-by letters of credit was different. Stand-by letters of credit were often designated as transferable and, under the proposed revision of the UCP ("UCP 500"), the actual transfer could only be effected by the issuing bank itself or by an entity referred to as the transferring bank, either by re-issuing or by amending the stand-by letter of credit. Moreover, stand-by letters of credit frequently were transferable more than once and therefore did not meet the requirement contained in article 54 (e) of the UCP that transferable credits be transferable once only. A suggestion was made that specific wording should be included in the text of variant A to reflect that practice. Referring to guaranty letters, some representatives pointed out that it would be helpful to establish a rule stating that a guaranty letter should be transferable only once.

113. Yet another question was whether a transfer needed to relate to the whole amount or whether a partial transfer was allowed. It was noted that this and other questions were addressed in detail in article 54 of the UCP and in even greater detail in the proposed revision of the UCP. It was suggested that at least some of the questions addressed in the UCP might usefully also be dealt with in the uniform law.

114. After discussion, it was agreed to retain the substance of variant A and to request the Secretariat to prepare draft provisions on those additional questions that might usefully be dealt with in the uniform law, taking into account the difference in legal character of a law and of operational rules such as the UCP.

#### *Paragraph (2)*

115. The Working Group was agreed that the first sentence served a useful purpose in that it established a clear distinction between the transfer of the right to make a demand for payment and the mere assignment of proceeds under a guaranty letter.

116. Divergent views were expressed as regards the second sentence. One view was that the provision should be deleted as unnecessary; the uniform law should not attempt to regulate such matters as the effect of payment, which would be addressed by the relevant provisions of the law applicable to the discharge of obligations.

117. Another view was that the provision was useful in that it relieved the guarantor from the need to examine the validity of the assignment. The provision did not attempt to unify the disparate national laws on assignment, for example, by making notice to the guarantor a requirement of validity of the assignment. It rather limited itself to addressing the effect of an assignment known to the guarantor by providing that payment should be effected to the assignee and that such payment discharged the guarantor's liability towards the beneficiary. It was suggested that the second sentence should be maintained without the word "only" and with additional wording to the effect that it was subject to the provisions on set-off in article 20.

118. Yet another view was that the reality was more complex than suggested in the draft provision and that the second sentence should be rephrased to take into account such

questions as what would be the obligations of the guarantor regarding payment upon receipt of several assignment notices exceeding the amount of the guaranty letter. In this connection, it was suggested that, for practical reasons, the provision should not focus on the assignment between the beneficiary and the assignee but on an acknowledgement by the guarantor that would lay down how to proceed when payment is demanded.

119. After discussion, the Working Group requested the Secretariat to prepare draft provisions reflecting the above stated views for consideration at a later session.

#### *Article 10. Cessation of effectiveness of guaranty letter*

120. The text of draft article 10 as considered by the Working Group was as follows:

"The guaranty letter ceases to be effective, irrespective of whether [the instrument] [any document embodying it] is returned to the guarantor, when:

(a) the guarantor receives from the beneficiary a statement of release from liability [in any form referred to in paragraph (1) of article 7];

(b) the beneficiary and the guarantor agree on the termination of the guaranty letter;

(c) the guarantor pays the maximum amount stated in the guaranty letter or, if that amount has been reduced according to an express provision in the guaranty letter [for reduction by a specified or determinable amount on a specified date or upon presentation to the guarantor of a document specified for this purpose in the guaranty letter], the remaining balance;

or

(d) the validity period of the guaranty letter expires in accordance with the provisions of article 11."

#### *Chapeau*

121. There was general support for the retention of the rule in the opening words that the non-return of the guaranty instrument was irrelevant to the cessation of the effectiveness of the guaranty letter. The rule was considered useful because there still were a limited number of jurisdictions in which the expiry date appearing in a guarantee was considered to be a mere indication of the expected time for the completion of the underlying transaction and, accordingly, of the expected duration of the guarantee, rather than the point of time at which the guarantee could definitely be considered as losing its effectiveness. It was also pointed out that in some jurisdictions a distinction was made between the expiry date of the guarantee, before which the default covered by the guarantee had to occur in order for a demand for payment to be in order, and the prescription period under the applicable law for the making of a demand for payment under the guarantee.

122. A number of suggestions and views were expressed as to the exact formulation of that rule. One suggestion was that the rule should be patterned on draft article 24 of the URDG and, for the purposes of emphasis, placed in a separate provision. Another suggestion was that the matter might be limited to the expiry of the guaranty letter and

therefore dealt with in article 11. Differing views were expressed as to whether, in the context of the return of the guaranty letter, reference should be made to the return of "the instrument" or of "any document embodying" the guaranty letter. The view was also expressed that the provisions of the uniform law, and in particular this provision, should indicate clearly whether they were of a mandatory or non-mandatory character. As to the latter comment, it was generally felt that the parties should be permitted to vary by agreement the rule on the effect of non-return of the instrument.

123. In the discussion of the rule on return of the instrument, reference was made to the dangers associated with the presence of instruments whose effectiveness has ceased. In particular, a concern was expressed that such instruments could, by giving the impression that they continued to represent a right to demand payment, serve fraudulent purposes. In order to counter that danger, it was proposed that the uniform law should, completely apart from the question of the cause of cessation of effectiveness, require the return of the ineffective guaranty instrument by the person in possession of it. Reservations were expressed to that proposal on the ground that, once the events specified in subparagraphs (a), (b), (c) or (d) had occurred, there existed no longer a payment obligation under the guaranty letter. Moreover, the inclusion of such a requirement would be inconsistent with the rule on the irrelevance of the non-return of the guaranty letter since it would lend credibility to the notion that legal consequences were in fact attached to non-return of the instrument. A concern was also expressed that such a requirement would result in uncertainty as to the legal consequences of a failure to return the instrument. In response to the latter concern, it was suggested that a failure to return the instrument would, under general contract law, leave the party in possession responsible for the damages resulting from the non-return of the instrument.

124. As to the remaining language in the *chapeau*, a question was raised as to the precise meaning of the words "ceases to be effective". A suggestion in the same vein was that particular care needed to be taken to ensure that the terminology used in article 10 did not conflict with that used in article 7.

#### *Subparagraphs (a) and (b)*

125. The Working Group agreed to retain subparagraph (a) in its present form, including the reference to formal requirements for the statement of release. It was observed that the present formulation of subparagraph (b), as well as of subparagraph (a), did not take account of the fact that, in particular in the case of a transferable stand-by letter of credit, there might be more than one beneficiary in the life of a guaranty letter due to successive transfers. Furthermore, the simultaneous presence of more than one beneficiary could result under a stand-by letter of credit that provided for a splitting of the payment between two or more beneficiaries. It was suggested that, in order to take account of the possibility of multiple beneficiaries, a term such as the "current beneficiary" might be used. It was also suggested that the problem might be dealt with by a rule of interpretation in conjunction with the provisions on transfer.

126. A question was raised as to whether subparagraph (b) should be more precise as to the form of the termination agreement between the beneficiary and the guarantor by including the same type of reference to formal requirements as was contained in subparagraph (a). In favour of the addition of such language, it was stated that the guarantor needed to have the termination in writing, in particular when the termination would result, as was often the case, in a reduction of the guarantor's security interest in the principal's assets. In favour of the existing text, it was stated that there was an advantage to having fewer formal requirements for the termination than for the establishment of a guaranty letter. For example, under the present text, the parties could agree orally to terminate the guaranty letter by way of the return of the instrument, with no additional formalities. After deliberation, the Working Group decided to add provisionally a reference to formal requirements similar to the one contained in subparagraph (a) and to review the question at a later stage.

#### *Subparagraph (c)*

127. The Working Group agreed with the basic premise of subparagraph (c), in particular that cessation of the effectiveness of the guaranty letter should result when the guarantor had paid the amount available under the guaranty letter. At the same time, there was a widely held view that subparagraph (c) needed to be refined or elaborated. This view was based on the perception that the simple reference to payment by the guarantor of "the maximum amount stated in the guaranty letter" did not take adequate account of a previous partial payment and particular characteristics of some types of transactions, in particular certain types of stand-by letter of credit transactions, thereby causing anomalous results in those transactions. For example, in the case of a stand-by letter of credit that did not envisage partial drawings, if the single drawing permitted to the beneficiary was for less than the maximum amount, subparagraph (c) would not operate to terminate effectiveness.

128. It was suggested that the present formulation of subparagraph (c) was, for similar reasons, incapable of dealing with stand-by letters of credit that operated on a revolving basis. Such "revolving credits", which were based on commercial credit practice, provided, under the same credit, for a series of periods in which drawings up to a specified maximum amount were permitted, with a maximum cumulative amount. The rationale behind this practice was to provide coverage for a series of transactions without the need for repeated issuances of stand-by letters of credit. Such arrangements varied as to whether the unused drawing capacity from one subperiod could be carried over to the next subperiod, or whether, in such cases, the cumulative amount of the credit would be reduced by the unused amount. It was also suggested that some elaboration was needed in order to take account of the practice used by some issuers, at the point when a stand-by letter of credit had been drawn down, of amending the credit so as to increase the amount. As in the case of revolving credits, this practice was intended to avoid multiple issuances of credits.

129. A number of suggestions of a drafting nature were made with a view to dealing with the above problems. One

suggestion was to refer to the guaranty letter as not having been "renewed or renewable" or to include some other specific language to cover the cessation of effectiveness in special cases such as revolving credits. Another suggestion was to delete the word "maximum". Yet another suggestion was to refer simply to the payment of the maximum amount "available" under the guaranty letter. A further suggestion was to refer to the cessation of effectiveness when the "stipulated amount is paid".

130. As to the reference in subparagraph (c) to clauses in the guaranty letter for the reduction of the amount, a view was expressed that the uniform law should present, either in article 2 or, perhaps, in article 10, a more elaborate provision on the reduction of the amount of the guaranty letter. It was stated that reduction clauses were often characterized by an insufficient degree of detail or clarity and that, as a result, such clauses gave rise to a high number of disputes. Support for that view was limited on the ground that the problem was less likely to arise under the uniform law since clauses on reduction mechanisms in instruments falling within the scope of the uniform law would operate on a documentary basis and that therefore no additional language in the uniform law was necessary. Another objection to the inclusion of additional details on reduction clauses was the difficulty of assigning legal consequences to the failure to comply with requirements that would be set forth in the uniform law as to reduction mechanisms. In response to that objection, it was stated that the uniform law could provide that, in cases of non-compliance, the reduction provision would be stripped of its effect, and the guarantor would be justified in paying the entire amount.

131. The view was expressed that subparagraph (c) should refer to payment in a specified currency, in view of the risks posed by exchange rate fluctuations.

132. After deliberation, it was decided to request the Secretariat to review the precise formulation of subparagraph (c) with a view to reflecting the deliberations of the Working Group.

#### *Subparagraph (d)*

133. The Working Group adopted subparagraph (d) unchanged.

### *Article 11. Expiry*

134. The text of draft article 11 as considered by the Working Group was as follows:

"(1) The validity period of the guaranty letter expires:

(a) at the expiry date [which may be a specified calendar date or the last day of a fixed period of time stipulated in the guaranty letter];

(b) if expiry depends according to the guaranty letter on the occurrence of an event, when the guarantor receives confirmation that the event has occurred by presentation of the document specified for that purpose in the guaranty letter [or, if no such document is specified, a statement of the beneficiary or other conclusive evidence of the occurrence of the event].

"(2) If the guaranty letter states neither an expiry date nor an expiry event or if a stated expiry event has not yet been established, the validity period expires [five] years after the establishment of the guaranty letter, unless the parties agree on an extension of the validity period."

#### Paragraph (1)

##### Subparagraph (a)

135. Wide support was expressed for the retention of the draft subparagraph, including the text between square brackets.

136. A concern was expressed regarding the situation where a counter-guaranty letter carried the same expiry date as the guaranty letter issued by the beneficiary of the counter-guaranty letter. While recognition of the independent nature of the two undertakings would normally lead to the conclusion that there could exist no link between the validity periods of the two instruments, it was suggested that the difficulties that were likely to arise in practice might call for a specific rule. Where a demand for payment was presented under the guaranty letter on the last day of the validity period of the guaranty letter, it would be impossible for the guarantor, in most instances, to present a demand to the counter-guarantor before the counter-guaranty letter had expired.

137. A view was expressed that, in this case, the guarantor had the possibility to make a conditional demand for payment under the counter-guaranty letter on the last day of validity of the counter-guaranty letter. That view was objected to on the ground that, in some jurisdictions, such a conditional or preventive call would be regarded as unfounded or abusive. Some support was given to the suggestion that the uniform law should provide for a limited extension of the validity period of the counter-guaranty letter beyond the expiry of the validity period of the guaranty letter; that extension, referred to as a period of grace, should be limited to the two or three days that would be necessary for the guarantor to present its demand to the counter-guarantor.

138. The contrary view was that the situation where the two instruments had the same date of expiry would be a consequence of an error or careless drafting and that it would not justify an exception to the principle of independence of the undertakings. After discussion, the Working Group was agreed that no exception should be made to the independent character of the guaranty letter.

139. In connection with the above discussion, the Working Group decided that a definition of the counter-guaranty letter should be included in the uniform law to make it clear that the counter-guaranty letter was as independent as any other guaranty letter and that it was not to be confused with any underlying obligation that might arise from an inter-bank indemnity or reimbursement agreement.

140. A suggestion was made to include in article 11 a provision to the effect that, should the validity period of the guaranty letter expire on a holiday, the validity period would be extended to the following business day. The Secretariat was requested to prepare a draft provision implementing that suggestion for consideration at a later session.

##### Subparagraph (b)

141. It was observed that, in subparagraphs (a) and (b), expiry through the passage of time and expiry upon the occurrence of an event were presented strictly as alternatives. It was pointed out, however, that in practice often a combined approach was used in that the guaranty letter contained an expiry date, but at the same time provided for expiry prior to that date upon the occurrence of a specified event. In order to accommodate that practice, it was suggested that the uniform law should reflect the possibility of combining the approaches contained in subparagraphs (a) and (b).

142. The view was expressed that the notion embodied in subparagraph (b) of an expiry of a guaranty letter upon the occurrence of an event was inappropriate. According to that view, the notion of expiry of the guaranty letter was properly linked to the passage of time, rather than to the occurrence of an event. The appropriate place for dealing with the issues raised in subparagraph (b) was said to be in subparagraph (a) or (b) of article 10, which dealt with the termination of the effectiveness of the guaranty letter. For example, it was suggested that the statement by the beneficiary referred to in subparagraph (b) might be considered to fall into the category of a release by the beneficiary as provided for in article 10(a). Along the same lines, it was suggested that the reference in subparagraph (b) to the occurrence of an event, aside from raising the danger of non-documentary conditions, was superfluous since, in a documentary instrument, it was not the occurrence of an event that was critical, but the presentation of a document. In response to the latter point, it was pointed out that the documentary guaranty letter would nevertheless refer to the occurrence of an event, albeit one the occurrence of which would be conclusively evidenced by a document.

143. Some of the same issues were raised in the discussion of whether to retain the text in square brackets, which indicated that, when the guaranty letter failed to specify the document to be submitted, the occurrence of the expiry event could be evidenced either by a statement from the beneficiary or by some other conclusive evidence. In particular, it was suggested that the retention of the language in question, which raised the spectre of non-documentary conditions, was inconsistent with the decision that the focus of the uniform law should be on instruments that bore only documentary conditions. The view was expressed that, were the language to be retained, its applicability to stand-by letters of credit would have to be specifically excluded.

144. Support was expressed for retention of the language in question on the ground that practice showed a significant degree of use, in guarantees as well as in stand-by letters of credit, of expiry-event clauses that did not specify the presentation of a particular document. It was suggested that, in the face of that practice, not recognizing such clauses in the uniform law would create uncertainty as to the law applicable to a significant number of instruments. It was further suggested that recognition of such a practice would not be inconsistent with a focus in the uniform law on documentary undertakings because non-documentary conditions relating to expiry could be distinguished from non-documentary conditions relating to payment. That distinction did not receive universal support, however, as it

was pointed out that the presence of a non-documentary condition as to expiry could force the guarantor to engage in an investigation of some sort.

145. A number of points were made and differing views expressed with regard to the proposition that a statement from the beneficiary or some other conclusive evidence as to the occurrence of the expiry event could be relied upon by the guarantor when no document was specified. It was suggested that, since it could be assumed that the issuance of such a statement would not be in the interest of the beneficiary, the reference to the beneficiary's statement was of limited value. It was also suggested that entrusting the beneficiary with the decision as to the expiry of the guaranty letter in such a manner would raise the possibility of a fraudulent call by a beneficiary that, rather than issuing the statement after the occurrence of the expiry event, made a demand for payment. In response to those observations, it was pointed out that, precisely because the expiry of the guaranty letter was not in the beneficiary's interest, the beneficiary's statement could be considered the most reliable evidence of the occurrence of the expiry event.

146. Reference was also made to the use in practice of guarantees which provided that evidence of the occurrence of the expiry event was to be provided by the principal. The Working Group was informed that such guarantees rarely raised any difficulties, if for no other reason than that principals were typically not in a position to present evidence of the occurrence of the event (e.g., completion of construction) prior to the expiry date specified in the guarantee. It was noted that subparagraph (b), in particular through its reference to "other conclusive evidence", opened the door to the presentation by the principal of evidence of the occurrence of the expiry event. However, conferring the right on the principal to trigger the expiry of the guaranty letter in such a fashion was questioned on the ground that, at least from the standpoint of the beneficiary, it would diminish the value of the guaranty letter as an independent undertaking.

147. The Working Group went on to note that the words "conclusive evidence" were not meant to refer to clauses containing similar wording that were used in some settings to identify documents that parties agreed would be sufficient proof of the occurrence of an event. As to whether the use of those words was appropriate, the view was expressed that they were unacceptable on the ground that it might suggest that the proper role of the issuer of a guaranty letter went beyond the mere checking of documents for facial compliance. However, support was expressed for the retention of the reference to other conclusive evidence that satisfied the guarantor, on the ground that it afforded a necessary degree of protection to the principal.

148. After deliberation, the Working Group decided, pending further review, to retain subparagraph (b) in its present form, including the continued retention in square brackets of the reference to non-documentary provisions on expiry events.

#### *Paragraph (2)*

149. There was general agreement with the basic proposition of paragraph (2), namely that the uniform law should provide for a maximum period of validity for guaranty

letters that do not state an expiry date, in particular because a rule on this issue was considered necessary to provide legal certainty. No objections were raised to setting that period at five years.

150. Several observations were made as to the precise formulation of the rule. One observation was that it was imperative that the rule should not be cast in terms of a prescription period, as this might preclude renunciation prior to the expiry of the five-year period. Another observation was that the reference to the extension of the validity period by the agreement of the parties would have to be aligned with the text that would finally be agreed upon for amendment of the guaranty letter, in particular under article 8(2). A further observation was that, by making reference to the occurrence of an expiry event, paragraph (2) raised the same issue of non-documentary conditions that had been discussed in connection with paragraph (1)(b).

151. The attention of the Working Group was drawn to the fact that there were cases in which the parties intended that a guarantee should be of indefinite duration, and that such arrangements were sometimes used in response to administrative requirements, for example, when the beneficiary was a State involved in a transaction of indefinite duration. Reference was also made to instruments containing "evergreen clauses", which provided, upon expiry, for the repeated, automatic extension of the period of validity, an indefinite number of times, with the possibility of termination upon notice. Such instruments were distinguished, however, from guarantees that contained no expiry provision or that expressly referred to indefinite validity.

152. There was support for the view that a degree of flexibility needed to be injected into the present formulation so as to accommodate cases in which it was the intent of the parties to establish an indefinite validity period. The Working Group noted that various approaches were found in legal systems as to the question of indefinite duration of a guarantee, with some legal systems permitting indefinite validity on the basis of silence in the guarantee on the question of expiry, and others requiring an express clause in the guarantee as to indefinite validity; it was stated that, should any of these approaches be taken, an exception would need to be made for stand-by letters of credit. A consensus was reached that the uniform law should follow the latter approach, namely, that the five-year limit in paragraph (2) would apply, unless otherwise expressly stated in the guaranty letter. It was observed, at the same time, that the proposition that a party could not be bound indefinitely without the possibility of renunciation was universally recognized and that the modification of paragraph (2) should not be seen as supervening that basic principle.

## **Chapter IV. Rights, obligations and defences**

### *Article 12. Determination of rights and obligations*

153. The text of draft article 12 as considered by the Working Group was as follows:

"Subject to the provisions of this Law, the rights and obligations of the parties are determined by the terms

[and conditions] set forth in the guaranty letter, including any rules, [general] conditions or usages referred to therein."

154. The Working Group noted that the word "general" had been added to the text adopted at the fourteenth session (A/CN.9/342, para. 48) with a view to distinguishing more clearly between the conditions incorporated into the guaranty letter by way of reference and the individual conditions set forth in the guaranty letter, mentioned earlier in the text of this article.

155. A concern was expressed that the opening words of the article, at least in the French language version, might be interpreted as conferring a mandatory character on the provisions of the uniform law. In response, it was stated that those opening words were not intended to take a stand as to the mandatory character of the provisions of the uniform law. The wording as found in the English language version had been used in previous international instruments and was commonly interpreted as meaning that, where the uniform law contained provisions of a mandatory nature that would conflict with the stipulations of an individual agreement, those mandatory provisions would be applicable notwithstanding the contrary stipulations of the agreement. Similarly, the suppletive provisions of the uniform law would apply in the absence of an agreement by the parties on the matters regulated by those provisions. It was agreed that the text, in its various language versions, should be reviewed so as to prevent any misinterpretation.

156. As regards the extent to which commercial usage might govern the rights and obligations under a guaranty letter, the Working Group noted that the current draft only mentioned the usages that were referred to in the text of the guaranty letter. The view was expressed that rules and usages commonly used in international commercial practice, in so far as they did not conflict with mandatory provisions of the uniform law, should also be made applicable to the guaranty letter through article 12 even if they were not referred to in the guaranty letter.

157. The Working Group recalled that the question of the relevance of international usages had been discussed at the fourteenth session on the basis of the following variant of what was then article 6(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]."

158. At the fourteenth session, divergent views had been expressed in respect of the bracketed reference to international usage at the end of the paragraph. One view had been 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, had been that the reference to international usages should not be retained since it created uncertainty and might provide a trap to unwary parties (A/CN.9/342, para. 47).

159. The Working Group resumed its discussion of the issue. The proponents of the divergent views advanced the following reasons, in addition to those presented at the fourteenth session. In support of requiring a reference in the guaranty letter, it was stated that usage and practice were of little significance once a law was enacted that itself was built on prevailing usage or practice. Moreover, it would seem to be unjustified to impose rules of usage or practice on parties that had not availed themselves of the option of referring in the guaranty letter to any rules of usage or practice.

160. In support of not requiring a reference in the guaranty letter, it was stated that no uncertainty would result since the only relevant international usage in the field of bank guarantees and stand-by letters of credit were the draft URDG and the UCP that reflected widely known and accepted practices. Furthermore, a mention in the uniform law of the general applicability of international usage would merely confirm existing case law in some jurisdictions, while in others it would provide national courts with the necessary guidance to address those situations where a solution had to be found outside the stipulations of the guaranty letter and the provisions of the uniform law. Reference to international usage would therefore create unity and certainty.

161. An intermediate view was that usages that were not referred to in the guaranty letter might be made applicable to the interpretation of terms and conditions used in the guaranty letter.

162. With reference to the practices concerning an international guaranty letter, it was stated that a large number of parties might be involved that might reside in different countries and refer to different local practices, for example, as regards the time and modalities for payment, or the methods used by the guarantor to decide whether a demand for payment was proper or not. It was pointed out that reference to practice inherently involved a degree of uncertainty and that, in any event, relevant practices would be difficult to prove. In that connection, a proposal was made to provide in the draft article that the international usage should be "expressly" described in the guaranty letter, in the sense that the usage should be specified. It was added that the obligation to expressly describe the usage should not be misinterpreted as precluding a court from referring to well-known usages such as the UCP where no answer was provided by the guaranty letter itself or by the uniform law.

163. The Working Group then considered the legal value of usages that were not mentioned in the guaranty letter in comparison with the suppletive provisions of the uniform law. One view was that any applicable usage not referred to in the guaranty letter should have the same legal value as if it were referred to in the guaranty letter and thus

displace, or prevail over, any suppletive provision of the uniform law. Another view was that any applicable usage not referred to in the guaranty letter should be accorded a lower status than any incorporated rules of usage and thus merely supplement the suppletive rules of the uniform law.

164. After deliberation, the Working Group requested the Secretariat to add to article 12, for consideration at a future session, alternative wording between square brackets, taking into account the above views on the relevance and legal value of international usages not referred to in the guaranty letter.

### *Article 13. Liability of guarantor*

165. The text of draft article 13 as considered by the Working Group was as follows:

"[The guarantor shall act in good faith and exercise reasonable care as required by good guaranty and credit practice.] Guarantors [and instructing parties] may not be exempted from liability for their failure to act in good faith or for any [grossly negligent conduct] [act or omission done either with the intent to cause damage or recklessly and with the knowledge that damage would probably result]."

#### *First sentence*

166. Comments were made about several components of the standard of care set forth in the first sentence. As regards the reference to "good faith", it was observed that, in understanding that reference, the distinction had to be kept in mind between the contractual freedom of the parties to define the performance expected from the guarantor and the execution of that performance in good faith by the guarantor. It was also suggested that, from a practical standpoint, it would in some cases be difficult to determine what constituted good faith conduct on the part of the guarantor because of conflicting interests of the principal and the beneficiary.

167. It was noted that the duty to exercise reasonable care set forth in the first sentence of article 13 was reflective of draft article 15 of the URDG and, as regards the examination of documents for facial conformity with the terms of a documentary credit, of article 15 of the UCP. A question was raised as to the relationship between that type of duty to exercise reasonable care in the examination of documents and the notion of exemption of responsibility for the genuineness or legal effect of documents, as that notion was embodied in article 17 of the UCP. It was suggested that the mainstream view on this question was that the scope of the documentary examination was limited to ascertaining, with reasonable care, the conformity of documents with the documentary requirements set forth in the letter of credit.

168. It was reported that in many instances guarantors had, due to the business needs of principals, little choice but to incorporate terms and conditions into guarantees that were not of their own choosing and that this needed to be taken into account when considering the notion of reasonable care on the part of the guarantor. Reference was also

made to different approaches to the taking up of and payment against documents. It was said that letters of credit tended to be more uniform in defining clearly the documents to be presented and in requiring strict documentary compliance, whereas there was a greater tendency in guarantee practice to define the contents of required documents in a looser fashion since the types of documents needed for default instruments were not yet standardized. The view was expressed that that distinction should be kept in mind during the preparation of the uniform law.

169. As regards the reference to "good guaranty and credit practice", the view was expressed that the reference was useful because it served to narrow the focus of the reasonable care standard to the particular domain of guarantees and stand-by letters of credit and to foster reliance on good banking practice. However, questions were raised as to the meaning and necessity of such a reference, in particular because of a concern that it was vague and might give rise to the same type of uncertainty that had been discussed in connection with the reference in article 12 to "usages". In particular, it was pointed out that the definition of good guaranty and credit practice might differ depending upon the type of instrument in question as well as on the local law and practice. A suggestion was made that the reference to good guaranty and credit practice might be deleted, bearing in mind that, even in the absence of such a reference, courts would look to practice in order to measure the sufficiency of the guarantor's conduct. Another proposal was that an adequate level of certainty could be achieved by referring instead to the guarantor's duty to exercise reasonable care "in the discharge of its obligations under the guaranty letter".

#### *Second sentence*

170. Differing views were expressed as to whether the uniform law should permit guarantors to exempt themselves from liability for failure to act in good faith or to exercise reasonable care. One view was that article 13, which permitted exemptions for conduct in good faith not amounting to gross negligence, should be modified so that no exemptions at all would be permitted. In support of that view, it was stated that permitting exemptions for simple negligence would create an imbalance of the obligations of the parties and an opportunity for a strong party to dictate terms unfavourable to another party, particularly when one of the parties was not habitually involved in international trade. In particular, it was suggested that the interests of the principal would not receive adequate protection if there was room under the uniform law for the guarantor to act in other than a prudent manner. It was added that a certain limitation of liability might nevertheless be achieved by a narrow description of the guarantor's obligations under the guaranty letter or by a restriction of liability to foreseeable damages.

171. The other view, however, was that the current approach in article 13 should be retained, in particular because it preserved the contractual freedom of the parties to define what the conduct of the guarantor should be. It was suggested that such an approach would be in line with the general tendency in the law to give effect to contractual exemptions except for grossly negligent conduct. It was also stated

that exemptions should be permitted because the transactions in question typically involved banks and commercial parties, and not consumers. It was further suggested that providing for exemptions benefited commerce by permitting parties, when they so wished, to agree to a reduction in the liability of the guarantor, thereby making possible lower-cost instruments. An intermediary view supported in principle the approach in article 13 but advocated a higher standard of mandatory liability in respect of the responsibilities of the guarantor under article 16. If the rule permitting exemptions were to be retained, a clear preference was expressed for the term "grossly negligent conduct" over the wording modelled on article 8(1) of the Hamburg Rules.

172. It was noted that the duties of a guarantor differed depending upon the relationship in question and that the question of the relationships to be covered by the liability provision could be considered in the light of provisions imposing duties on the guarantor towards different parties. This could be seen, for example, in the UCP which established different duties on the part of the issuer to different parties. For example, article 17 of the UCP was particularly relevant to the relationship between the issuer and the principal, article 18 of the UCP to the relationship of the issuer to both the principal and the beneficiary, and article 19 of the UCP perhaps more to the relationship with the beneficiary. It was suggested that a similar breakdown could be found in the draft URDG, as well as in the description of a guarantor's duties set forth in general conditions governing a guaranty letter. It was suggested that, because of these different duties and parties involved, consideration might be given to applying different liability rules to the different relationships involved, with the further possibility of rules for liability of the guarantor prior to issue being distinct from rules governing liability after issue. This would, for example, allow guarantors and principals to agree on a lower standard than would apply to the guarantor's relationship with the beneficiary. In favour of establishing one standard to govern all relationships in question, reference was made to the increasing frequency with which parties involved in undertakings of a documentary character acted in multiple capacities, in that banks often were in the position of beneficiaries tendering documents, acted as instructing parties or principals, and might be regarded as account parties of confirming banks.

173. It was noted that, while mention of the instructing party was made in the second sentence, no such mention appeared in the first sentence. The reason for not referring to the instructing party in the standard of care set forth in

the first sentence for the performance of obligations under the uniform law was that the uniform law, in its present form, did not make any specific reference to obligations of an instructing party. Mention of the instructing party was made in the second sentence, however, because that sentence established a minimum or unbreakable standard of liability for all obligations under the guaranty letter, irrespective of the source of those obligations. The need for including a reference to the instructing party was questioned on the ground that it was not the usual practice for instructing parties to seek exemptions of the type permitted under the second sentence. The view was expressed, however, that including instructing parties within the ambit of article 13 would be useful, for example, to address the possibility that the conduct of the instructing party might be responsible for delay in the issuance of a guaranty letter and to cover the possible breach of other obligations that were imposed on instructing parties by draft articles of the URDG or the UCP.

174. A question was raised as to the interaction of the rule on liability set forth in article 13 with related provisions in the UCP and the draft URDG, either of which might be incorporated in the guaranty letter pursuant to article 12. It was noted that the approach in the present version of article 13 differed somewhat from the approaches taken in those two sets of rules and, furthermore, that the UCP and the draft URDG differed from each other. In the UCP, articles 17 through 20 exempted the issuer from liability on a wide variety of points such as genuineness, falsification and legal effect of documents, delay or loss in transmittal of documents, and the utilization of the services of other banks. The draft URDG exempted guarantors and instructing parties as to the same types of questions, but differed from the UCP in that the exemption did not apply, according to draft article 15 of the URDG, to failures to act in good faith and with reasonable care. Unlike the draft URDG, the UCP did not generally preclude exemptions in the case of negligence. Accordingly, a guaranty letter incorporating the URDG as currently drafted would not be affected by article 13 of the uniform law since the draft URDG contained a stricter standard as to exemption. By contrast, were a guaranty letter to be issued subject to the UCP, article 13 would, in the case of gross negligence, come into play to restrict the broad exemptions contained in the UCP.

175. After deliberation, the Working Group requested the Secretariat to prepare, in the light of the above suggestions and observations, a revised draft of article 13, including alternative versions of a rule on exemption from liability.

**B. Working paper submitted to the Working Group on International Contract Practices at its sixteenth session: independent guarantees and stand-by letters of credit: tentative draft of a uniform law on international guaranty letters: note by the Secretariat**

**(A/CN.9/WG.II/WP.73 and Add.1) [Original: English]**

[A/CN.9/WG.II/WP.73]

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[Tentative draft articles on conflict of laws, court measures and jurisdiction will be presented in an addendum to this note.]

**INTRODUCTION**

1. At its fourteenth session, the Working Group on International Contract Practices examined draft articles 1 to 7 prepared by the Secretariat (A/CN.9/WG.II/WP.67) and requested the Secretariat to revise those draft articles on the basis of the Working Group's conclusions (A/CN.9/342, para. 10). The Working Group considered, at its fourteenth and fifteenth sessions, 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) and requested the Secretariat to prepare a first draft of articles on the issues discussed (A/CN.9/342, para. 11; A/CN.9/345, para. 11). At its fifteenth session, the Working Group considered also the issues discussed in notes by the Secretariat relating to fraud and other objections to payment, injunc-

tions and other court measures (A/CN.9/WG.II/WP.70) and relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71) and requested the Secretariat to prepare, on the basis of the conclusions of the Working Group, a first draft set of articles on the issues discussed.

2. The present note has been prepared pursuant to those requests. It presents a tentative draft of a uniform law on international guaranty letters that contains provisions on all of the above issues on which the Working Group requested draft articles for its consideration. Draft articles on conflict of laws and on court measures and jurisdiction will be presented in an addendum to this note.

3. The style of presentation aims at facilitating the deliberations and decisions of the Working Group on the vari-

ous issues dealt with in the draft provisions. Alternative wordings or tentative suggestions by the Secretariat 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 article is followed by a list of references to the pertinent portions of reports of the Working Group and of notes by the Secretariat, and 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 which may be easily gathered from the sources given in the list of references.

## CHAPTER I. SPHERE OF APPLICATION

### Article 1. *Substantive scope of application\**

This Law [1] applies to international guaranty letters[2]. [3]

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

#### References

- A/CN.9/342, paras. 14-16  
A/CN.9/WG.II/WP.67, remarks on article 1  
A/CN.9/330, paras. 11-14, 35-57  
A/CN.9/WG.II/WP.65, paras. 8-59

#### Remarks

1. 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.
2. The term "guaranty letter" is defined in draft article 2, and draft article 4 sets forth the conditions under which a guaranty letter is international.
3. This draft article deals only with the substantive scope of application, unlike the previous version that addressed also the issue of the territorial scope of application. As was pointed out at the fourteenth session, the decision on that issue depends in some respects on whether the uniform law will 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). Accordingly, the issue of the territorial scope of application might be addressed at a later stage if the uniform law would be adopted in the form of a convention, or if the uniform law, adopted in the form of a model law, would not contain any provisions on conflict of laws.

### Article 2. *Guaranty letter* [1]

A guaranty letter [, however named or described,] is an [express] undertaking of independent [and essentially documentary] [2] character, given by a bank or other institution or person ([ "guarantor" ] [ "issuer" ] [3])

*Variant A:* at the request of its customer ("principal") or on the instruction of another bank, institution or person ("instructing party") acting at the request of that instructing party's customer ("principal"), [4]

*Variant B:* , whether or not so requested or instructed by another bank, institution or person, to pay to another person ("beneficiary") a certain or determinable amount of a specified currency or unit of account [or other item of value] [or to accept or negotiate without recourse a bill of exchange for a specified amount] [5] in conformity with the terms of the undertaking upon receipt of a demand

*Variant X:* made in the manner prescribed in the undertaking, provided that the undertaking [indicates that it] [6] is given for the purpose of [indemnifying the beneficiary for the consequences of a specified contingency] [securing the beneficiary against the non-fulfilment of certain financial or other obligations by the principal or against another specified risk].

*Variant Y:* stating or, if so required in the undertaking, certifying or otherwise establishing that payment is due.

#### References

- A/CN.9/342, paras. 17-21, 111-118  
A/CN.9/WG.II/WP.67, remarks on article 2  
A/CN.9/330, paras. 15-46, 77-81  
A/CN.9/WG.II/WP.65, paras. 9-52

#### Remarks

1. As indicated in draft article 6(a), the definition of guaranty letter would also apply to a counter-guaranty letter and a confirming guaranty letter. Following the approach suggested at the thirteenth session (A/CN.9/330, para. 78), special definitions of these two terms might later be included in the uniform law, in particular, if these terms would be used in operative rules in the uniform law.
2. The added reference to the essentially documentary character of the undertaking may serve as a reminder of the unresolved problem of the treatment of non-documentary conditions (A/CN.9/342, paras. 111-118) and indicate a possible location for a restriction of the scope of application to undertakings that are not only independent but also essentially documentary in nature. It is submitted that the most difficult part of the problem is to ascertain what non-documentary conditions that do not have the effect of rendering the undertaking to be accessory are found in practice and how that limited category of conditions should be

clearly defined. It may be noted that the tentative draft law presented in this note provides, in those instances where the problem of non-documentary conditions might be crucial, for the conversion of such conditions into documentary ones, at least in one variant of the draft provisions (e.g., articles 7(2), 10(c), 11(1)(b) and 14).

3. The term "issuer" has been added as a possible alternative to the term "guarantor" which, at least in some languages, might be associated more closely with an accessory than an independent undertaking. The term "issuer" might also be more appropriate if the Working Group were to decide that commercial letters of credit would be included in the scope of the uniform law. It is submitted that the ultimate choice might be facilitated by a review in the drafting group of the terminology currently used in the six official languages of the United Nations and, possibly, other languages.

4. If variant A were to be adopted, consideration might be given to expressing its substance in a separate paragraph (new (2)) that might, in addition, define a direct and indirect guaranty letter and, possibly, a guaranty letter given on the guarantor's own behalf, e.g.,

"(2) The undertaking may be given

(a) at the request of the customer ('principal') of the guarantor ('direct guaranty letter');

(b) on the instruction of another bank, institution or person ('instructing party') acting at the request of the customer ('principal') of that instructing party ('indirect guaranty letter'); or

(c) on behalf of the guarantor itself ('guaranty letter on guarantor's own behalf')."

5. The reference to bills of exchange has been added with a view to accommodating the practice under stand-by letters of credit that the undertaking is often, and apparently in the Far Eastern region exclusively, to accept or negotiate a bill of exchange rather than to make actual immediate payment.

6. Variant X, unlike variant Y, contains a reference to the purpose of the undertaking that would help to exclude from the definition the commercial letter of credit and other facilities without guaranteeing purpose. The purpose of the guaranty letter may also become relevant in the context of an improper demand (under article 19); in this context, consideration might be given to requiring, as suggested in the wording between square brackets, that the purpose be indicated in the guaranty letter.

### Article 3. *Independence of undertaking*

(1) An undertaking is independent if [, according to its terms,] [1] the payment obligation [does not depend on] [is not subject to, or qualified by,] the existence or validity of an underlying transaction [, whether or not referred to in the undertaking,] [between the principal and the beneficiary or between an instructing party and the guarantor] or of any other relationship, and the guarantor may [therefore] not invoke any defence arising from a relationship other than its relationship with the benefici-

ary. [The independent character of an undertaking is not affected by the fact that the guarantor, as provided in article 17(1)(c), may raise certain objections to payment that might be based on facts relating to any such other relationship.] [2]

(2) (a) An undertaking is [irrebuttably] deemed to be independent when it contains the heading "[Independent guaranty letter] [Independent documentary promise] [First demand guaranty letter]" and contains the same words also in its text. [Where an undertaking is deemed to be independent, any term or condition that would have the effect of rendering the undertaking to be accessory shall be treated as void.] [3]

(b) [Otherwise] [Subject to the provisions of subparagraph (a) of this paragraph], any characterization or a single term found in the text of the undertaking shall not be deemed conclusive [of whether or not the undertaking is independent] if other terms clearly weigh in favour of the opposite result. In evaluating the terms in their totality, the following factors may be regarded as points weighing in favour of independence:

- (i) The undertaking to pay is expressed to be "on simple demand", "on first demand", "on demand", "upon receipt of a written request", "unconditional", "irrespective of the validity or existence of X-Contract", "waiving all rights of objection and defences arising from said contract", "without proof of default" or is qualified by any other words of similar import;
- (ii) Payment is due upon receipt of a statement by the beneficiary or any document by a third party, and the guarantor is not required to verify any fact outside its purview;
- (iii) Any underlying transaction is referred to in the undertaking only in a preamble or otherwise in a recital of what has gone before, and not in operative clauses [, provided that the text of the undertaking is divided in that manner];
- (iv) The undertaking is stated to be subject to the Uniform Customs and Practice for Documentary Credits or the Uniform Rules for Demand Guarantees of the International Chamber of Commerce.

### References

- A/CN.9/342, paras. 22-31  
 A/CN.9/WG.II/WP.67, remarks on article 3  
 A/CN.9/330, paras. 16-19  
 A/CN.9/WG.II/WP.65, paras. 21-29

### Remarks

1. The reference to the terms of the undertaking has been placed between square brackets to invite consideration of whether that reference is appropriate or too restrictive. The reference might be regarded as a consequence of the view prevailing at the fourteenth session that the rule of interpretation in favour of independence, as contained in variant A of the previous version, should not be retained since it might lead to a result not expected by the parties concerned (A/CN.9/342, para. 24). It is submitted that the latter concern might be overcome by the educational effect of a new

law and, apart from that, might be raised with equal force against the provision of an irrebuttable presumption ("safe haven") as suggested in paragraph (2)(a).

2. The sentence between square brackets has been added to meet the concern expressed at the fourteenth session 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 or whether illegality of the underlying transaction may have an effect on the undertaking in the guaranty letter.

3. The sentence between square brackets has been added to invite consideration of whether it is necessary to spell out the effect of the presumption of independence and, if so, whether the suggested wording would be appropriate.

#### Article 4. *Internationality of guaranty letter*

(1) A guaranty letter is international if:

*Variant A:* (a) the places of business specified in the guaranty letter of any two of the following parties are in different States: guarantor, beneficiary, principal [instructing party, confirming guarantor]

*Variant B:* (a) any two of the guarantor, beneficiary and principal have their place of business in different States, provided that this fact is apparent to the guarantor and the beneficiary either from the undertaking or from information disclosed no later than the time of receipt of the guaranty letter by the beneficiary [1]

[, or

(b) if the guaranty letter expressly so states].

(2) For the purposes of the preceding paragraph [2]:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the guaranty letter; [3]

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

#### References

A/CN.9/342, paras. 32-47

A/CN.9/WG.II/WP.67, remarks on article 4

A/CN.9/330, paras. 47-57

A/CN.9/WG.II/WP.65, paras. 53-59

#### Remarks

1. The proviso contained in variant B is modelled on article 1(2) of the United Nations Sales Convention, as suggested at the fourteenth session (A/CN.9/342, para. 35) as an alternative to the requirement of specification contained in variant A.

2. Consideration might later be given to making the rule of paragraph (2) applicable to all provisions of the uniform law where the term "place of business" is used (e.g., any future articles on conflict of laws and on court measures and jurisdiction). If that term were eventually used in a

number of provisions, the rule contained in paragraph (2) might appropriately be incorporated into draft article 6.

3. The criterion suggested for determining the relevant place of business of a party that has more than one place of business is that adopted in article 10(a) of the United Nations Sales Convention. It is submitted that the place of business which has the closest relationship to the guaranty letter is the one where the party in question takes the steps that are typical of its involvement (i.e., where the principal gives its instructions; where the beneficiary receives the guaranty letter; where the guarantor undertakes its payment obligation by issuing the guaranty letter, even if the demand and any accompanying documents were to be presented at another place of business).

## CHAPTER II. INTERPRETATION

#### Article 5. *Interpretation of this [Law] [Convention] [1]*

*Version for Model Law:* In the interpretation of this Law, regard is to be had to its international origin and to the need to promote the observance of good faith [2] in international guaranty and credit practice.

*Version for Convention:* In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international guaranty and stand-by letter of credit practice.

#### References

A/CN.9/342, paras. 38-41

A/CN.9/WG.II/WP.67, remarks on article 5

A/CN.9/330, paras. 77-85

A/CN.9/WG.II/WP.65, paras. 83-86

#### Remarks

1. As an exception to the general drafting approach used in this tentative draft, this article is presented in two versions, pending the decision of the Working Group on whether the uniform law would be adopted in the form of a model law or in the form of a convention.

2. It may be noted that the principle of good faith is also embodied in some operative provisions (e.g., articles 13, 17(2) and 19). It is submitted that its inclusion in article 5 is nevertheless appropriate since that article deals with the issue of interpretation and covers all articles.

#### [Article 6. *Definitions and rules of interpretation* [1]]

For the purposes of this Law and unless otherwise indicated in a provision of this Law or required by the context:

(a) "guaranty letter" includes "counter-guaranty letter" and "confirming guaranty letter," and "guarantor" includes "counter-guarantor" and "confirming guarantor";

(b) any reference to the terms of the guaranty letter or the undertaking of the guarantor is to the text as orig-

inally established in accordance with article 7 or, if later amended in accordance with article 8, to the text in its last amended version;

(c) where a provision of this Law refers to a possible agreement of the parties, the parties meant are the guarantor and the beneficiary of the guaranty letter in question and the reference is to any term of the guaranty letter or its amendment or to any separate agreement between the guarantor and the beneficiary.]

#### References

A/CN.9/330, paras. 77-81

#### Remarks

1. This draft article has been added to indicate an appropriate location for a possible catalogue of definitions and rules of interpretation and to invite consideration of whether the suggested definitions and rules of interpretation would be regarded as useful. As noted at the thirteenth session, the decision as to which individual terms should be defined can be made only when it will be clear which issues are covered and which operative rules are contained in the uniform law; one may then decide whether the definitions should be lumped together in provisions placed in the first part of the uniform law or whether at least some definitions should be placed in the context of the substantive operative rules to which they primarily relate (A/CN.9/330, para. 78).

### CHAPTER III. EFFECTIVENESS OF GUARANTY LETTER [1]

#### Article 7. *Establishment of guaranty letter*

(1) *Variant A:* A guaranty letter may be established by any means of communication that [itself] [2] provides a record of the text of the guaranty letter.

*Variant B:* A guaranty letter may be issued in any form which preserves a complete record of the information contained therein [and is authenticated as to its source by generally accepted means or by a procedure agreed upon by the parties].

*Variant C:* The guaranty letter shall be issued by a means of communication that provides a record thereof, including by an authenticated teletransmission or equivalent electronic data interchange message. [3]

(2) *Variant X:* The guaranty letter becomes binding and, unless it expressly states that it is revocable, irrevocable, when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt] [4]. The guaranty letter becomes effective at that time, unless it states a different time of effectiveness [, by reference to a fixed date or to a determinable period of time,] or [it expressly provides that its effectiveness is subject to a specified condition that is determinable by the guarantor on the basis of a document specified in the guaranty letter] [5] [it makes its effectiveness depend on the occurrence of a specified, uncertain future event, in which case the guarantor may require the beneficiary to certify that occurrence, unless the parties have agreed on

another means of establishing that occurrence or its verification is within the purview of the guarantor].

*Variant Y:* Unless otherwise stated therein, a guaranty letter becomes effective and irrevocable when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt].

#### References

A/CN.9/342, paras. 55-75

A/CN.9/WG.II/WP.67, remarks on article 7

A/CN.9/330, paras. 103-107

#### Remarks

1. Chapter III comprises those provisions that delimit the "life time" of the guaranty letter by regulating its period of effectiveness from the beginning to the end.

2. The word "itself" has been added between square brackets to invite consideration whether that addition is helpful to make clear that, as discussed at the fourteenth session (A/CN.9/342, para. 59), the form requirement suggested in this provision would not be met by the establishment of the guaranty letter by telephone where the conversation was recorded on tape since the taped record is not an output of the chosen communication system itself. It is submitted, however, that the addition seems unnecessary and might adversely affect the interpretation of other legal texts emanating from the Commission's work that use the same wording without that addition (e.g., article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration).

3. Variant C essentially constitutes a combination of variant A and the formula used in article 2(d) of the ICC Draft Uniform Rules for Demand Guarantees (document No. 460/470-1/19 Rev.2 of 17 April 1991; hereinafter referred to as "URDG"). It may be noted that the form required by article 7(1) is referred to in various other draft articles. If a number of those references were to be retained, consideration might be given to placing the provision on form into draft article 6 in terms of a definition of "writing" or "non-oral form".

4. The proviso envisaging possible rejection by the beneficiary has been retained between square brackets, as decided by the Working Group at its fourteenth session (A/CN.9/342, para. 67). In reconsidering the matter, the Working Group may wish to take into account the following two points. A beneficiary who is not willing to accept a guaranty letter as issued is likely to want an amendment and does not seem to lose anything by retaining the guaranty letter as long as it protests about the inadequacy of the guaranty letter to the principal or the guarantor. In the less likely event that the beneficiary indeed wants to reject the guaranty letter, draft article 10(a) or (b) should provide an appropriate way for achieving that result.

5. The reference to a specified condition that is determinable on the basis of a specified document is modelled on draft article 6 URDG. The effect of such wording would be that any non-documentary condition would be without effect on the time of effectiveness and would thus be disre-

garded; in contrast, the wording at the end of variant X would not disregard any non-documentary condition but convert it into a documentary one. Yet another approach is taken by variant Y which does not distinguish, in its proviso, between different types of conditions and would thus have the effect of recognizing non-documentary conditions of effectiveness.

#### Article 8. *Amendment*

(1) A guaranty letter may be amended in the form agreed upon by the parties or, failing such agreement, [in the form in which the guaranty letter was established] [1] [in any form referred to in paragraph (1) of article 7]. [A party may be precluded by its conduct from asserting non-compliance with such form requirement to the extent that the other party has relied on that conduct.] [2]

(2) The amendment becomes effective, unless it states a different time of effectiveness,

*Variant A:* when it is issued by the guarantor [, provided that the beneficiary does not reject it promptly upon receipt].

*Variant B:* when it is issued by the guarantor, provided that the guarantor receives notice of the acceptance by the beneficiary within [ten] business days. [3]

*Variant C:* when the guarantor receives notice of the acceptance by the beneficiary.

(3) *Variant X:* The provisions of paragraphs (1) and (2) of this article do not excuse the failure of the guarantor to obtain the consent of the principal as may be required by the instructions of the principal or an agreement with the principal.

*Variant Y:* The provisions of paragraphs (1) and (2) of this article do not entitle the guarantor to invoke the amendment in support of any claim for reimbursement against the principal if the guarantor failed to obtain the consent of the principal as required by instructions of the principal or an agreement between the principal and the guarantor.

*Variant Z:* When issuing an amendment, the guarantor shall promptly dispatch a copy thereof to the principal.

#### References

A/CN.9/342, paras. 76-87

A/CN.9/WG.II/WP.68, paras. 3-17

A/CN.9/330, para. 106

#### Remarks

1. A possible reason for requiring that the amendment be established in the form in which the given guaranty letter was established might be the consideration that the amendment modifies in part that guaranty letter. However, one might regard such a requirement as too restrictive in practice; in that respect one might favour the alternative wording that allows any form referred to in article 7(1) and, in effect, only excludes purely oral communications.

2. The sentence between square brackets is modelled on article 29 of the United Nations Sales Convention, pursuant to a proposal made at the fourteenth session (A/CN.9/342, para. 85).

3. While variant A embodies the concept of implied or silent acceptance, variants B and C require express acceptance. Variant B differs from variant C in that it does not use the time of receipt of the notice of acceptance as the point determining the time of effectiveness, as variant C does, but uses for that purpose the earlier point of time of the issuance of the amendment, subject to timely receipt of the notice of acceptance.

#### Article 9. *Transfer of rights; assignment of proceeds*

(1) The beneficiary may not transfer its right to make a demand for payment under the guaranty letter,

*Variant A:* unless so authorized by the guarantor [, either in the guaranty letter or by separate consent in any form referred to in paragraph (1) of article 7].

*Variant B:* except where the guaranty letter was given for the purpose of securing the beneficiary against the non-performance of certain obligations by the principal and the right to claim performance from the principal has passed from the beneficiary to the intended transferee. [1]

(2) However, the beneficiary may assign to another person any proceeds to which it may be entitled under the guaranty letter. If the guarantor has notice of the assignment, only payment to the assignee discharges the guarantor from its liability towards the beneficiary. [2]

#### References

A/CN.9/342, paras. 88-93

A/CN.9/WG.II/WP.68, paras. 18-23

#### Remarks

1. Variant B is designed to implement the proposal made at the fourteenth session (A/CN.9/342, para. 90) 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. While that variant, which might be combined with variant A, would have the advantage of providing certainty about the effect of such a change on the relationship between the beneficiary and the guarantor (by indirectly rejecting the notion of an automatic termination of the guaranty letter or of an automatic transfer of the beneficiary's rights), it might be viewed as undermining the independent nature of the guaranty letter.

2. The second sentence of paragraph (2) does not attempt to unify the disparate national laws on assignment, for example, by making notice to the guarantor a requirement of validity of the assignment. It rather limits itself to addressing the effect of an assignment known to the guarantor by providing that payment may be effected only to the assignee and that such payment alone discharges the guarantor's liability under the guaranty letter.

### Article 10. *Cessation of effectiveness of guaranty letter* [1]

The guaranty letter ceases to be effective, irrespective of whether [the instrument] [any document embodying it] is returned to the guarantor [2], when:

(a) the guarantor receives from the beneficiary a statement of release from liability [in any form referred to in paragraph (1) of article 7];

(b) the beneficiary and the guarantor agree on the termination of the guaranty letter;

(c) the guarantor pays the maximum amount stated in the guaranty letter or, if that amount has been reduced according to an express provision in the guaranty letter [for reduction by a specified or determinable amount on a specified date or upon presentation to the guarantor of a document specified for this purpose in the guaranty letter] [3], the remaining balance;

or

(d) the validity period of the guaranty letter expires in accordance with the provisions of article 11.

#### References

A/CN.9/342, paras. 97-98

A/CN.9/WG.II/WP.68, paras. 30-33

A/CN.9/330, paras. 44-46

#### Remarks

1. This draft article is designed to lump together expiry and other grounds on which the guaranty letter may become ineffective. Expiry of the validity period, which constitutes the most likely ground of ineffectiveness and requires regulation in detail, is dealt with in draft article 11.

2. The rule that expiry does not depend on the return to the guarantor of the guaranty instrument, if such document exists at all, is undoubtedly of considerable importance. If it were felt that the rule should be further emphasized, consideration might be given to adding a separate paragraph along the lines of draft article 24 URDG 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."

3. The wording between square brackets would have the effect of disregarding any non-documentary reduction clause for the purposes of determining the maximum amount available under the guaranty letter. It is submitted, however, that any reduction based on a non-documentary reduction clause and consented to by the beneficiary would become relevant under subparagraphs (a) or (b) as a partial release or termination agreement.

### Article 11. *Expiry*

(1) The validity period of the guaranty letter expires:

(a) at the expiry date [, which may be a specified calendar date or the last day of a fixed period of time stipulated in the guaranty letter] [1];

(b) if expiry depends according to the guaranty letter on the occurrence of an event, when the guarantor receives confirmation that the event has occurred by presentation of the document specified for that purpose in the guaranty letter [or, if no such document is specified, a statement of the beneficiary or other conclusive evidence of the occurrence of the event] [2].

(2) If the guaranty letter states neither an expiry date nor an expiry event or if a stated expiry event has not yet been established, the validity period expires [five] years after the establishment of the guaranty letter, unless the parties agree on an extension of the validity period. [3]

#### References

A/CN.9/342, paras. 94-102

A/CN.9/WG.II/WP.68, paras. 24-43

#### Remarks

1. Where a fixed period of time is stipulated in the guaranty letter, it would commence to run at the time of establishment according to article 7(2), unless another starting point is stipulated in the guaranty letter. If deemed desirable, that rule might be expressed in the provision.

2. The wording between square brackets would allow to take into account any non-documentary condition of expiry but would impose the means of establishing the occurrence of the specified event.

3. The cut-off point suggested in paragraph (2) is designed to have the same effect as the expiry of the validity period under paragraph (1), namely, that any demand for payment, accompanied by any required documents, must be made within that period, as expressed in draft article 14. It is submitted that any prescription or limitation period of longer duration under the law applicable to that question would be relevant only if the demand was made within the validity period and would then govern the guarantor's payment obligation based on such conforming demand.

## CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

### Article 12. *Determination of rights and obligations*

Subject to the provisions of this Law, the rights and obligations of the parties are determined by the terms [and conditions] set forth in the guaranty letter, including any rules, [general] [1] conditions or usages referred to therein.

#### References

A/CN.9/342, paras. 42-54

A/CN.9/WG.II/WP.67, remarks on article 6

A/CN.9/330, paras. 58-67

A/CN.9/WG.II/WP.65, paras. 60-70

#### Remarks

1. The word "general" has been added to the text adopted at the fourteenth session (A/CN.9/342, para. 48) with a

view to distinguishing more clearly between the conditions incorporated into the guaranty letter by way of reference and the individual conditions set forth in the guaranty letter, mentioned earlier in the text of this article.

#### Article 13. *Liability of guarantor*

[The guarantor shall act in good faith and exercise reasonable care as required by good guaranty and credit practice.] [1] Guarantors [and instructing parties] may not be exempted from liability for their failure to act in good faith or for any [grossly negligent conduct] [act or omission done either with the intent to cause damage or recklessly and with the knowledge that damage would probably result] [2].

#### References

- A/CN.9/345, paras. 30-36  
A/CN.9/342, paras. 103-110  
A/CN.9/WG.II/WP.68, paras. 65-72

#### Remarks

1. The first sentence placed between square brackets is designed to provide, as suggested at the fifteenth session (A/CN.9/345, para. 34), an additional liability rule that would not be mandatory and would supplement the draft provision on the standard of care in examining documents (see draft article 16). It is submitted that it is neither necessary nor appropriate to express the non-mandatory nature of that rule by adding wording such as "Unless otherwise agreed by the parties" since the following sentence limits, and thus recognizes, the possibility of such derogation by way of an exemption clause.

2. The last wording between square brackets is modelled on article 8(1) of the Hamburg Rules and might provide an acceptable alternative to the reference to gross negligence.

#### Article 14. *Demand for payment*

Any demand for payment under the guaranty letter shall be made in a form referred to in paragraph (1) of article 7 and in conformity with the terms of the guaranty letter. In particular, the demand shall be made, and received by the guarantor, within the time of effectiveness of the guaranty letter and shall be accompanied by any statement or document required by the guaranty letter [or this Law] [1]. [If no statement or document is required, the beneficiary, when demanding payment, is deemed to impliedly certify that payment is due.] [2]

#### References

- A/CN.9/342, paras. 20, 95-96, 104  
A/CN.9/WG.II/WP.68, paras. 25, 29-30  
A/CN.9/330, para. 23

#### Remarks

1. The reference to "this Law" has been added to take into account the possibility of any non-documentary condition that would, by virtue of a provision of this Law, be converted into a documentary one.

2. This sentence between square brackets has been added to clarify for two types of guaranty letter that any demand for payment implies the assertion that payment is due, as might, for example, be relevant in determining whether the demand is improper according to article 19. The first type would be a guaranty letter payable on simple demand. The second type would be a guaranty letter where payment is subject to a non-documentary condition provided that it would fall within the scope of the uniform law. For that latter type of guaranty letter, consideration might be given to providing for more than an implied certification and, for example, requiring an express certification or other conclusive evidence satisfying the guarantor.

#### [Article 15. *Notice of demand* [1]]

Without prejudice to the provisions of articles 16 and 17, [2] the guarantor shall promptly upon receipt of the demand give notice thereof to the principal or, where applicable, its instructing party, unless otherwise agreed between the guarantor and the principal.]

#### References

- A/CN.9/345, paras. 18-24  
A/CN.9/WG.II/WP.68, para. 63

#### Remarks

1. The draft article is presented with square brackets in view of the fact that the Working Group, at its fifteenth session, 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 (A/CN.9/345, paras. 21-22).

2. The proviso is designed to reflect the view prevailing at the fifteenth session that the duty of notification should not be linked in terms of time to the duty of examining the claim and deciding about payment (A/CN.9/345, para. 23). If deemed desirable, consideration might be given to making the substance of the proviso more explicit by such wording as "Without affecting the duty of the guarantor to examine the demand and to decide whether or not to pay". It may be added that, as pointed out at the fifteenth session (A/CN.9/345, para. 23), 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 (e.g., where timely notice would have enabled the principal to recover the amount from a beneficiary that speedily moved its assets out of a certain jurisdiction). As noted at the fifteenth session (A/CN.9/345, para. 23), the question of damages is still to be considered by the Working Group for this and other possible instances of breach of obligations (e.g., wrongful dishonour or late payment).

#### Article 16. *Examination of demand*

(1) *Variant A:* In examining the demand and any required statement or document accompanying it, the guarantor shall comply with the standard of reasonable care prevailing in international guaranty and stand-by letter of credit practice to ascertain their facial conform-

ity with the terms of the guaranty letter, which are to be construed strictly. [1]

*Variant B:* The demand and any required statement or document accompanying it shall be examined by the guarantor with the professional diligence of a knowledgeable, prudent guarantor to ascertain whether they appear on their face to conform with the terms of the guaranty letter and to be consistent with one another. [2]

(2) Unless otherwise agreed by the parties, the guarantor shall have

*Variant X:* reasonable time

*Variant Y:* [four] business days

*Variant Z:* reasonable time, but not more than [seven] business days in which to examine the demand and to decide whether or not to pay.

#### References

A/CN.9/345, paras. 15-17

A/CN.9/342, paras. 107-110

A/CN.9/WG.II/WP.68, paras. 49-57

A/CN.9/330, paras. 86-102

A/CN.9/WG.II/WP.65, paras. 87-99

#### Remarks

1. Variant A is based on a proposal made at the fourteenth session and attempts to meet the concerns expressed with regard to that proposal (A/CN.9/342, paras. 108-109). The Working Group may wish to consider the relationship of variant A or B and draft article 13 as regards the suggested standard of care and the possible need for alignment.

2. Variant B is modelled on draft article 9 URDG which, in turn, has been modelled on article 15 of the Uniform Customs and Practice for Documentary Credits (ICC Publication No. 400).

#### Article 17. *Payment or rejection of demand*

(1) The guarantor shall make payment as demanded by the beneficiary, unless:

(a) the guaranty letter is non-existent, invalid or unenforceable [1]; or

(b) the demand does not meet the requirements referred to in article 14 [; or

*Variant A:* (c) the demand is [manifestly] [clearly and obviously] improper according to article 19]. [2]

(2) *Variant B:* [The guarantor may make payment despite an assertion by the principal that the demand is improper according to article 19, provided that the guarantor acts in good faith. However, if] [3]

[If] the principal asserts that the demand is improper according to article 19 and the guarantor decides not to reject the demand, the guarantor shall promptly inform the principal about its decision [and, if so requested by the principal, defer payment for [three] business days] [4].

(3) If the guarantor decides to reject the demand on any ground referred to in paragraph (1)(a) and (b) of this article, it shall promptly give notice thereof, indicating,

where appropriate, the reasons for the decision, to the beneficiary by teletransmission or, if that is not possible, by other expeditious means. [5]

[4] If the guarantor fails to comply with the provisions of article 16 or paragraph (3) of this article, it shall be precluded from claiming that the demand is not in conformity with the terms of the guaranty letter.] [6]

#### References

A/CN.9/345, paras. 25-28, 79-80

A/CN.9/WG.II/WP.70, paras. 76-79

A/CN.9/342, paras. 103-105

A/CN.9/WG.II/WP.68, paras. 45-48

#### Remarks

1. As regards the impediment of unenforceability, consideration might be given to a more refined regulation that would take into account the possibility of a temporary impediment (e.g., limited prohibition of funds transfers) or of an impediment that might be overcome by an acceptable deviation from a term of the guaranty letter (e.g., conversion of a blocked currency into an unblocked one).

2. Variant A presents the instance of a manifestly improper demand as one of three instances (in addition to those set forth in subparagraphs (a) and (b)) in which the guarantor is not obliged to pay. It should be noted that variant A as well as subparagraphs (a) and (b) do not take a clear stand on the crucial question whether the guarantor is merely entitled to refuse payment or whether it is obliged to refuse payment. Once the Working Group will have decided that fundamental question, the wording of draft article 17(1) should be revised.

3. Variant B entitles the guarantor acting in good faith to make payment. If the question referred to in the preceding remark were to be answered in favour of an obligation of the guarantor to refuse payment, the difference between variant A and B is submitted to be minimal since it is difficult to conceive of circumstances in which a demand is manifestly or clearly and obviously improper but the guarantor nevertheless pays in good faith.

4. The suggestion of deferring payment for a very limited number of days attempts to strike a balance between the need for prompt payment of the independent undertaking and the interest of the principal to submit documentary evidence to the guarantor or, if feasible within that short period, to seek injunctive relief from a court.

5. It may be noted that paragraph (3) is modelled on draft article 10(b) URDG.

6. Paragraph (4) is presented between square brackets in view of the particularly tentative nature of the conclusions of the Working Group at the fifteenth session concerning the concept of preclusion in the context of guaranty letters (A/CN.9/345, para. 28).

#### Article 18. *Request for extension or payment*

If the beneficiary [demands in the alternative payment or] [combines a demand for payment with a request for] [1] an extension of the validity period of the guaranty

letter, the guarantor shall comply with the following rules, unless otherwise agreed by the parties:

(a) The guarantor shall give prompt notice of the alternative demand for extension or payment to the principal [directly or through an instructing party];

(b) The guarantor may not extend the validity period without the consent of the principal; however, even if the principal consents to the extension, the guarantor is not obliged to extend the validity period, unless so required by an agreement with the principal;

(c) The guarantor shall examine the demand for payment in accordance with article 16 and decide whether to pay or to reject that demand [2]; if the guarantor decides not to reject the demand, it [shall] [may] defer payment until [ten] business days have elapsed after [giving notice to the principal] [receiving the alternative demand from the beneficiary] and then make payment, unless the guarantor extends the validity period.

#### References

A/CN.9/345, paras. 73-77

A/CN.9/WG.II/WP.70, paras. 51-54

#### Remarks

1. Both wordings between square brackets are designed to express the same idea. However, the second wording might be viewed as expressing more clearly the point that the provision applies only where the request for an extension is coupled with a clear and definite demand for payment and not, for example, with a mere threat of demanding payment in the future.

2. The first sentence of subparagraph (c) would have the effect that the examination of the demand for payment and possible negotiations concerning the extension of the validity period would take place concurrently and that the guarantor shall reject the demand if it determines that there exists one of the grounds set forth in article 17(1). If, however, there is no reason for rejecting the demand for payment, the second sentence suggests a special procedure to be considered by the Working Group.

#### Article 19. *Improper demand* [1]

*Variant A:* A demand for payment is improper if:

(a) any certification by the beneficiary or any required document accompanying the demand is [untrue] [essentially incorrect] or forged; or

(b) the demand falls clearly outside the purpose for which the guaranty letter was given or otherwise lacks any plausible basis.

*Variant B:* (1) [Same as variant A]

(2) A demand has no plausible basis, for example, where: [2]

(a) in the case of a guaranty letter that [supports] [backs up] the financial obligation of a third party, the principal amount is not due;

(b) in the case of a tender guaranty letter,

- (i) the contract has not yet been awarded; or
- (ii) the contract has been awarded to a tenderer other than the principal; or
- (iii) the contract has been awarded to the principal and the principal has [accepted] [signed] the contract and secured any required performance guaranty letter;

(c) in the case of a repayment guaranty letter, no advance payment has been made;

(d) in the case of a performance guaranty letter,

- (i) a competent court or arbitral tribunal has determined [in a final decision] that the obligations of the principal towards the beneficiary, the performance of which the guaranty letter was intended to secure, do not exist or are unenforceable on the ground that the underlying transaction [between the principal and the beneficiary] is non-existent, violates public policy or is otherwise invalid;
- (ii) the principal has completely [to the satisfaction of the beneficiary] fulfilled its obligations the performance of which the guaranty letter was intended to secure;
- (iii) the beneficiary has prevented the principal from fulfilling its obligations, the performance of which the guaranty letter was intended to secure, by a [wilful] [serious] breach of its own [fundamental] obligations of the underlying transaction;
- (iv) the amount demanded is [grossly disproportionate to] [at least five times higher than] the damage suffered due to the failure of the principal to fulfil its obligations; [3]

(e) in the case of a counter-guaranty letter, the beneficiary of the counter-guaranty letter has paid [or intends to pay] to its beneficiary under its guaranty letter, the reimbursement for which constitutes the purpose of the counter-guaranty letter, upon a demand that is [evidently] affected by one of the infirmities referred to in paragraph (1) of article 17, provided that the beneficiary of the counter-guaranty letter

*Variant X:* acted in collusion with its beneficiary.

*Variant Y:* [acted in bad faith] [failed to exercise professional care].

*Variant Z:* is by virtue of the counter-guaranty letter or any reimbursement agreement with the counter-guarantor or by virtue of law [entitled] [under a duty] to reject the demand because of such infirmity]. [4]

*Variant C:* (1) A demand for payment is improper if making it constitutes fraud or an abuse of rights.

(2) The making of a demand constitutes fraud where:

- (i) the beneficiary [has no belief that the amount demanded is due] [knows or cannot be unaware of the fact that the amount demanded is not due] on the basis asserted in the demand and any supporting statements and documents; or

- (ii) any supporting statement or document is [untrue] [essentially incorrect]; or
- (iii) any supporting document is forged.

(3) The making of a demand constitutes an abuse if:

*Variant X:* the beneficiary exercises its right for a purpose other than that for which the guaranty letter was given.

*Variant Y:* the contingency against the consequences of which the guaranty letter was designed to indemnify the beneficiary has undoubtedly not materialized or has clearly been brought about by a fundamental breach of the underlying transaction wilfully committed by the beneficiary.

*Variant D:* The guarantor [may] [shall] reject a demand as improper if, having due regard to the independent [and essentially documentary] character of its undertaking, the guarantor concludes that the demand is made in bad faith or fraudulently, including fraud or forgery relating to the documents or fraud in the underlying transaction, or that the making of the demand constitutes an abuse of rights by the beneficiary, provided that the facts constituting the basis of that conclusion are clearly and convincingly established without investigation by the guarantor. [5]

#### References

A/CN.9/345, paras. 37-57, 67-80

A/CN.9/WG.II/WP.70, paras. 7-79, 89

#### Remarks

1. It may be noted that article 19 does not generally qualify an improper demand as being manifestly or evidently fraudulent or abusive. Firstly, the improper nature of the demand does not usually depend on whether or not that nature is clear and obvious; an exception is, for example, provided in paragraph (3) of variant C, where the definition of abuse (in variant Y) includes the element of certainty or lack of doubt in order to draw a line against genuine contract disputes. Secondly, the question of the certainty or evidence of the improper nature of a demand is more appropriately dealt with in the context of the guarantor's right or duty to refuse payment (see article 17) and of any court proceedings (future draft articles on court measures and jurisdiction).

2. It may be noted that any instance described in this paragraph need not be considered as a possible basis of an improper demand if the very instance is the subject of a payment condition set forth in the guaranty letter.

3. Subparagraph (iv) has been presented between square brackets to invite reconsideration of the controversial case discussed at the fifteenth session (A/CN.9/345, para. 46). If that case were to be regarded as an instance of abuse and the provision retained at all, consideration might be given to providing for payment of an amount equivalent to the damages suffered instead of rejecting the demand in full.

4. This special provision dealing with an improper demand under a counter-guaranty letter might be retained even if variant B as such would not be retained. It reflects in its variants X, Y and Z the different views expressed at

the fifteenth session (A/CN.9/345, para. 69). As regards the specific question whether the beneficiary of the counter-guaranty letter is under a duty to reject an improper demand by the ultimate beneficiary, consideration might be given to regulating that question (referred to in remark 1 on article 17) in the uniform law, at least for that special context, in favour of a duty to reject payment, since the very purpose of a counter-guaranty letter is to reimburse the beneficiary for expenses incurred by carrying out the instructions of the counter-guarantor.

5. Variant D is designed to implement the last suggestion made at the fifteenth session to provide a guideline in general terms (A/CN.9/345, para. 51). If that variant were to be adopted, consideration might be given to incorporating it into draft article 17.

#### Article 20. Set-off [1]

*Variant A:* Unless otherwise [expressly] agreed by the parties, the guarantor may not avail itself of a set-off with any claim against the demand for payment under the guaranty letter.

*Variant B:* Unless otherwise agreed by the parties and subject to the provisions of the law of insolvency, the guarantor may discharge its payment obligation under the guaranty letter by means of a set-off with any claim not assigned to it by the principal, provided that the claim of the guarantor is [liquidated and] certain or undisputed.

*Variant C:* Unless otherwise expressly agreed by the parties, the guarantor is precluded from discharging its payment obligation under the guaranty letter by means of a set-off with any claim, except where:

(a) the beneficiary is insolvent; or

(b) the guaranty letter is designed to secure the fulfilment of a financial or payment obligation of the principal or the guarantor and that obligation could have been discharged by means of a set-off with the claim of the guarantor.

#### References

A/CN.9/345, paras. 81-83

A/CN.9/WG.II/WP.70, paras. 80-85, 89

#### Remarks

1. Variants A and B embody the principle widely supported at the fifteenth session that the guarantor should not be entitled to a set-off with claims assigned to it by the principal (A/CN.9/345, para. 82). It is submitted that this limitation does not seem necessary in variant C, which anyway allows set-off only in very restricted circumstances. Otherwise, the three variants reflect the divergent views expressed at the fifteenth session (along the lines of the different views reported in document A/CN.9/WG.II/WP.70, paras. 83-85).

[Tentative draft articles on conflict of laws, court measures and jurisdiction will be presented in an addendum to this note.]

[A/CN.9/WG.II/WP.73/Add.1]

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## CHAPTER V. PROVISIONAL COURT MEASURES [1]

Article 21. *Preliminary injunction against guarantor* [2]

(1) Where, on an application by the principal, [3]

*Variant A:* strong prima facie evidence is produced to the satisfaction of a competent court [4]*Variant B:* clear and liquid proof is presented to a court of competent jurisdiction

*Variant C:* it is manifestly shown by documentary means, including [sworn witness statements] [affidavits] that a demand made [or anticipated to be made] [5] by the beneficiary constitutes an improper demand, [6] the court may issue a preliminary order enjoining the guarantor from meeting the demand [or from debiting the account of the principal] [7], provided that [the court is satisfied that] the refusal to issue such an order would cause the principal [serious harm] [irreparable loss] which would be [clearly] more substantial than the loss that might be suffered by the beneficiary as a result of the issuance of such an order, [8]

(2) Before deciding on the application of the principal, the court [may hear the guarantor] [shall provide the guarantor with an opportunity to be heard]. It may also [if so permitted under its procedural law,] consider the advisability of hearing the beneficiary or of allowing the principal to seek injunctive relief against the beneficiary as co-defendant. [9]

(3) An order referred to in paragraph (1) of this article shall be issued for a specified period of effectiveness not exceeding [six] months. An extension of that period may be made dependent on the initiation by the principal of proceedings other than preliminary proceedings against the guarantor or the beneficiary.

(4) The court may make the effect of an order referred to in paragraph (1) of this article subject to the furnishing by the principal of such security as the court deems appropriate. [10]

*References*

A/CN.9/345, paras. 54-57, 58-66

A/CN.9/WG.II/WP.71, paras. 49, 54, 56-58

A/CN.9/WG.II/WP.70, paras. 19-21, 27, 38, 60-61, 75, 90-107, 113-114

*Remarks*

1. The draft articles presented in this chapter are particularly provisional and reflect, to some extent, the uncertainty about the future form of the uniform law and about the matters of court jurisdiction and access to courts for injunctive relief. They reflect, above all, the difficulty of aiming, in line with the prevailing view at the fifteenth session (A/CN.9/345, para. 64), at harmonized and certain procedural measures without encroaching on the organization of national courts and their traditional procedures. While article 23 attempts to implement the first suggestion made at the fifteenth session, namely to deal in general terms with the access of all parties to the courts and to call for expeditious proceedings, articles 21 and 22 attempt to implement the second suggestion, namely 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 (A/CN.9/345, para. 65).

2. In line with such cautious approach, only certain provisional court measures are dealt with in articles 21 and 22. Not covered are, for example, possible injunctions by the beneficiary against the guarantor or vice versa or by the guarantor against the principal. Also not covered are attachments and similar measures to freeze assets; it is submitted that, if such measures should be addressed at all, consideration might be given to imposing similar requirements as those suggested in articles 21 and 22 or to disallow generally the attachment of the beneficiary's claim or its assets based on an allegation of fraud or abuse.

3. The Working Group may wish to consider here (or in the context of article 23(1)) whether, in the case of an indirect guaranty letter, the principal itself may apply for injunc-

tive relief or whether that should be done by the instructing party that may or may not be a counter-guarantor.

4. Variant A contains a somewhat less strict standard of proof than do variants B and C, and it does not limit the admissible means of evidence. It is submitted that the standard of proof in article 21 need not necessarily be identical to that applied to the decision of the guarantor whether or not to pay (see articles 17 and 19). Article 21 is designed to address the situation before payment and to provide a limited possibility of a court to prevent a sufficiently probable wrong where such prevention is less likely to affect the guarantor's reputation.

5. The wording between square brackets has been added to invite consideration of the question whether or not an application for injunctive relief before the making of a demand would be premature, in particular if the uniform law, as suggested in article 15, were to impose on the guarantor a duty of notification (see A/CN.9/WG.II/WP.70, para. 95).

6. While article 21 covers as a basis for an injunction only the improper nature of the demand in terms of article 19, consideration might be given to extending its scope to embrace non-conformity or other objections to payment referred to in article 17(1)(a).

7. The wording between square brackets has been added to invite consideration of whether this matter of reimbursement should be addressed by the uniform law and, if so, whether the wording needs to be refined so as to be clearly limited to the situation before payment (see remark 4).

8. The proviso attempts to provide a common formula that would be more concrete and workable than concepts such as balance of convenience or public interest. However, consideration might be given to adding other points to be evaluated by the courts.

9. The idea of involving the beneficiary in the preliminary proceedings is based on the consideration that, in substantive terms, the dispute is primarily between the principal and the beneficiary, and that it is ultimately the beneficiary that is adversely affected by an injunction against the guarantor. If that idea were shared by the Working Group, consideration might be given to extending the scope of the provision to cover, in the case of an injunction against the counter-guarantor, not only the beneficiary of the counter-guarantor but also the ultimate beneficiary.

10. Paragraph (4) is designed to reduce the risk of obstruction by principals that might abuse preliminary proceedings, in particular where such proceedings tend to be long, for dilatory purposes (A/CN.9/345, para. 60).

#### Article 22. *Preliminary injunction against beneficiary* [1]

(1) Where, on an application by the principal, strong prima facie evidence is presented to a competent court that a demand made by the beneficiary constitutes an improper demand, the court may order the beneficiary

not to accept payment or to withdraw its demand or, if such a demand is anticipated to be made, not to make the demand, provided that the refusal to issue such an order would cause the principal serious harm that would be more substantial than the loss that might be suffered by the beneficiary due to such an order.

(2) Before deciding on the application of the principal, the court [may hear the beneficiary] [shall provide the beneficiary with an opportunity to be heard]. [2]

(3) An order referred to in paragraph (1) of this article shall be issued for a specified period of effectiveness not exceeding [six] months. An extension of that period may be made dependent on the initiation by the principal of proceedings other than preliminary proceedings against the beneficiary. [If an order restraining the beneficiary from making a demand is repealed or becomes otherwise ineffective, the period of effectiveness of the guaranty letter shall be deemed to have been extended so as to allow the beneficiary [ten] days after the time of ineffectiveness of that order for making a demand.]

(4) The court may make the effect of an order referred to in paragraph (1) of this article subject to the furnishing by the principal of such security as the court deems appropriate.

#### References

- A/CN.9/345, paras. 54-57, 58-66  
A/CN.9/WG.II/WP.71, paras. 49, 54, 56-58  
A/CN.9/WG.II/WP.70, paras. 19-21, 27, 38, 60-61, 75, 90-91, 108-114

#### Remarks

1. This draft article does not address the question of jurisdiction, in particular, whether the courts of the State enacting the uniform law would be competent only if the beneficiary has its place of business in that State or whether they may issue an injunction against the beneficiary, for example, if the guarantor has its place of business in that State. That question is addressed in article 25(2).

2. Along the lines of the idea presented in remark 9 on article 21, consideration might be given to involving, in the case of a counter-guaranty letter, the ultimate beneficiary in preliminary proceedings against the beneficiary of the counter-guaranty letter.

#### Article 23. *Principles of preliminary proceedings* [1]

(1) Injunctive relief may be sought from a competent court against the guarantor by the principal or by the beneficiary, and against the beneficiary by the principal or by the guarantor, even if the place of business of the applicant is not situated in this State.

(2) The court shall [endeavour to] deal expeditiously with an application for injunctive relief [and take into due account the special character of the guaranty letter]. [2]

### References

- A/CN.9/345, paras. 59-61, 64-66, 105-110  
 A/CN.9/WG.II/WP.71, paras. 49, 54, 56-58  
 A/CN.9/WG.II/WP.70, paras. 109-110

### Remarks

1. While article 23 might be viewed as a possible alternative to the more detailed provisions in articles 21 and 22 (see remark 1 on article 21), it might also be viewed as a possible addition to those articles. It is submitted that the decision on that matter depends to some extent on how the question of jurisdiction will be dealt with in the uniform law (see articles 24 and 25).

2. Due to the general and exhortatory nature of paragraph (2), consideration might be given to incorporating its wording in a preamble or a footnote, possibly combined with the principle of free access that underlies paragraph (1).

## CHAPTER VI. JURISDICTION [1]

### Article 24. *Choice of court or of arbitration*

(1) The parties may, in the guaranty letter or by a separate agreement in a form referred to in paragraph (1) of article 7, designate a court or the courts of a specified State as competent to settle disputes that have arisen or may arise in relation to the guaranty letter, or stipulate that any such dispute shall be settled by arbitration.

(2) If the parties have designated a court or the courts of a specified State in accordance with paragraph (1) of this article, only the designated court or courts shall have jurisdiction. [2]

(3) The provisions of the preceding paragraphs of this article do not constitute an obstacle to the jurisdiction of the courts of this State for provisional or protective measures. [3]

### References

- A/CN.9/345, paras. 104-110  
 A/CN.9/WG.II/WP.71, paras. 44-58

### Remarks

1. The draft articles presented in this chapter reflect to some extent the uncertainty about the future form of the uniform law and about the extent to which jurisdictional matters should be included in the uniform law. While article 25 and paragraph (3) of article 24 are drafted in the style of a model law, article 24(1) and (2) are reminiscent of conventions. Above all, the draft articles do not cover such important ancillary matters as recognition and enforcement, *res judicata* and stay of proceedings that would more appropriately be dealt with in a convention than in a model law.

2. Paragraph (2) is modelled on article 17 of the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (Brussels 1968). If the concept of exclusive jurisdiction would have to be expressed in

model law language, the wording suggested in A/CN.9/WG.II/WP.71, para. 53, might serve as a starting point. In this connection, or in the context of article 25, the substantive question needs to be addressed whether exclusivity is appropriate only in respect of a chosen forum or whether it should extend to court jurisdiction determined by the uniform law.

3. Paragraph (3) is modelled on article 21(3) of the Hamburg Rules and reflects an approach also adopted by the 1968 Brussels Convention and the 1965 Hague Convention on Choice of Court (see A/CN.9/WG.II/WP.71, para. 49).

### Article 25. *Determination of court jurisdiction*

(1) Unless otherwise provided in accordance with paragraph (1) of article 24 [or if a designated court of another State declines to exercise jurisdiction], the courts of this State [may exercise] [have] jurisdiction over disputes between the guarantor and the beneficiary relating to the guaranty letter if [the guaranty letter was issued] [the guarantor has its place of business, where the guaranty letter was issued,] in the territory of this State.

(2) The courts of this State may also entertain an application by the principal for a preliminary order against the guarantor [or the beneficiary] if the guaranty letter was issued in this State. [1]

### References

- A/CN.9/345, paras. 104-110  
 A/CN.9/WG.II/WP.71, paras. 44-58

### Remarks

1. Paragraph (2) is designed to supplement articles 21 and 22 as regards the issue of jurisdiction. If the substance of the paragraph were to be accepted by the Working Group, that paragraph and articles 21, 22 and 23 would have to be reviewed for consistency and revised in the light of the conclusions of the Working Group at its sixteenth session, or at a later session that might be devoted to issues of jurisdiction and conflict of laws, possibly in cooperation with the Hague Conference on Private International Law in a form still to be discussed.

## CHAPTER VII. LAW APPLICABLE TO GUARANTY LETTER [1]

### Article 26. *Choice of applicable law*

[The rights and obligations arising out of] [The rights, obligations and defences relating to] a guaranty letter are governed by the [rules of] law designated by the parties [2]. Such designation shall be by an express clause in the guaranty letter or in a separate agreement, or

*Variant A:* result without doubt from the terms of the guaranty letter.

*Variant B:* be demonstrated by the terms of the guaranty letter [or the circumstances of the relationship between the guarantor and the beneficiary].

*Variant C:* result by implication from the terms of the guaranty letter. [3]

#### References

A/CN.9/345, paras. 84-94, 102-103

A/CN.9/WG.II/WP.71, paras. 5-21, 36-43

#### Remarks

1. As indicated in remark 3 on article 1, the issue of the territorial scope of application of the uniform law, if adopted in the form of a model law, would be settled by conflict-of-laws rules as presented here. It may be noted, however, that the territorial scope of application thus settled by articles 26 and 27 does not encompass these two articles themselves, nor does it encompass the provisions on jurisdiction as they are addressed to the courts of the State implementing the model law.

2. The parties designating (i.e. agreeing on) the applicable law are the guarantor and the beneficiary, as made clear in article 6(c). That might raise the question as to whether such designation would be relevant to the legal position of the principal, for example, where the solution adopted in the designated law is less advantageous than the solution obtaining from the otherwise applicable law. It is submitted that, from a practical point of view, the problem is of limited importance since the guarantor is unlikely to include, without instructions or consent by the principal, in the guaranty letter the choice of a law, at least not that of a State other than where the guarantor has its place of business. Apart from that, the designated law applicable to the guaranty letter is unlikely to interfere with the separate relationship between the guarantor and the principal in that it limits itself to regulating the rights and obligations under the guaranty letter; such regulation, as illustrated by the substantive provisions of the uniform law, may, however, affect in an indirect manner the legal position and interests of the principal, and it often takes into account any agreement between the guarantor and the principal.

3. Variants A, B and C are based on the various suggestions, made at the fifteenth session, as to which non-express modalities of choice should be allowed (A/CN.9/345, para. 93).

#### Article 27. *Determination of applicable law*

Failing a choice of law in accordance with article 26, [the rights and obligations arising out of] [the rights, obligations and defences relating to] a guaranty letter are governed by the law of the State where the guarantor has its place of business or, if the guarantor has more than one place of business, where the guarantor has that place of business at which the guaranty letter was issued. [1] [However, if according to the guaranty letter the examination of the demand and any required documents takes place in another State the law of that State applies to the standard of care and responsibility for such examination, failing a specific agreement to the contrary.] [2]

#### References

A/CN.9/345, paras. 95-103

A/CN.9/WG.II/WP.71, paras. 22-35, 38

#### Remarks

1. Consideration might be given either to using one of the shorter wordings presented in article 25 or to consolidating all provisions dealing with a plurality of places of business in a single provision within article 6, if the same criterion were deemed appropriate in all cases (see remark 2 on article 4).

2. The sentence between square brackets has been added to invite consideration of a suggestion made at the fifteenth session (A/CN.9/345, para. 99, based on the discussion in A/CN.9/WG.II/WP.71, paras. 32 and 38).

### C. Report of the Working Group on International Contract Practices on the work of its seventeenth session

(New York, 6-16 April 1992) (A/CN.9/361) [Original: English]

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## INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,<sup>1</sup> 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.<sup>2</sup>

3. At its thirteenth session (A/CN.9/330), 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

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 the 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. At its fifteenth session (A/CN.9/345), 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 the 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 Working Group then considered the issues discussed in a 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 Working

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 22.

<sup>2</sup>Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

Group also considered the issues discussed in a note by the Secretariat relating to conflict of laws and jurisdiction (A/CN.9/WG.II/WP.71). The Secretariat was requested to prepare, on the basis of the deliberations and conclusions of the Working Group, a first draft set of articles on the issues discussed.

6. At its sixteenth session (A/CN.9/358), the Working Group examined draft articles 1 to 13 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.73).

7. The Working Group, which was composed of all States members of the Commission, held its seventeenth session in New York, from 6 to 16 April 1992. The session was attended by representatives of the following States members of the Working Group: Bulgaria, Cameroon, Canada, China, Cyprus, Czechoslovakia, Egypt, France, Germany, India, Iran (Islamic Republic of), Iraq, Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Nigeria, Russian Federation, Spain, United Kingdom of Great Britain and Northern Ireland and United States of America.

8. The session was attended by observers from the following States: Albania, Algeria, Australia, Austria, Bahamas, Brazil, Côte d'Ivoire, Ecuador, Ethiopia, Finland, Gabon, Guinea-Bissau, Haiti, Holy See, Indonesia, Pakistan, Paraguay, Poland, Romania, Senegal, Sudan, Sweden, Switzerland, Thailand, Uganda, Ukraine, United Republic of Tanzania and Viet Nam.

9. The session was attended by observers from the following international organizations: United Nations Industrial Development Organization (UNIDO), Asian-African Legal Consultative Committee (AALCC), Hague Conference on Private International Law, Banking Federation of the European Community, International Chamber of Commerce (ICC).

10. The Working Group elected the following officers:

*Chairman:* Mr. J. Gauthier (Canada)

*Rapporteur:* Mr. A. Ogario (Mexico)

11. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.72) and a note by the Secretariat containing tentative draft articles of a uniform law on international guaranty letters (A/CN.9/WG.II/WP.73 and Add.1).

12. 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

13. The Working Group examined draft articles 14 to 27 of the uniform law prepared by the Secretariat (A/CN.9/WG.II/WP.73 and Add.1). The deliberations and conclu-

sions 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 14 to 27 of the uniform law.

## II. CONSIDERATION OF DRAFT ARTICLES OF A UNIFORM LAW ON INTERNATIONAL GUARANTY LETTERS

### Chapter IV. Rights, obligations and defences

#### Article 14. Demand for payment

14. The text of draft article 14 as considered by the Working Group was as follows:

"Any demand for payment under the guaranty letter shall be made in a form referred to in paragraph (1) of article 7 and in conformity with the terms of the guaranty letter. In particular, the demand shall be made, and received by the guarantor, within the time of effectiveness of the guaranty letter and shall be accompanied by any statement or document required by the guaranty letter [or this Law]. [If no statement or document is required, the beneficiary, when demanding payment, is deemed to impliedly certify that payment is due.]"

#### First two sentences

15. As regards the words "demand for payment", a concern was expressed that the draft article might insufficiently reflect the practice of stand-by letters of credit. It was explained that the beneficiary of a stand-by letter of credit, when seeking payment, would often present a bill of exchange (or "draft"), in which case the beneficiary would not make a formal demand for payment. The Working Group was agreed that the provision should be redrafted so as to encompass all possible forms in which payment might be requested from the guarantor.

16. As regards the words "any statement or document required by the guaranty letter [or this Law]", a concern was expressed that the current provision might be misinterpreted as recognizing demands for payment accompanied by non-documentary statements. The Working Group recalled that, at its sixteenth session, it had decided that the provisions in the uniform law should focus on instruments containing only documentary conditions (see A/CN.9/358, para. 61).

17. As regards the words "and received by the guarantor", it was stated that the current wording might not clearly accommodate situations where payment was claimed not directly from the guarantor or a confirming bank but from another bank which could either be a bank specifically designated in the text of a stand-by letter of credit as an agent of the guarantor, or any other bank, in the rare case where a stand-by letter of credit was issued in a freely negotiable form.

18. It was noted that article 19 of the draft Uniform Rules for Demand Guarantees (URDG) prepared by the International Chamber of Commerce (ICC), on which article 14 of

the draft uniform law was modelled, mentioned the place where a demand for payment should be presented. It was generally agreed that a mention along those lines should be added in the text of article 14.

#### *Third sentence*

19. It was recalled that the sentence between square brackets had been added to clarify, especially in the case of a guaranty letter payable on simple demand, that any demand for payment implied the assertion that payment was due, as might, for example, be relevant in determining whether the demand was improper according to article 19.

20. Differing views were expressed as to the manner in which guaranty letters payable on simple demand should be accommodated by the uniform law. Under one view, the uniform law should focus on guaranty letters payable upon presentation of documents in connection with the non-performance of the underlying commercial obligation. It was thus suggested that article 14 should be redrafted along the lines of article 20 of the draft URDG to the effect that the beneficiary had at least to present a bona fide statement about the principal's default unless the guaranty letter expressly provided otherwise.

21. The prevailing view, however, was that it would not be appropriate for a legislative text such as the uniform law to encourage or discourage the use of any specific type of guaranty letter. It was recalled that guaranty letters payable on simple demand were widely used in practice and that, irrespective of the frequency of use, the Working Group, at its twelfth session, had felt that a legal rule should take into account, and provide certainty for, all types of guarantees in use and leave the choice of the type of guarantee to be used to the credit decision of the parties involved (see A/CN.9/316, para. 89).

22. While some doubts were expressed as regards the substance and wording of the third sentence, the Working Group, after deliberation, agreed to retain the sentence without square brackets.

23. The Working Group requested the Secretariat to prepare a revised draft of article 14 in the light of the above deliberations and decisions.

#### *Article 15. Notice of demand*

24. The text of draft article 15 as considered by the Working Group was as follows:

"[Without prejudice to the provisions of articles 16 and 17, the guarantor shall promptly upon receipt of the demand give notice thereof to the principal or, where applicable, its instructing party, unless otherwise agreed between the guarantor and the principal.]"

25. The Working Group noted that article 15, which was patterned on article 17 URDG, appeared in brackets as opinion had been divided at the fifteenth session on whether the uniform law should impose an obligation on the guarantor to give notice to the principal of a demand made by the beneficiary. At the present session, opinion was again divided as to the desirability of imposing such an obligation.

26. The concerns cited in support of the deletion of article 15 included the following: that the imposition of a statutory duty to give notice to the principal would compromise the integrity, independence and reliability of the guarantor's undertaking, in particular by facilitating the initiation by the principal of steps to block payment; that the only type of contact between the guarantor and the principal concerning the demand for payment should be in the case of a request by the guarantor for a waiver by the principal of discrepancies identified by the guarantor; that the inclusion of an obligation to give notice would run counter to the objective of providing a unified regime covering both guarantees and stand-by letters of credit, since, it was stated, the giving of notice was a procedure that was foreign to stand-by letters of credit and might, in some jurisdictions, raise regulatory concerns, and that the giving of notice was not an established practice as regards guarantees; and that the nature of the notice obligation set forth in article 15 was vague, in particular as to the content of the notice, its timing, and the legal consequences of a failure to give notice. Finally, it was suggested that the principal and the guarantor were free to agree on a notice procedure, that the obligation to give notice could in fact be placed on the beneficiary and that the guaranty letter could always require that documentary evidence of the fulfilment of that obligation accompany the demand for payment, all of which minimized the need to include in the uniform law an obligation to give notice. It was suggested that, in the event the Working Group decided to retain the provision, stand-by letters of credit would need to be exempted.

27. Support for retaining the obligation to give notice was expressed on the grounds that such a procedure enhanced the possibility of negotiated settlements of disputes between the principal and the beneficiary and helped to balance the positions of the two parties. It was also stated that notice to the principal prior to payment was a common practice, that it served to inform the principal that its account was to be debited and that it was a precondition to enable the principal to protect itself in cases of manifestly improper demands. It was also stated that the giving of notice did not compromise the independence of the guarantor's undertaking because the obligation to give notice, as had been decided at the fifteenth session, would not be linked in terms of time to the duty of examining the claim and deciding about payment. In this connection, it was suggested that it should be made clear that non-compliance with the duty of notification would not affect the effectiveness of payment and that the proviso should be reformulated so as to make it abundantly clear that the guarantor was not required to give notice before payment. It was further suggested that the notice procedure, while possibly foreign to stand-by letters of credit, might nevertheless usefully be applied to them.

28. The Working Group considered how some of the concerns that had been raised about article 15 might be addressed, short of deleting that provision. One suggestion was to make the provision more precise as to the consequences of a failure to give notice by providing that the guarantor would be liable for damages. Damages would be available, for example, when the principal could prove that, had timely notice been provided, it could have recovered from the beneficiary the amount paid out by the guarantor.

It was also suggested that it should be made clear that the principal would not be entitled, solely by virtue of a failure to give notice, to refuse to reimburse the guarantor after a claim under the guaranty letter had been paid. Another suggestion was that it should be made clearer that article 15 also applied to counter-guarantors.

29. After deliberation, the Working Group decided to postpone, pending further review, a final decision as to whether it would be desirable to retain a provision along the lines of article 15. It was therefore decided to retain the article in square brackets. The Secretariat was requested, meanwhile, to refine article 15 to address issues that had been raised, including sanctions for failure to give the notice and the independence of the undertaking to pay from the notice requirement.

#### *Article 16. Examination of demand*

30. The text of draft article 16 as considered by the Working Group was as follows:

"(1) *Variant A:* In examining the demand and any required statement or document accompanying it, the guarantor shall comply with the standard of reasonable care prevailing in international guaranty and stand-by letter of credit practice to ascertain their facial conformity with the terms of the guaranty letter, which are to be construed strictly.

*Variant B:* The demand and any required statement or document accompanying it shall be examined by the guarantor with the professional diligence of a knowledgeable, prudent guarantor to ascertain whether they appear on their face to conform with the terms of the guaranty letter and to be consistent with one another.

"(2) Unless otherwise agreed by the parties, the guarantor shall have

*Variant X:* reasonable time

*Variant Y:* [four] business days

*Variant Z:* reasonable time, but not more than [seven] business days in which to examine the demand and to decide whether or not to pay."

#### *Paragraph (1)*

31. The Working Group considered two variants of paragraph (1), which is intended to set forth the standard for the conduct of the guarantor in examining a demand for payment and determining whether the demand complied with the terms of the guarantee.

32. Support was expressed for variant A on the ground that it included a reference to an established, internationally recognized standard, namely, the standard of reasonable care prevailing in international guaranty and stand-by letter of credit practice. It was suggested that such an approach, with its implicit reference to UCP, was the more objective of the two variants and would thus protect against the intrusion of exorbitantly strict or unduly lenient standards of examination. It was said that objectivity would be strengthened by virtue of the fact that the revision of UCP currently being carried out was likely to result in more explicit standards concerning the elements to be reviewed when exam-

ining principal types of trade documents. Furthermore, the view was expressed that reference to an internationally recognized standard was desirable from the viewpoint of certainty and harmonization. If multiple standards were injected, disputes might arise, in particular as to the right of the guarantor to reimbursement. A view was expressed that there was no substantial difference between variants A and B since the professional diligence of the guarantor could only be determined by reference to the standard of care prevailing in international practice.

33. Reservations were expressed as to variant A on the ground that the uniform law would not fulfil its mandate to establish a standard of conduct for the guarantor if it merely referred to international practice, thus leaving the standard to be developed elsewhere. The concern was also expressed that the reference to international practice was vague and that the use of the word "prevailing" might suggest that the international standard was a changing one. Moreover, support was expressed for variant B on the ground that it was consistent with an analogous provision in URDG article 9, that variant B rather than variant A was the more objective alternative, that it took better account of the needs of the users of the uniform law and that the drafting style was preferable.

34. A view was expressed that the provision found in both variants to the effect that the demand was to be judged only for its apparent or facial conformity with the terms of the guaranty letter should be replaced by a rule requiring the guarantor to ascertain to the greatest extent possible that the demand conformed in fact to the terms of the guaranty letter. That view did not receive support, as the Working Group considered it essential, in view of the independent nature of the undertaking, to limit the scope of the examination to apparent or facial compliance.

35. The Working Group next considered proposals aimed at capturing the advantages of both variants of paragraph (1). Those proposals ranged from a suggestion that the uniform law should not express a preference for either approach to a proposal that the two variants be combined. Furthermore, a note of caution was struck that the uniform law should avoid adding to the existing number of different formulations concerning the standard of care of the guarantor. These already included the standards found in UCP article 15, URDG article 9 and the draft revision of the UCP.

36. One suggested approach for combining variants A and B was to add words such as "having due regard to prevailing international standards" to the language in variant B concerning professional diligence. Such a combination, it was said, would usefully promote internationalization of standards applicable to examination of demands for payment. The concern was raised that the combined approach might be confusing, although the extent to which confusion could ensue was disputed on the ground that the reference to the internationally recognized standard would, in effect, be to internationally recognized contractual rules such as UCP. It was also cautioned that any combination should retain the emphasis on facial conformity of the demand for payment with the terms of the guaranty letter.

37. The discussion of the standards set forth in variants A and B revealed a close link between the provisions of article 16, dealing with examination of the demand for payment, and article 13, dealing with the liability of the guarantor. However, in addition to this issue shared with article 13, article 16 also addressed the standard to be used to determine whether a demand and any accompanying documents were in conformity with the terms of the guaranty letter. Accordingly, it was proposed that the provision of paragraph (1) that established the standard of care to be followed in examining the demand might be incorporated into article 13 or should at least be aligned with that article. With such a division, paragraph (1) in its variant B would focus on the standard to be used in determining whether the demand and any accompanying documents were in conformity with the terms of the guaranty letter.

38. A view was expressed that the proposed division was complicated because article 13 was said to focus on the relationship between the principal and the guarantor, and between the counter-guarantor and the guarantor, while article 16 dealt with issues related to the relationship between the guarantor and the beneficiary. On this point it was observed that it might be useful to examine further the extent to which the uniform law should or should not encompass the principal-guarantor relationship. A further matter was whether the standards in question should be mandatory, or subject to contractual variation.

39. The Working Group, after deliberation, decided to reconsider the matter at a future session on the basis of draft provisions to be prepared by the Secretariat along the lines of the suggested division.

#### *Paragraph (2)*

40. The Working Group expressed its agreement with the provision in the *chapeau* recognizing the right of contractual modification of the time-limit set forth in paragraph (2) for the examination of the demand for payment. A suggestion was made, however, to use the words "unless otherwise stipulated in the guaranty letter", so as to make it clear that this provision only dealt with an agreement between the guarantor and the beneficiary. The Working Group then considered three variants as to the length of time to be allowed for the examination of the demand for payment.

41. Some support was expressed for variant X, which provided the guarantor with "reasonable time", on the ground that the flexibility inherent therein would permit adequate recognition of the circumstances in each individual case, since cases might, if complex, require more than the time provided for in variant Y. Variant X was said to be preferable also because it would be difficult to fix a general maximum limit of the type envisaged in variant Z. However, objections were raised to variant X, in particular that the provision would, due to its imprecision, not deliver the desired degree of certainty. A measure of support was found for variant Y also on the ground that the four-day period envisaged therein accurately reflected typical banking practice. However, it was observed that it was not bank practice to allow examinations of demands for payment to drag on, and that the need for an absolute time-limit was questionable.

42. Support was also expressed in favour of the approach taken in variant Z, which attempted to combine the flexibility offered by the "reasonable time" provision in variant X with the certainty offered by the fixed time-limit in variant Y.

43. The Working Group, after deliberation, decided to retain variant Z, without thereby foreclosing reconsideration at a future session.

#### *Article 17. Payment or rejection of demand*

44. The text of draft article 17 as considered by the Working Group was as follows:

"(1) The guarantor shall make payment as demanded by the beneficiary, unless:

(a) the guaranty letter is non-existent, invalid or unenforceable; or

(b) the demand does not meet the requirements referred to in article 14 [; or

*Variant A:* (c) the demand is [manifestly] [clearly and obviously] improper according to article 19].

"(2) *Variant B:* [The guarantor may make payment despite an assertion by the principal that the demand is improper according to article 19, provided that the guarantor acts in good faith. However, if]

[If] the principal asserts that the demand is improper according to article 19 and the guarantor decides not to reject the demand, the guarantor shall promptly inform the principal about its decision [and, if so requested by the principal, defer payment for [three] business days].

"(3) If the guarantor decides to reject the demand on any ground referred to in paragraph (1) (a) and (b) of this article, it shall promptly give notice thereof, indicating, where appropriate, the reasons for the decision, to the beneficiary by teletransmission or, if that is not possible, by other expeditious means.

"[(4) If the guarantor fails to comply with the provisions of article 16 or paragraph (3) of this article, it shall be precluded from claiming that the demand is not in conformity with the terms of the guaranty letter.]"

#### *Paragraph (1) (a) and (b)*

45. As regards subparagraph (a), concerns were expressed that the reference to legal concepts such as non-existence, invalidity or unenforceability might result in uncertainty or disparities as to the rules applicable in different jurisdictions. It was stated that certain instances of "non-existence" of a guaranty letter recognized in particular jurisdictions might be regarded in other jurisdictions as instances of absolute nullity or invalidity of the guaranty letter. Examples of uncertainty concerning "non-enforceability" included boycott and the case where the text of the guaranty letter stipulated payment in a non-convertible currency but did not establish a conversion mechanism for payment in another currency. It was thus suggested that the uniform law, rather than focusing on concepts of legal doctrine, should list the factual situations that could justify the rejection of a demand for payment.

46. The prevailing view was, however, that no attempt should be made to list within the uniform law all factual situations where the guarantor would be justified to refuse payment since it would be difficult, if not impossible, to establish an exhaustive list. Furthermore, any attempt to list the cases where the guarantor would be obliged or entitled not to pay might raise difficulties as regards the determination of the applicable law since the conflict-of-laws rules would be different depending upon whether the nullity of the undertaking resulted from violation of legal requirements concerning the personal capacity of the parties, the form in which the undertaking was agreed upon or the substance of the undertaking.

47. Reference was made to circumstances generally described as *force majeure* where the guarantor would be faced with an absolute impossibility to make payment. A suggestion was made that the uniform law should address those situations. In that connection, a view was expressed that the uniform law might indicate more clearly, in the case of a temporary obstacle, whether the obligation of the guarantor would be only temporarily suspended until such time as the impediment disappeared or whether the obstacle should be viewed as terminating the obligation of the guarantor.

48. In support of the current wording of subparagraph (a), it was explained that, while such concepts as "non-existence", "invalidity" and "unenforceability" might be interpreted differently in different jurisdictions, such differences would not affect the application of the provision in so far as the undertaking was vitiated by, and the non-payment based on, circumstances to which at least one of those three concepts was applicable. However, it was stated in reply that the provision was inappropriate where the events or circumstances that vitiated the undertaking fell outside the scope of paragraph (1)(a) in some jurisdictions but were retained within that scope in others.

49. The view was expressed that the obligations of the guarantor addressed in article 17 were a "mirror image" of the obligations of the beneficiary stated in article 14, which established as a general rule that a demand for payment presented by the beneficiary had to conform with the terms of the guaranty letter. It was suggested that article 17 should be redrafted along the same lines to state in general terms that the guarantor was obliged to pay against a demand in conformity with the terms of the undertaking. It was stated that a reference to the obligation to pay pursuant to and in accordance with the terms of the undertaking would encompass not only subparagraph (b) but also the cases currently addressed in subparagraph (a), as questions relating to the issuance, the existence, the validity and the enforceability of the undertaking would be raised in connection with the terms of the undertaking.

50. While it was observed that the suggested formulation could not easily embrace a reference to article 19 on improper demand, the Working Group, after deliberation, adopted the suggested structure as outlined in paragraph 49 and requested the Secretariat to prepare a revised draft of the paragraph. It was noted that the new structure left open the question as to whether the guarantor, in the exceptional circumstances where it would not be obliged to pay, would

have an obligation or a mere authorization to refuse payment. It was generally felt that question should be addressed in the context of the discussion on variants A and B.

#### *Variants A and B*

51. As regards the substance of the tests contained in variants A and B, it was stated that the difference was minimal since it was difficult to conceive of circumstances in which a demand was manifestly or clearly and obviously improper but the guarantor nevertheless paid in good faith. However, variants A and B were seen as differing in their scope. Variant A stated as a general principle that the guarantor should not pay in case of a manifest fraud, while variant B addressed the exceptional situation where the guarantor was instructed by the principal not to pay, based on the assertion that the demand was improper.

52. Divergent views were expressed as to whether the guarantor, faced with a manifestly improper demand, should be obliged to refuse payment or whether he should have discretion to pay or not to pay. It was noted that this question had repercussions on the relationship between the guarantor and the principal, in particular as regards the right of the guarantor to obtain reimbursement from the principal and on the principal's right to apply for injunctive relief as suggested in article 21.

53. In favour of granting the guarantor discretion, it was stated that a fundamental principle of the uniform law was that payment by the guarantor should be the norm and non-payment a rare exception. It was suggested that purpose of the uniform law might be defeated if the guarantor was under an obligation not to pay since that would encourage the guarantor not to pay. It was also stated that the guarantor should be allowed to rely on the facial conformity of the documents, unless the principal obtained a court decision enjoining the guarantor from paying under the guaranty letter. The prevailing view, however, was that the guarantor should be obliged to refuse payment in blatant fraud or abuse situations that could be perceived by anyone.

54. While some doubts were expressed as to whether the test provided in variant A would be applied uniformly in all jurisdictions, it was noted that the concept of bad faith might lend itself to even greater divergence in interpretation. It was agreed that the common core of the tests contained in variants A and B consisted of the fact that the improper nature of the demand was known to the guarantor or was beyond any reasonable doubt, without any investigation on the part of the guarantor.

55. After deliberation, the Working Group was agreed that the uniform law should contain a rule to the effect that, where the guarantor knew or ought to have known that the demand for payment was improper, the guarantor would have an obligation not to pay. In all other cases, i.e., not only in case of facial conformity of the demand and documents but also in case of a doubt, irrespective of whether the guarantor was faced with an allegation that the demand was improper, the general rule would apply and the guarantor had to pay. The Working Group decided to reconsider the matter at a future session on the basis of a revised provision to be prepared by the Secretariat in the light of the above deliberations and decisions.

*Last sentence of paragraph (2)*

56. The provision deferring payment for a very limited number of days was supported on the ground that it attempted to strike a balance between the need for prompt payment of the independent undertaking and the interest of the principal to submit documentary evidence to the guarantor or, if feasible within that short period, to seek injunctory relief from a court.

57. However, the prevailing view was that the provision was likely to encourage systematic deferral of payment and that the sentence should be deleted. It was also stated that there should be no obligation imposed on the guarantor to inform the principal if it is decided not to reject the demand. Another argument for the deletion of the provision was that it was contrary to the practice of stand-by letters of credit which did not allow any time for possible negotiation.

*Paragraph (3)*

58. A concern was raised that the words "where appropriate" would give the guarantor the option not to inform the beneficiary of the reasons why it had decided not to pay under the guaranty letter. It was stated that paragraph (3) might seem inconsistent with the preclusion rule contained in paragraph (4) for the cases where the guarantor had failed to comply with the provisions of article 16 and paragraph (3).

59. Accordingly, one view was that, following the approach of article 10(b) URDG, the requirement of giving notice to the beneficiary should not embrace the giving of reasons. However, the prevailing view was that the guarantor should give reasons in all cases. It was suggested that the uniform law should provide some guidance in that respect, for example by requiring, in the case of non-conformity, a statement as to the specific discrepancy, and in the case of an improper demand or of a fundamental defect, a general statement to that effect.

60. The Working Group requested the Secretariat to prepare a revised version of paragraph (3) in the light of the above deliberations.

*Paragraph (4)*

61. Divergent views were expressed as regards the rule of preclusion contained in paragraph (4). One view was that the preclusion rule was too harsh and that the uniform law should remain silent on that point. That would still allow parties to agree on the preclusion rule contained in the Uniform Customs and Practice for Documentary Credits (UCP). It was stated in support of that view that the idea of finality underlying the preclusion rule was of greater importance in the context of payments under commercial letters of credit than under guaranty letters.

62. Another view was that the rule of preclusion should be retained since finality was essential for guaranty letters as well, at least for stand-by letters of credit. It was stated in support of that view that it was not sufficient to leave the matter to the UCP since preclusion was an important rule of traffic that had to be made known to all parties potentially involved in the transaction.

63. After discussion, the Working Group decided that the text of paragraph (4), possibly to be refined by the Secretariat, would remain between square brackets.

*Article 18. Request for extension or payment*

64. The text of draft article 18 as considered by the Working Group was as follows:

"If the beneficiary [demands in the alternative payment or] [combines a demand for payment with a request for] an extension of the validity period of the guaranty letter, the guarantor shall comply with the following rules, unless otherwise agreed by the parties:

(a) The guarantor shall give prompt notice of the alternative demand for extension or payment to the principal [directly or through an instructing party];

(b) The guarantor may not extend the validity period without the consent of the principal; however, even if the principal consents to the extension, the guarantor is not obliged to extend the validity period, unless so required by an agreement with the principal;

(c) The guarantor shall examine the demand for payment in accordance with article 16 and decide whether to pay or to reject that demand; if the guarantor decides not to reject the demand, it [shall] [may] defer payment until [ten] business days have elapsed after [giving notice to the principal] [receiving the alternative demand from the beneficiary] and then make payment, unless the guarantor extends the validity period."

65. As had been the case when the Working Group first discussed "extend-or-pay" requests at the fifteenth session (A/CN.9/345, paras. 73-77), opinions differed as to whether the uniform law should contain specific provisions on such requests. Doubts were expressed as to the need for article 18 on the ground that the circumstances addressed therein were already adequately covered by other provisions in the uniform law. In particular, it was suggested that a request to extend or to pay could properly be classified as a request for an amendment of the guaranty letter falling under article 8. According to this view, if the uniform law contained an adequate amendment procedure providing for notice and consent of the parties, the need for article 18 would diminish. To the demand-for-payment component of an extend-or-pay request, article 14 might be applied. The necessity of including article 18 was also questioned on the ground that the need for the procedures envisaged in subparagraphs (a) through (c) could be seen as sufficiently covered by the general standards of conduct imposed by the uniform law.

66. The primary factors cited in favour of retaining article 18 included uncertainty surrounding extend-or-pay requests and the guarantor's response thereto, along with the frequency with which such requests occurred. It was stated that, accordingly, the uniform law would have, either in article 18 or in some other provision, to address such requests. It was said that extend-or-pay requests could not be treated as simple requests for amendment and that specific rules were desirable to regulate the legal effect and procedures of those types of requests. The rules would help to address the problems that arose when, after an extend-or-

pay request was refused, the guaranty letter expired without payment having been made. Retention of article 18 was also supported on the ground that extend-or-pay requests, rather than being viewed in all cases with apprehension as a practice to be discouraged by the uniform law, might be regarded as potentially useful steps towards negotiated settlement of disputes between the principal and the beneficiary. In that respect, the provision of subparagraph (c) to defer payment for a certain number of days was regarded as a useful device.

67. A number of additional observations were made, to be considered were article 18 to be retained. One such suggestion was that the scope of the article should be limited to bank guarantees, thus excluding stand-by letters of credit, in particular because the extend-or-pay procedure was incompatible with financial stand-by letters of credit, since the expectation of the parties was that the bank would pay immediately upon demand. In response, it was stated that the extend-or-pay situation was one which arose not only in relation to bank guarantees, but might also arise under stand-by letters of credit, and that therefore no limitation on the scope of article 18 would be warranted.

68. The Working Group noted that it was not the intent of article 18 to confer a right on the beneficiary to obtain an extension of the validity period of the guaranty letter merely by virtue of making an extend-or-pay request. Another area of potential clarification was the effect on the counter-guaranty letter of an extend-or-pay request under the indirect guaranty letter. It was also suggested that additional clarity might be achieved by modifying the title of article 18 to read along the lines of "request for extension or demand for payment", as well as by placing it in closer proximity to or incorporating it in article 8 or 14.

69. The Working Group then turned to a discussion of whether an extend-or-pay request should be regarded as containing a firm demand for payment, such that, were the extension to be denied, the beneficiary would not have to make any additional demand for payment in order to receive payment. It was noted that this was the approach underlying article 18. Support was expressed for that approach. A differing view was that extend-or-pay requests should not be regarded as demands for payment as this would run counter to the notion of strict compliance of the demand for payment with the terms of the guaranty letter. It was pointed out that such an approach had been taken by a number of jurisdictions. Mention was also made of the distinction between those cases in which the contingency secured by the guaranty letter had occurred and those cases in which the contingency had not occurred. In the latter type of case, for example when an extend-or-pay request was made merely because the duration of the underlying contract was being extended, the demand for payment might be considered abusive.

70. After deliberation, the Working Group decided, in order to facilitate further consideration, to request the Secretariat to present it with two possible approaches. Under the first approach, a request to extend or to pay would not be regarded as a proper demand for payment. It was observed that this approach, while possibly leading to the elimination of extend-or-pay requests in their present form,

would not prevent beneficiaries from achieving the same result by first requesting extension of the guaranty letter prior to a specified deadline, and then, if the validity period was not extended by the deadline, filing a demand for payment. Under the second approach to be presented in the next draft, the demand for payment portion of an extend-or-pay request would not be vitiated.

71. In reviewing article 18, the Working Group had occasion to engage in a discussion of the manner in which the uniform law might establish a unified set of rules governing guarantees and stand-by letters of credit while at the same time taking account of various peculiarities of those types of instruments. It was noted that, with respect to several draft articles, questions had been raised as to the feasibility of applying the same rule both to bank guarantees and to stand-by letters of credit. Such questions had arisen not only with respect to the extend-or-pay procedure in article 18, but also regarding requirements elsewhere in the uniform law, for example, the notice of a demand for payment to be given by the guarantor to the principal, the treatment of non-documentary conditions, the question of limiting transfers and the rule of preclusion. In each of those cases, it was suggested that the distinction previously made between stand-by practice and guarantee practice did not adequately account for differences among those who utilized guarantees. Rather than utilize terms such as "hard" or "soft" which had pejorative connotations, it was asked whether it might not be better to think of undertakings which were directed to immediate payment by a neutral paymaster based on a purely documentary demand as opposed to instruments which were intended to assure a solvent paymaster after a process of negotiation between the parties. As to the former, the beneficiary would hold the funds during any negotiation between the parties to the underlying transaction, whereas in the latter, the paymaster would withhold payment. The two approaches contained many similarities as well as significant differences. It was suggested that evidently some guarantees fell within the former category and some within the latter, which explained the differences in position among those using guarantees with regard to the various issues such as notice to the applicant before payment and extend-or-pay requests. The distinction, it was suggested, was not between guarantees and stand-by letters of credit but between payment-oriented instruments, with stand-by letters of credit and some guarantees falling within the former category and other types of guarantees falling within the latter.

72. A view was expressed that, in view of the above, perhaps consideration might have to be given to excluding from the scope of the uniform law instruments that did not, with respect to both purpose and function, fall within the scope of the traditional bank guarantee. That approach, however, was objected to on the ground that instruments such as financial stand-by letters of credit represented a large volume of the undertakings intended to be covered by the uniform law. Furthermore, it was suggested that it would be inappropriate for the uniform law to distinguish instruments such as financial stand-by letters of credit from bank guarantees and to attempt to apply separate rules for each type of instrument. It was reported that bank guarantees were used, like financial stand-by letters of credit, in financial markets and were accepted by beneficiaries as

offering the required high degree of firmness in the undertaking. Accordingly, it was suggested that it might be more fruitful for the uniform law to take the necessary account of the different purposes that an undertaking covered by the uniform law could serve, as well as possible attendant differences in the certainty of the guarantor's undertaking. Under this approach, the uniform law would take account of the essential features both of undertakings used in financial markets and of undertakings whose purpose was to secure performance — irrespective of whether those financial or performance assurances took the form of bank guarantees or the form of stand-by letters of credit. The Working Group was urged at the same time not to overemphasize differences between financial and performance stand-bys, in view of the established classification of financial stand-bys as a species of stand-by letters of credit, which themselves were generally regulated under the umbrella of letters of credit.

73. It was agreed that the effort would continue to be made to formulate rules of general application, and that in that process account should be taken of the differing purposes and features of the various instruments covered by the uniform law. It was also recalled that one of the guiding notions of the uniform law was that of party autonomy to agree on the terms of the guaranty letter. That autonomy, the extent of which remained to be determined in respect of each article, was an avenue through which differences in practice could be accommodated, in particular, as regards the choice of particular types of undertakings and of particular payment conditions.

#### *Article 19. Improper demand*

74. The text of draft article 19 as considered by the Working Group was as follows:

*“Variant A:* A demand for payment is improper if:

(a) any certification by the beneficiary or any required document accompanying the demand is [untrue] [essentially incorrect] or forged; or

(b) the demand falls clearly outside the purpose for which the guaranty letter was given or otherwise lacks any plausible basis.

*“Variant B:* (1) [Same as variant A]

(2) A demand has no plausible basis, for example, where:

(a) in the case of a guaranty letter that [supports] [backs up] the financial obligation of a third party, the principal amount is not due;

(b) in the case of a tender guaranty letter,

(i) the contract has not yet been awarded; or  
(ii) the contract has been awarded to a tenderer other than the principal; or

(iii) the contract has been awarded to the principal and the principal has [accepted] [signed] the contract and secured any required performance guaranty letter;

(c) in the case of a repayment guaranty letter, no advance payment has been made;

(d) in the case of a performance guaranty letter,

(i) a competent court or arbitral tribunal has determined [in a final decision] that the obligations of the principal towards the beneficiary, the performance of which the guaranty letter was intended to secure, do not exist or are unenforceable on the ground that the underlying transaction [between the principal and the beneficiary] is non-existent, violates public policy or is otherwise invalid;

(ii) the principal has completely [to the satisfaction of the beneficiary] fulfilled its obligations the performance of which the guaranty letter was intended to secure;

(iii) the beneficiary has prevented the principal from fulfilling its obligations, the performance of which the guaranty letter was intended to secure, by a [wilful] [serious] breach of its own [fundamental] obligations of the underlying transaction;

[(iv) the amount demanded is [grossly disproportionate to] [at least five times higher than] the damage suffered due to the failure of the principal to fulfil its obligations;]

(e) in the case of a counter-guaranty letter, the beneficiary of the counter-guaranty letter has paid [or intends to pay] to its beneficiary under its guaranty letter, the reimbursement for which constitutes the purpose of the counter-guaranty letter, upon a demand that is [evidently] affected by one of the infirmities referred to in paragraph (1) of article 17, provided that the beneficiary of the counter-guaranty letter

*Variant X:* acted in collusion with its beneficiary.

*Variant Y:* [acted in bad faith] [failed to exercise professional care].

*Variant Z:* is by virtue of the counter-guaranty letter or any reimbursement agreement with the counter-guarantor or by virtue of law [entitled] [under a duty] to reject the demand because of such infirmity].

*“Variant C:* (1) A demand for payment is improper if making it constitutes fraud or an abuse of rights.

(2) The making of a demand constitutes fraud where:

(i) the beneficiary [has no belief that the amount demanded is due] [knows or cannot be unaware of the fact that the amount demanded is not due] on the basis asserted in the demand and any supporting statements and documents; or

(ii) any supporting statement or document is [untrue] [essentially incorrect]; or

(iii) any supporting document is forged.

(3) The making of a demand constitutes an abuse if:

*Variant X:* the beneficiary exercises its right for a purpose other than that for which the guaranty letter was given.

*Variant Y:* the contingency against the consequences of which the guaranty letter was designed to indemnify the beneficiary has undoubtedly not materialized or has clearly been brought about by a fundamental breach of the underlying transaction wilfully committed by the beneficiary.

*Variant D:* The guarantor [may] [shall] reject a demand as improper if, having due regard to the independent [and essentially documentary] character of its undertaking, the guarantor concludes that the demand is made in bad faith or fraudulently, including fraud or forgery relating to the documents or fraud in the underlying transaction, or that the making of the demand constitutes an abuse of rights by the beneficiary, provided that the facts constituting the basis of that conclusion are clearly and convincingly established without investigation by the guarantor."

75. Four variants of article 19 were presented to the Working Group, reflecting various proposals that had been made at the fifteenth session (see A/CN.9/345, para. 51). Variants A through C contained definitions of the term "improper demand". Variant D, rather than setting forth a definition of that term, gave a general guideline.

76. In the review of the variants, a number of factors were identified as relevant to defining or describing an "improper demand". Prominent among these was the distinction that sometimes had to be drawn between fraud in the underlying transaction and fraud in the documents presented to the guarantor in order to obtain payment. In this regard, it was recognized that, in cases of fraud in the documents, a degree of tension existed with the principle of examination of the demand on the basis of facial compliance and, in cases of fraud in the transaction, with the principle of independence of the undertaking. It was the general view of the Working Group that the circumstances in the underlying transaction had to be given some opportunity to affect the guaranty transaction so that in a limited number of cases the demand for payment could be treated as improper. Thus the notion of "improper demand" would be limited to cases where the misconduct could be described by terms such as "manifest" or "beyond doubt" and "egregious". It was also suggested that one of the ways of focusing article 19 would be to indicate that demands for payment that fell clearly outside the purposes of the guaranty letter were improper.

77. An important related factor was the difference in terminology used by legal systems to refer to improper demands. Notably, in some legal systems, the use of the term "fraud" was confined to cases of forgery of documents presented to the guarantor, while demands for payment related to fraud in the underlying transaction fell under the notion of "abuse of rights". In other legal systems, both aspects fell under the umbrella notion of fraud. While some consideration was given to elaborating definitions of terms such as "fraud" and "abuse", the general preference of the Working Group was to attempt to bridge those differences in terminology by avoiding the use of such terms and to aim instead at a commonly understood description of the improper demand.

78. Also said to be relevant were differences among legal systems as to procedural and substantive rules under which guarantors operated. For example, in some countries, efforts to prevent payment of an allegedly improper demand typically took the form of applications to the court for preliminary injunctive measures, while in certain other jurisdictions such preliminary measures were not available for cases of this type. It was also noted that the circumstances in each case of improper demand differed, and that this affected the ease with and the extent to which the guarantor could become cognizant of the irregularity in the demand for payment. The Working Group noted that in a usual case the guarantor would not be kept informed as to the implementation of the underlying transaction.

79. An observation of a more general type was that the working assumption in the uniform law should be that the parties generally act in good faith. A concern was also raised that, in formulating the uniform law, adequate account should be taken of the beneficiary's perspective, in particular since the guaranty letter was the product of the negotiated agreement of commercial parties and was often the only source of monetary compensation for a default in the underlying transaction. The Working Group was urged to search for a formulation of article 19 that was as objective as possible, avoiding terms such as "concludes", which might suggest not only that the process was subjective in character, but also that the guarantor was to conduct an investigation of the fraud. It was also suggested that the formulation of variant D might be simplified by deletion of the words "demand is made in bad faith or fraudulently, including fraud or forgery relating to the documents or fraud in the underlying transaction, or that the".

80. As to the specific evaluation and comparison of the variant versions of article 19, as noted above, the Working Group generally preferred that article 19 should avoid attempting to define terms such as "fraud" that might be the subject of traditionally divergent interpretations. Accordingly, the Working Group preferred the approach taken in variant D over the definitional approach in the other variants. Variants A and B drew criticism on the ground that the significance of the words "plausible basis" found therein was not clear and seemed overly broad. It was suggested that clear language was needed in order to indicate whether the guarantor was to judge only whether there was any basis at all for the demand for payment, or whether the guarantor was to evaluate the sufficiency of any basis that did exist for the demand for payment.

81. The approach used in variant B, that of providing an illustrative list of cases of improper demand, was not regarded as appropriate for the uniform law. Concerns included the possibility that the list of examples would not be comprehensive and might not take adequate account of the circumstances of individual cases, and that the use of such a list was incompatible with the legislative drafting tradition in a number of States. The suggestion was made that a list of examples such as that in variant B might usefully be included in a commentary.

82. The Working Group also considered possible modifications and refinements of variant D beyond the avoidance of terms such as "fraud" or "abuse". In doing so, it sur-

veyed the various cases of improper demand specified or referred to in the other variants in order to determine which of these situations should be covered by the broad rule along the lines of variant D. In connection with paragraph (1)(a) in variant A, the Working Group considered what the notion of fraud in the documents should encompass. It was agreed that the case of forged documents should be included. The case of false or inaccurate documents seemed less clear. The Working Group noted that in some jurisdictions the notion of forgery encompassed false or inaccurate documents, while in others it did not. Enunciating general rules for such cases was complicated by the fact that the falsity or inaccuracy might not always be tantamount to the fraud to be sanctioned by the uniform law. It was suggested that for such cases it might be helpful to provide in article 19 that, for a false or inaccurate document to render the demand improper, the beneficiary must have intended to deceive.

83. In this regard, the Working Group noted that the courts of some jurisdictions have held that in such cases the guarantor was obligated to pay if the beneficiary was unaware of the tampering with the documents. Such holdings raised the broader question of whether the uniform law should generally limit itself to cases in which the beneficiary was involved in or otherwise aware of the fraud. There was general agreement that demands for payment in such cases should be deemed improper. No final conclusions were reached, however, as to whether the awareness of involvement of the beneficiary would be a prerequisite for action pursuant to article 19. The Working Group did agree, though, that, as a whole, the situations addressed by variant A should fall within the purview of article 19.

84. The view was expressed that the situation envisaged in paragraph (2)(a) of variant B would not in all cases constitute an improper demand. It was pointed out that it indeed might be the purpose of a guaranty letter to provide for payment even before the sum in the underlying transaction became due (e.g., when the principal became insolvent). It was suggested that the problem might be solved by linking such a ground for impropriety to the terms and conditions of the guaranty letter.

85. While support was expressed for the general thrust of paragraph (2)(d)(i) of variant B, the Working Group was reminded that it might be the purpose of a guaranty letter to cover the risk of the occurrence of the type of situation referred to in that paragraph (invalidity, unenforceability of the underlying transaction). It was pointed out that payment under such circumstances has withstood judicial scrutiny in a number of jurisdictions.

86. Some hesitation was expressed with regard to the type of situation referred to in paragraph (2)(d)(iii), which concerned prevention by the beneficiary of performance of obligations in the underlying transaction that were secured by the guaranty letter. It was suggested that the assessment of that type of situation tended to be particularly subjective and linked to the circumstances of the particular case and should therefore not be covered by article 19.

87. Reservations were expressed as to the coverage of the situation addressed in paragraph (2)(d)(iv) of variant B,

which referred to disproportionality between the damage suffered and the amount claimed under the guaranty letter. One concern was that assessment of the demand in such terms would involve a value judgement by the guarantor. Another concern was that the integrity of the undertaking would be undermined if payment could be refused on grounds other than complete lack of any basis for the demand. It was pointed out that the risk of disproportionality could be dealt with by the principal by seeing to it that the guaranty letter contained a mechanism for reduction of the guaranty amount and called for the presentation of documents certifying the amount due.

88. Differing views were expressed as to whether rejection of an improper payment demand should, under article 17 in tandem with article 19, be mandatory or discretionary. Some support was expressed for a discretionary approach, in particular because of a concern that a mandatory approach would accentuate uncertainty as to whether the law governing the underlying transaction or the law governing the guaranty letter would be used for resolving the concepts of fraud and abuse of rights contained in variant D. The prevailing view, in line with the decision in respect of article 17, was that rejection should be mandatory for the kind of cases of manifest fraud or abuse being contemplated by article 19. Such an approach was said to have the benefit also of avoiding uncertainty that would result were the principal's obligation to reimburse the guarantor to be linked to the proper exercise of discretion in such cases by the guarantor.

89. The Working Group agreed that the case of the counter-guaranty letter should be encompassed in article 19. It was noted that fraud in the counter-guaranty context may centre on the counter-guaranty itself, for example, when a demand for payment under the counter-guaranty letter was made without there having been a demand under the indirect guaranty letter. In other cases, payment under the indirect guaranty letter took place, but was tainted with fraud of the ultimate beneficiary.

90. As to the formulation concerning counter-guaranty letters found in paragraph (2)(e) of variant B, it was suggested that the text in that paragraph should be reworded in order to take better account of differences in national law concerning the room to manoeuvre allowed to the guarantor confronted with an improper demand for payment. The Working Group reviewed the three variants set forth in paragraph (2)(e) concerning the circumstances in which article 19 would apply to the counter-guaranty context. Variants X and Y raised some hesitation, in particular because they contained terms of uncertain meaning, including "collusion", "bad faith" and "professional care". Regarding variant Y, a view was expressed that the reference to failure to exercise professional care might suggest that a guarantor had to engage in more than an examination of the demand for payment. The remaining approach, in variant Z, which avoided the use of uncertain terms, was considered preferable. It was noted that the word "not" had inadvertently been left out before the words "[entitle] [under a duty]".

91. After deliberation, the Working Group requested the Secretariat to revise article 19 based on the preference that

had been expressed for the approach in variant D. As had been discussed, the provision would concern cases in which the impropriety of the demand was clear and unambiguous or beyond doubt to the guarantor. It would also avoid defining terms such as "fraud" and "abuse of right", focusing rather on a description of the improper demand and taking into account various types of instruments and their different possible purposes. The provision further would treat counter-guaranty letters, drawing some of its features from paragraph (2)(e) of variant B, including the substance of variant Z in that paragraph.

#### Article 20. Set-off

92. The text of draft article 20 as considered by the Working Group was as follows:

*"Variant A:* Unless otherwise [expressly] agreed by the parties, the guarantor may not avail itself of a set-off with any claim against the demand for payment under the guaranty letter.

*"Variant B:* Unless otherwise agreed by the parties and subject to the provisions of the law of insolvency, the guarantor may discharge its payment obligation under the guaranty letter by means of a set-off with any claim not assigned to it by the principal, provided that the claim of the guarantor is [liquidated and] certain or undisputed.

*"Variant C:* Unless otherwise expressly agreed by the parties, the guarantor is precluded from discharging its payment obligation under the guaranty letter by means of a set-off with any claim, except where:

(a) the beneficiary is insolvent; or

(b) the guaranty letter is designed to secure the fulfilment of a financial or payment obligation of the principal or the guarantor and that obligation could have been discharged by means of a set-off with the claim of the guarantor."

93. As had been the case at the fifteenth session, divergent views were expressed as to whether the uniform law should include a provision on set-off. In support of deletion of article 20, reference was made to divergencies among national laws as to the extent to which set-off was permitted. For example, in some countries set-off was only permitted in cases of insolvency. In the face of diversity, a rule in the uniform law would be certain to contradict the jurisprudence and laws of a number of countries. Other factors said to favour deletion of article 20 included the relatively low frequency with which cases of set-off arose in the guaranty context and the fact that set-off might be regarded merely as a method of execution of payment under the guaranty letter.

94. The prevailing view was in favour of retaining a provision on set-off in the uniform law. It was stated that a clear solution of the issue of set-off was one that was of importance to the integrity of the guaranty letter. Set-off was a commonly used extrajudicial remedy that should not fall outside the uniform law. Whereas inclusion of a rule of common understanding would foster harmonization and uniformity, the absence of such a rule in the uniform law

might contribute to uncertainty and inconsistency. It was also felt that such a rule might usefully clarify matters not covered in the laws of all States, for example, whether the guarantor was permitted to set off a claim assigned to the guarantor by the principal.

95. As to the content of the rule on set-off, the view was expressed that variant A, which prohibited set-off, should be chosen, though modified to permit set-off in cases of insolvency of the beneficiary. A rationale behind a prohibition of set-off was that the guaranty letter was essentially a substitute for placing money in escrow and that, therefore, payment needed to be carried out when it fell due. Reference was also made to judicial decisions in the analogous area of documentary credits prohibiting set-off and to the uncertainty that might arise for holders of security interests in the guaranty amount, were set-off to be envisaged.

96. The prevailing view, however, was that such an attempt to prohibit set-off would not be reflective of practice and would diminish the acceptability of the uniform law. According to that view, set-off was not incompatible with the purposes of the guaranty letter and therefore the permissive approach in variant B was preferable. It was also suggested that an inability to set off would lead to difficulties related to the tracing of assets and might increase the incidence of double payment. The Working Group also expressed its support for the prohibition in variant B of the set-off of claims assigned by the principal to the guarantor. It was felt that such set-off would run counter to the purpose of the guaranty letter and to the principle of independence. A related question concerned the manner in which the notion of claims of the principal would be defined, for example, whether it would include claims of a company in which the principal had an interest.

97. Divergent views were expressed as to certain aspects of variant B. Some support was expressed for the reference at the end of variant B to the liquid, certain or undisputed nature of claims that might be set off. Deletion of that language was widely urged on the ground that such detailed aspects of set-off were treated in national law and it was not necessary to address them in the uniform law, thereby running the risk of conflict with national law.

98. It was reported that in the laws of some countries set-off was restricted to claims of the guarantor arising out of the same transaction as the beneficiary's claim. While there was some support for such a restriction in the uniform law, it was widely regarded as a matter to be left to the general law of set-off in each country. It was suggested that it might be useful to indicate that set-off had to be against a party that was claiming payment. Such a limitation would be necessary to cope with cases of assignment or transfer of the guaranty letter. Such a rule would prohibit a guarantor, for example, from setting off its claim involving the original beneficiary against a demand for payment made by a transferee.

99. After deliberation, the Working Group requested the Secretariat to revise article 20 in line with the preference that had been expressed for variant B.

## Chapter V. Provisional court measures

### Article 21. Preliminary injunction against guarantor

100. The text of draft article 21 as considered by the Working Group was as follows:

"(1) Where, on an application by the principal,

*Variant A:* strong prima facie evidence is produced to the satisfaction of a competent court

*Variant B:* clear and liquid proof is presented to a court of competent jurisdiction

*Variant C:* it is manifestly shown by documentary means, including [sworn witness statements] [affidavits] that a demand made [or anticipated to be made] by the beneficiary constitutes an improper demand, the court may issue a preliminary order enjoining the guarantor from meeting the demand [or from debiting the account of the principal], provided that [the court is satisfied that] the refusal to issue such an order would cause the principal [serious harm] [irreparable loss] which would be [clearly] more substantial than the loss that might be suffered by the beneficiary as a result of the issuance of such an order.

"(2) Before deciding on the application of the principal, the court [may hear the guarantor] [shall provide the guarantor with an opportunity to be heard]. It may also [, if so permitted under its procedural law,] consider the advisability of hearing the beneficiary or of allowing the principal to seek injunctive relief against the beneficiary as co-defendant.

"(3) An order referred to in paragraph (1) of this article shall be issued for a specified period of effectiveness not exceeding [six] months. An extension of that period may be made dependent on the initiation by the principal of proceedings other than preliminary proceedings against the guarantor or the beneficiary.

"(4) The court may make the effect of an order referred to in paragraph (1) of this article subject to the furnishing by the principal of such security as the court deems appropriate."

### General Remarks

101. The Working Group noted that article 21 and the two other articles in the present chapter were particularly preliminary in nature, meant to reflect various views that had been expressed at the fifteenth session and to facilitate further consideration by the Working Group as to whether and how the uniform law should treat provisional court measures, in particular the preliminary injunction.

102. As had been the case at the fifteenth session, various opinions were expressed on the question of preliminary injunctions. There was a degree of hesitation to incorporate article 21 and its companion provisions, in particular to the extent that they contained procedural rules that differed from State to State and that might better be left to local law. It was suggested that the acceptability of the uniform law would be adversely affected if it presented legislatures with the prospect of having to revamp established rules governing injunctions for one particular area of the law. It

was also pointed out that for some States the injunctive relief envisaged in the draft articles would be foreign. In the light of the above, it was suggested that the articles in question might be deleted, or at least directed only at those States in which injunctions were a recognized measure.

103. In favour of retaining a provision on injunctions, it was stated that such a provision was an integral element of the provisions in the uniform law dealing with fraud and abuse. It was also suggested that it was not the intent of the draft articles to bring about drastic changes in current national procedures, although it was said to be precisely because of the diversity in national approaches that it would be salutary to include the provisions in question in the uniform law. To the extent that injunction procedures did not exist in some States, retention of provisions on injunctions was said to have the benefit of providing guidance to those States in formulating such provisions. Both with respect to such States, as well as to the problem of diversity of national approaches, inclusion of provisions on preliminary injunctions was said to be beneficial for international uniformity and for protection of the integrity of the guaranty letter. It was further noted that the discussion of article 21 was hampered somewhat by uncertainty as to whether the final form of the uniform law would be a convention or a model law.

### Paragraph (1)

104. The Working Group considered three variants in paragraph (1) concerning the main requirement that the principal would have to meet in order to obtain an injunction. The first approach, variant A, which required the principal to present strong prima facie evidence, encountered criticism as being too loose. Variant B, which referred to clear and liquid proof, was considered to be a stricter standard and therefore received more support. Reservations were expressed, however, as to the use of the expression "clear and liquid proof", which might not be widely understood. Variant C, which referred to the manifest showing of the impropriety of the demand through documentary means, did receive some support, but was generally regarded as being too strict a standard and potentially harmful to the interests of justice. In particular, it might not be advisable, in court proceedings, to limit to documentary means the manner in which parties may prove impropriety. A question was also raised concerning the appropriateness of referring to affidavits, in view of the unfamiliarity with such instruments in some legal systems. A substantial degree of interest was shown in a proposal to combine variants B and C, so as to provide that the application of the principal must manifestly show that the demand was improper.

105. In the review of the variants in paragraph (1), various observations were made, including the following: that, in view in particular of the diversity of national legal regimes, the provisions in the uniform law on preliminary injunctions should be of a general, skeleton character, and that they should be flexible and avoid impinging on the access of parties to the courts; that it should be made abundantly clear that the preliminary injunction was to be available only in the strictly limited cases that fell under the category of "improper demand" enunciated in article 19 and that the link to article 19 might have to be made more

explicit than it was in the current draft; that the significance of the references to competent courts was not clear; and that the same standard of proof should be applied to both article 21 and to article 22.

106. The Working Group then considered whether article 21 should permit the principal to apply for a preliminary injunction prior to a demand having been made. Deletion of this possibility was urged on the ground that such anticipatory applications would broaden the scope of injunctive relief under the uniform law to an excessive degree. It was also pointed out that the willingness of courts to grant such anticipatory relief would vary from jurisdiction to jurisdiction. A differing view was that the typically short time between the demand and payment made it unrealistic not to permit anticipatory applications for injunctive relief while still hoping to preserve a meaningful remedy for the principal. It was said that this time pressure would be accentuated were the Working Group to finally decide under article 15 not to provide for notice to the principal of the demand for payment. The view was also expressed that the reference to the debiting of the principal's account as one of the acts that an injunction could block should be deleted. The concern behind that view was that, if the guarantor had paid in good faith, the court should not intervene to block the debiting of the principal's account.

107. Differing views were exchanged as to whether to retain the language at the end of paragraph (1) concerning the court's assessment of the relative harm that would be caused to the parties by a refusal to grant the injunctive relief. Concerns in favour of deletion were that the rule enunciated in article 21 might conflict with various approaches to such an assessment that existed in practice and that it was primarily the responsibility of the principal to assess the risks that were inherent in the use of guaranty letters. Proponents of retaining the provision said that it would have the desired effect of narrowing the availability of preliminary injunctions and that it would foster harmonization. It was also noted that the assessment by the court that an injunction should be granted could be balanced by requiring the principal to post a security.

108. The Working Group considered a number of possible ways of expanding the scope of article 21. The first was a proposal to expand the article to deal with provisional measures other than preliminary injunctions, for example, prejudgement seizure or attachment of assets. It was noted that the laws of some States, while not providing for preliminary injunctions, did authorize attachment. Doubts were expressed as to covering attachment, in particular because it was uncertain whether that device would or could be uniformly applied to intangibles such as the obligation to make payment under a guaranty letter or the right to claim payment. Another suggestion was that article 21 should contain a prohibition against the clause, sometimes included in counter-guaranties, requiring the counter-guarantor to pay even in the face of a court order prohibiting payment. Yet another proposal was that article 21 include a provision concerning the response of the guarantor to an application for a preliminary injunction. It was noted that the practice varied from State to State as to the extent to which the guarantor became involved in the defence against an application for a preliminary injunction.

109. Divergent views were expressed as to whether the uniform law should cover injunctions not based on improper demand but on other objections to payment such as non-existence, invalidity or unenforceability of the guaranty letter. One view was that article 21 should be broadened so as to encompass such objections and to subject applications for injunctions to the same requirements, in particular as regards the standard of proof. Another view was that an injunction should be available as an extraordinary measure only in the extraordinary case of an improper demand and that it would be especially disruptive if an injunction were allowed on the ground of non-conformity of documents. Yet another view was that the uniform law should deal only with injunctions based on improper demand and leave the question of the availability of injunctions based on other objections to payment to other provisions of national procedural law. The Working Group, after deliberation, requested the Secretariat to prepare draft provisions reflecting those three views for reconsideration at a future session.

#### Paragraph (2)

110. The Working Group exchanged views on whether the application for a preliminary injunction should be dealt with in *ex parte* proceedings, or whether the guarantor, and perhaps the beneficiary, should be given an opportunity to be heard. One view was that it was imperative that the opportunity to be heard be given to both sides and that the matter should not be left discretionary. Another view was that, due to the time constraints involved, it would not be realistic to impose an across-the-board requirement that the guarantor, and perhaps the beneficiary, should be given a hearing. It was suggested that the circumstances of each individual case should be permitted to determine the nature of the proceeding. Another suggestion was to accommodate the practice of issuing temporary restraining orders in *ex parte* proceedings.

111. There was a mixture of views also with respect to including a reference to injunctive action against the beneficiary as a co-defendant. It was suggested, in particular, that such a manoeuvre might encounter jurisdictional difficulties.

#### Paragraph (3)

112. A question was raised as to whether it was appropriate for article 21 to provide the degree of procedural detail contained in paragraph (3). It was stated that the answer depended to some extent on whether the final form of the uniform law would be that of a convention or that of a model law.

#### Paragraph (4)

113. Some support was expressed for the inclusion of a provision along the lines of paragraph (4), in particular since it helped to underscore the serious and extraordinary character of an injunction that, based on the application by the principal, interrupted the payment process envisaged under the guaranty letter. A suggestion that the uniform law require the principal to post security in all cases did not attract wide support, the preponderant view being that the matter was better left to the discretion of the court.

114. After deliberation, the Working Group requested the Secretariat to revise article 21 to reflect the discussion that had taken place. The revised article would deal less extensively with procedural details than did the current provisions of paragraphs (2) to (4).

*Article 22. Preliminary injunction against beneficiary*

115. The text of draft article 22 as considered by the Working Group was as follows:

"(1) Where, on an application by the principal, strong prima facie evidence is presented to a competent court that a demand made by the beneficiary constitutes an improper demand, the court may order the beneficiary not to accept payment or to withdraw its demand or, if such a demand is anticipated to be made, not to make the demand, provided that the refusal to issue such an order would cause the principal serious harm that would be more substantial than the loss that might be suffered by the beneficiary due to such an order.

"(2) Before deciding on the application of the principal, the court [may hear the beneficiary] [shall provide the beneficiary with an opportunity to be heard].

"(3) An order referred to in paragraph (1) of this article shall be issued for a specified period of effectiveness not exceeding [six] months. An extension of that period may be made dependent on the initiation by the principal of proceedings other than preliminary proceedings against the beneficiary. [If an order restraining the beneficiary from making a demand is repealed or becomes otherwise ineffective, the period of effectiveness of the guaranty letter shall be deemed to have been extended so as to allow the beneficiary [ten] days after the time of ineffectiveness of that order for making a demand.]

"(4) The court may make the effect of an order referred to in paragraph (1) of this article subject to the furnishing by the principal of such security as the court deems appropriate."

116. There was general agreement that, should the uniform law contain rules on preliminary injunctions against the beneficiary, those rules, particularly as regards the required standard of proof, should be parallel to the rules contained in article 21 on preliminary injunctions against the guarantor. It was stated that an important feature of the uniform law would be to establish a "level playing field", i.e., to provide for equal treatment of both the guarantor and the beneficiary. In that connection, it was agreed that an attempt should be made to merge the provisions of the article with those of article 21 and to reduce the procedural details regulated in paragraphs (2) to (4).

117. As regards the substance of the article, it was stated that rules on preliminary injunctions against the beneficiary were not very common in national legislation and that it might be difficult for national legislators to allow the principal to apply for a court injunction against the beneficiary, i.e., to make it possible for the principal to intervene in the context of a relationship between the guarantor and the beneficiary to which the principal was not a party. It was also stated that in those cases where the beneficiary resided

in a foreign country the provision would be of limited use. It was stated in reply that the provision might nevertheless be of some use, particularly in situations where the injunction would be effective and recognized. It was also pointed out that there was some wisdom in providing for injunctive relief within the relationship (between the principal and the beneficiary) where the root of the dispute tended to lie.

118. It was noted that the decision would to some extent depend upon a decision yet to be made as to whether the uniform law would be in the form of a convention or of a model law. The Working Group, after deliberation, agreed to reconsider the matter at a future session on the basis of a draft to be prepared by the Secretariat in the light of the above deliberations.

*Article 23. Principles of preliminary proceedings*

119. The text of draft article 23 as considered by the Working Group was as follows:

"[(1) Injunctive relief may be sought from a competent court against the guarantor by the principal or by the beneficiary, and against the beneficiary by the principal or by the guarantor, even if the place of business of the applicant is not situated in this State.

"(2) The court shall [endeavour to] deal expeditiously with an application for injunctive relief [and take into due account the special character of the guaranty letter]."

120. It was noted that the draft article was designed to lay down two principles, namely free access to courts for injunctive relief by applicants from within or outside the State in question and an appeal for expeditious proceedings on preliminary injunctions. Reservations were expressed as to the term "competent court" and to the scope of the provision which, unlike articles 21 and 22, embraced not only applications by the principal but also applications by the guarantor and the beneficiary.

121. While support was expressed for the principles underlying the draft article, it was generally felt that there was no need for retaining the draft article in the uniform law. Accordingly, the Working Group decided to delete the draft article.

## Chapter VI. Jurisdiction

*Preliminary discussion on appropriateness of including in the uniform law provisions on jurisdiction*

122. At the outset, it was explained that draft articles 24 and 25 reflected to some extent the uncertainty about the future form of the uniform law and about the extent to which jurisdictional matters should be included in the uniform law. While article 25 and paragraph (3) of article 24 were drafted in the style of a model law, article 24(1) and (2) were reminiscent of conventions. Above all, the draft articles did not cover such important ancillary matters as recognition and enforcement, *res judicata* and stay of proceedings that would more appropriately be dealt with in a convention than in a model law.

123. It was suggested that any future provisions on jurisdiction in the uniform law should be consistent with such international instruments as the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters and the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters. It was realized that it would be difficult, if not impossible, for a State that adhered to any of those conventions to accept different rules and that difficulty might shape its position on the general question of whether the uniform law should include jurisdiction provisions at all. It was suggested that the Governments of those States might wish to examine this potential conflict and the issue of substantive compatibility, and that the Hague Conference on Private International Law might assist in the process of examination. Another suggestion was that the uniform law should not include provisions on jurisdiction since the above Conventions, while formulated on a regional level, were open for accession by all States.

124. It was stated in reply that the universal composition of the Working Group necessitated due regard to the interests of the many States not adhering to a particular regional convention. A suggestion was made that the Commission might wish to consider in a wider context, not limited to the specific area of guaranty letters, the relationship between universal and regional unification and discuss the desirability and feasibility of providing a universal framework on jurisdictional matters, building on relevant conventions dealing with such matters for regional purposes. As regards the inclusion of provisions on jurisdiction in the uniform law, it was suggested that such provisions should be limited to essential issues of relevance in guaranty contexts along the lines of draft articles 24 and 25. While the formulation of such provisions, because of their close link to substantive and procedural provisions in the uniform law, should be carried out by the Working Group, the Hague Conference on Private International Law could usefully assist in this undertaking at the secretariat level and, if so agreed, at a session of the Working Group with additional or joint participation.

#### *Article 24. Choice of court or of arbitration*

125. The text of draft article 24 as considered by the Working Group was as follows:

"(1) The parties may, in the guaranty letter or by a separate agreement in a form referred to in paragraph (1) of article 7, designate a court or the courts of a specified State as competent to settle disputes that have arisen or may arise in relation to the guaranty letter, or stipulate that any such dispute shall be settled by arbitration.

"(2) If the parties have designated a court or the courts of a specified State in accordance with paragraph (1) of this article, only the designated court or courts shall have jurisdiction.

"(3) The provisions of the preceding paragraphs of this article do not constitute an obstacle to the jurisdiction of the courts of this State for provisional or protective measures."

#### *Paragraph (1)*

126. The Working Group recalled the decision made at its fifteenth session that arbitration or forum clauses should be allowed (A/CN.9/345, para. 107). As regards forum clauses, a discussion took place as to whether the parties' freedom of choice should be unlimited, as currently provided by article 24, or whether the court 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 might be a practical need to allow parties to choose a forum that bore no connection with the transaction, for example, because it was perceived as neutral by the parties. It was also stated that unlimited freedom of choice would be more consistent with the general principle of party autonomy expressed in the uniform law. It was noted that unlimited recognition of forum clauses did not preclude a designated court from declining to take jurisdiction where appropriate, as provided in article 25(1). After discussion, the Working Group decided to maintain the paragraph.

#### *Paragraph (2)*

127. It was explained that paragraph (2) was modelled on a similar provision in article 17 of the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (Brussels 1968). While some support was expressed for the retention of the paragraph on the basis of the widest possible recognition of party autonomy, strong reservations were expressed against the recognition of exclusive court jurisdiction clauses. It was stated that such clauses were rejected in a number of jurisdictions. It was also stated that the recognition of such prorogation clauses might be dangerous if it was not coupled with the recognition of foreign court decisions. The example was given of a situation where a decision rendered by a designated court with exclusive jurisdiction in a given country might not be enforceable, for lack of recognition, in the country where the assets of the defendant were located. After deliberation, the Working Group decided that the paragraph should be deleted.

#### *Paragraph (3)*

128. It was explained that paragraph (3) was modelled on article 21(3) of the Hamburg Rules and reflected an approach also adopted by the 1968 Brussels Convention and the 1965 Hague Convention on Choice of Court (see A/CN.9/WG.II/WP.71, para. 49). No objection was raised against the text of the paragraph and the Working Group decided that it should be maintained in the draft text.

#### *Article 25. Determination of court jurisdiction*

129. The text of draft article 25 as considered by the Working Group was as follows:

"(1) Unless otherwise provided in accordance with paragraph (1) of article 24 [or if a designated court of another State declines to exercise jurisdiction], the courts of this State [may exercise] [have] jurisdiction over dis-

putes between the guarantor and the beneficiary relating to the guaranty letter if [the guaranty letter was issued] [the guarantor has its place of business, where the guaranty letter was issued,] in the territory of this State.

"(2) The courts of this State may also entertain an application by the principal for a preliminary order against the guarantor [or the beneficiary] if the guaranty letter was issued in this State."

130. As regards the substance of paragraph (1), i.e., the determination of jurisdiction failing a choice by the parties or in the situation where a designated court declined to exercise jurisdiction, it was widely felt that such a provision was useful. However, it was agreed that the rule contained in the paragraph should not be understood as providing for exclusive court jurisdiction, for reasons similar to those expressed in the context of the discussion on article 24.

131. It was noted at the outset that, while the scope of article 24 was limited to the relationship between the guarantor and the beneficiary, the scope of article 25 was wider, in that paragraph (2) covered preliminary orders sought by the principal. It was recalled that the paragraph implemented a suggestion made at the fifteenth session in the light of the fact that certain issues relating to the principal and possibly injunctions brought by the principal might be addressed by the uniform law. However, some doubts were expressed as to whether the paragraph should be maintained, particularly in view of the fact that its scope encompassed injunctions sought by the principal against the guarantor or the beneficiary. If the paragraph were to be retained, it should be reviewed for consistency with other pertinent provisions of the uniform law.

132. After discussion, the Working Group requested the Secretariat to prepare a revised draft of article 25 in the light of the above deliberations. It was noted that the Working Group had not yet taken a final decision as to whether provisions on jurisdiction should be included in the uniform law.

## Chapter VII. Law applicable to guaranty letters

### Article 26. Choice of applicable law

133. The text of draft article 26 as considered by the Working Group was as follows:

"[The rights and obligations arising out of] [The rights, obligations and defences relating to] a guaranty letter are governed by the [rules of] law designated by the parties. Such designation shall be by an express clause in the guaranty letter or in a separate agreement, or

*Variant A:* result without doubt from the terms of the guaranty letter.

*Variant B:* be demonstrated by the terms of the guaranty letter [or the circumstances of the relationship between the guarantor and the beneficiary].

*Variant C:* result by implication from the terms of the guaranty letter."

134. As had been the case at the fifteenth session differing views were expressed as to whether or not to include in the uniform law provisions on applicable law. Those who felt that little or no attention should be given in the uniform law to this question cited the limited extent to which questions of applicable law caused difficulties in practice and the consensus that had developed concerning the law applicable to the primary relationships involved in the guaranty letter. Proponents of retention of provisions on applicable law responded that, owing in particular to the uncertainty that might arise when a multiplicity of relationships and laws were involved, the matter warranted attention in the uniform law. It was generally felt that, were any provisions on applicable law to be included, they should be kept as simple as possible, along the lines of draft articles 26 and 27.

135. Turning to the specific formulation of article 26, the Working Group considered whether it was sufficient to refer at the beginning of the article to the "rights and obligations" arising out of the guaranty letter, or whether it would be preferable to refer to the "rights, obligations and defences" relating to the guaranty letter. Some were of the view that the additional reference to "defences" was helpful, while others felt that, though such a reference might not do any harm, it was unnecessary because the notion of "defences" was encompassed in the notion of "rights and obligations".

136. The bracketed reference to "rules" of law designated by the parties also attracted both supporters and opponents. Supporters of retention of that reference felt that it was useful because it would be read as an affirmation of the parties contractual freedom to make the guaranty letter subject to non-legislative rules such as the UCP or URDG. The prevailing view was that the reference to "rules" of law may be inconsistent with the domestic legal order of a number of States and that therefore article 26 should be limited to sanctioning the freedom of the parties to choose a particular law.

137. Support was expressed for the basic approach used in the draft prepared by the Secretariat, in particular the recognition of party autonomy. As to the implied designation provision contained in article 26, a view was expressed that provision would lead to uncertainty and should therefore be deleted. A suggestion was made that article 26 should be aligned with the language used in the 1980 Rome Convention on the Law Applicable to Contractual Obligations. In response it was pointed out that, while that Convention did exist in particular for regional application, the aim of the uniform law was to provide a uniform rule for universal application. It was also noted that there was some doubt as to the applicability of that Convention to guarantees and stand-by letters of credit and that it might therefore be preferable to formulate language specifically geared to guaranty letters. The members of the Working Group agreed that they would attempt to gather additional information on the manner in which provisions in the uniform law on applicable law would interact with any conventions on conflicts of law. It was further noted that the question of the final form which the uniform law would take was of relevance to an assessment of the provisions in chapter VII.

138. Of the three variants concerning the manner in which designation could be implied, variant A drew the greatest degree of support, particularly from those whose preferred option would be to exclude article 26 altogether from the uniform law. An appealing feature of this variant was that it was directly linked to the terms of the guaranty letter. Variant A did, however, encounter some reservations on the ground that it was too strict a standard. Variant B met with reservations because of the reference to the circumstances of the relationship between the guarantor and the beneficiary. Some doubt was also expressed as to the feasibility of covering in a single formula the various situations covered by the uniform law, in some of which the laws of a variety of States might be at play. A view was also expressed that the review of the provisions on applicable law highlighted the importance of deciding the extent to which relationships other than the guarantor-beneficiary relationship would be covered in the uniform law.

139. After deliberation, the Working Group decided to retain article 26, a decision that would be open to future review. The Secretariat was requested, in revising the article, to reflect the support given to the principle of party autonomy, to remove the reference to "rules", and to incorporate variant A. The Working Group also agreed that the Secretariat should continue to maintain contact and exchange information with the Secretariat of the Hague Conference on Private International Law concerning the preparation of provisions in the uniform law on applicable law and jurisdiction, and to explore, if necessary, other forms of possible cooperation. It was also felt that issues of applicable law specific to the guaranty letter did not appear to merit treatment in a separate convention and that short, simple rules along the lines of draft articles 26 and 27 could appropriately be included within the uniform law.

#### *Article 27. Determination of applicable law*

140. The text of draft article 27 as considered by the Working Group was as follows:

"Failing a choice of law in accordance with article 26, [the rights and obligations arising out of] [the rights, obligations and defences relating to] a guaranty letter are governed by the law of the State where the guarantor has its place of business or, if the guarantor has more than one place of business, where the guarantor has that place of business at which the guaranty letter was issued. [However, if according to the guaranty letter the examination of the demand and any required documents takes place in another State the law of that State applies to the standard of care and responsibility for such examination, failing a specific agreement to the contrary.]"

141. No objections were raised as to the basic approach in article 27, which provided that, when the parties have not designated an applicable law, the law of the place of business of the guarantor (or the place of issuance if the guarantor had more than one place of business) would be applicable. Questions were raised, however, as to the necessity for setting forth this rule in the uniform law, in particular since it was already generally recognized.

142. Differing views were exchanged as to whether to retain the second sentence of article 27, which provided that, where the examination of the demand for payment took place in a country other than that of the guarantor, the law of that other country would provide the standard of care and responsibility for the examination. The need for such a provision was questioned on the ground that the uniform law already provided, in article 16, a standard of care for the examination and that it was therefore unnecessary to include also a conflict-of-laws rule on the point. It was pointed out, however, that the inclusion of the standard of care in a substantive provision might have the desired effect only if the uniform law took the form of a convention.

143. It was noted here, as in other provisions of the uniform law, that the intent was to cover counter-guaranty letters, as provided for in draft article 6(a), with the result that the law applicable to the relationship between the counter-guarantor and its beneficiary (i.e., the guarantor issuing the indirect guaranty letter) would be that of the place of business of the counter-guarantor.

144. After deliberation, the Working Group decided to retain article 27, subject to deletion of the second sentence and to the alignment of the opening words with those of article 26.

### III. FUTURE FORM OF THE UNIFORM LAW

145. It was noted that the views expressed in respect of the need for, and the substance of, provisions on jurisdiction and applicable law as well as some other previously discussed draft articles depended in part on the future form of the uniform law. The Working Group, therefore, engaged in an exchange of views on whether the draft text should eventually be adopted in the form of a convention or in the form of a model law.

146. Some support was expressed for the form of a model law since that provided States with a wider latitude as to which provisions of the text were acceptable and could readily be incorporated into the national law. Somewhat wider support was expressed for the form of a convention since that was more in line with the character of the rules envisaged and since it would foster uniformity which was said to be essential for the smooth operation of international guaranty letter transactions.

147. In the light of the continuing divergence of views on the future form of the text, it was proposed that the Working Group should proceed on the working assumption that the final text would take the form of a convention without thereby precluding the possibility of reverting to the more flexible form of a model law at the final stage of the work when the Working Group would have a clear picture as to the provisions included in the draft text. After deliberation, the Working Group adopted that proposal, with the expectation that it would facilitate its future work by providing a degree of certainty.

148. In connection with the discussion of the future form of the uniform law but as a separate point, a concern was

reiterated that had been voiced in the context of the discussion of "extend-or-pay" requests (see paragraphs 71-72). The concern was, in short, that the draft text disregarded the existing difference in terms of firmness between stand-by letters of credit and European-style bank guarantees and that it might be inappropriate to aim for a unitary set of rules that would do justice to neither type of undertakings, for both of which there was a demand on the market. A suggestion was made therefore to envisage some separate provisions that applied only to firm undertakings, whether or not labelled in the uniform law as stand-by letters of credit, and it was promised, for that purpose, to provide the Secretariat with a list of such provisions and relevant information.

149. It was stated in reply that the degree of firmness was not a valid criterion to distinguish between stand-by letters

of credit and bank guarantees as such; differences in firmness existed within each of these two categories that were developed separately for historical reasons. It was also recalled that, during the similar discussion referred to above, suggestions had been made for taking into account practical differences of undertakings according to their purpose and payment conditions and, above all, that it had been agreed to continue with the effort of formulating rules of general application.

#### IV. OTHER BUSINESS

150. The Working Group decided to hold its next session from 30 November to 11 December 1992 at Vienna, subject to confirmation by the Commission at its twenty-fifth session.

**D. Working paper submitted to the Working Group on International Contract Practices at its seventeenth session: independent guarantees and stand-by letters of credit: tentative draft of a uniform law on international guaranty letters: note by the Secretariat**

**(A/CN.9/WG.II/WP.73 and Add.1) [Original: English]**

[Text reproduced in part two, IV, B, pp. 313-327.]

## V. LEGAL ISSUES OF ELECTRONIC DATA INTERCHANGE

### A. Report of the Working Group on International Payments on the work of its twenty-fourth session

(Vienna, 27 January-7 February 1992) (A/CN.9/360) [Original: English]

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### INTRODUCTION

1. The Commission, at its seventeenth session (1984), decided to place the subject of the legal implications of automatic data processing to the flow of international trade on its programme of work as a priority item.<sup>1</sup> It did so after considering a report of the Secretary-General entitled "Legal aspects of automatic data processing" (A/CN.9/254), which identified several legal issues, relating to the legal value of computer records, the requirement of a writing, authentication, general conditions, liability and bills of lading. The decision of the Commission was made after taking note of a report of the Working Party on Facilitation of

International Trade Procedures, which is jointly sponsored by the Economic Commission for Europe and the United Nations Conference on Trade and Development. The report suggested that, since the legal problems arising in this field were essentially those of international trade law, the Commission as the core legal body in the field of international trade law appeared to be the appropriate central forum to undertake and coordinate the necessary action.<sup>2</sup>

2. At its eighteenth session (1985), the Commission had before it a report by the Secretariat entitled "Legal value of computer records" (A/CN.9/265). That report came to the

<sup>1</sup>Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17 (A/39/17), para. 136.

<sup>2</sup>"Legal aspects of automatic trade data interchange" (TRADE/WP.4/R 185/Rev.1). The report submitted to the Working Party is reproduced in A/CN.9/238, annex.

conclusion that, on a global level, there were fewer problems in the use of data stored in computers as evidence in litigation than might have been expected. It noted that a more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arose out of requirements that documents had to be signed or be in paper form. After discussion of the report, the Commission adopted a recommendation, the substantive provisions of which read as follows:

*"The United Nations Commission on International Trade Law,*

*"1. Recommends to Governments:*

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

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

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

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

*"2. Recommends to international organizations elaborating legal texts related to trade to take account of the present Recommendation in adopting such texts and, where appropriate, to consider modifying existing legal texts in line with the present Recommendation."*<sup>3</sup>

3. At its twenty-first session (1988), the Commission considered a proposal to examine the need to provide for the legal principles that would apply to the formation of international commercial contracts by electronic means. It was noted that there existed no refined legal structure for the important and rapidly growing field of formation of contracts by electronic means and that future work in that area could help to fill a legal vacuum and to reduce uncertainties and difficulties encountered in practice. The Commission requested the Secretariat to prepare a preliminary study on the topic.<sup>4</sup>

<sup>3</sup>Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17), para. 360.

<sup>4</sup>Ibid., Forty-third Session, Supplement No. 17 (A/43/17), paras. 46 and 47, and *ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 289.

4. At its twenty-third session (1990), the Commission had before it a report entitled "Preliminary study of legal issues related to the formation of contracts by electronic means" (A/CN.9/333). The report summarized work that had been undertaken in the European Communities and in the United States of America on the requirement of a writing as well as on other issues that had been identified as arising in the formation of contracts by electronic means. The efforts to overcome some of those problems by the use of model communication agreements were also discussed. The Commission requested the Secretariat to continue its examination of the legal issues related to the formation of contracts by electronic means and to prepare for the Commission at its twenty-fourth session a report that would analyse existing and proposed model communication agreements with a view to recommending whether a model agreement should be available for worldwide use and, if so, whether the Commission should undertake its preparation. The Commission expressed the wish that the report would give it the basis on which to decide what work might be undertaken by the Commission in the field.<sup>5</sup>

5. At its twenty-fourth session (1991), the Commission had before it the report it had requested, entitled "Electronic Data Interchange" (A/CN.9/350). The report described the current activities in the various organizations involved in the legal issues of electronic data interchange (EDI) and analysed the contents of a number of standard interchange agreements already developed or currently being developed. It also pointed out that such documents varied considerably according to the various needs of the different categories of users they were intended to serve and that the variety of contractual arrangements had sometimes been described as hindering the development of a satisfactory legal framework for the business use of EDI. It suggested that there was a need for a general framework that would identify the issues and provide a set of legal principles and basic legal rules governing communication through EDI. It concluded that such a basic framework could, to a certain extent, be created by contractual arrangements between parties to an EDI relationship but that the existing contractual frameworks that were proposed to the community of EDI users were often incomplete, mutually incompatible, and inappropriate for international use since they relied to a large extent upon the structures of local law.

6. The report also noted that, although many efforts were currently being undertaken by different technical bodies, standardization institutions and international organizations with a view to clarifying the issues of EDI, none of the organizations that were primarily concerned with worldwide unification and harmonization of legal rules had, as yet, started working on the subject of a communication agreement. Accordingly, the report suggested that the Commission, in view of its ability to bring to bear the views of all legal systems, including those of developing countries that were already or would soon be confronted with the issues of EDI, might wish to consider itself preparing a standard communication agreement for use in international trade.

<sup>5</sup>Ibid., Forty-fifth Session, Supplement No. 17 (A/45/17), paras. 38-40.

7. The report also suggested that, on the legislative level, possible future work for the Commission on the legal issues of EDI might concern in particular the subject of the replacement of negotiable documents of title, and more specifically transport documents, by EDI messages. That was an area where the need for statutory provisions seemed to be developing most urgently with the increased use of EDI. The report suggested that the Secretariat might be requested to submit a report to a further session of the Commission on the desirability and feasibility of preparing such a text.

8. The Commission was agreed that the legal issues of EDI would become increasingly important as the use of EDI developed and that the Commission should undertake work in that field. As regards the specific suggestions reflected above, there was wide support for the suggestion that the work of the Commission should be aimed at identifying the legal issues and principles involved in communication through EDI and providing a set of basic legal rules. The Commission was agreed that, given the number of issues involved, the matter needed detailed consideration by a Working Group.

9. Divergent views were expressed at the twenty-fourth session of the Commission as to whether the preparation of a standard communication agreement should be undertaken by the Commission as a priority item. One view was that work on a standard agreement should be undertaken immediately since no such document existed for worldwide use and since the Commission, because of its representative character, would be a particularly good forum for such work. The prevailing view, however, was that it was premature to engage immediately in the preparation of a standard communication agreement and that it might be preferable, until the next session of the Commission, to monitor developments in other organizations, particularly the Commission of the European Communities and the Economic Commission for Europe.

10. After deliberation, the Commission decided that a session of the Working Group on International Payments would be devoted to identifying the legal issues involved and to considering possible statutory provisions, and that the Working Group would report to the Commission at its next session on the desirability and feasibility of undertaking further work such as the preparation of a standard communication agreement. The Commission also took note of the suggestion by the Secretariat to prepare a uniform law on the replacement of negotiable documents of title, and more particularly transport documents, by EDI messages.<sup>6</sup>

11. The Working Group, which was composed of all States members of the Commission, held its twenty-fourth session at Vienna, from 27 January to 7 February 1992. The session was attended by representatives of the following States members of the Working Group: Argentina, Bulgaria, Canada, Chile, China, Costa Rica, Cuba, Czechoslovakia, Egypt, France, Germany, Hungary, Iran (Islamic Republic of), Italy, Japan, Mexico, Morocco, Netherlands, Spain, United Kingdom of Great Britain and Northern Ireland and the United States of America.

12. The session was attended by observers from the following States: Algeria, Australia, Austria, Belgium, Brazil, Finland, Indonesia, Lebanon, Oman, Pakistan, Paraguay, Peru, Philippines, Poland, Saudi Arabia, Sweden, Switzerland, Thailand, Tunisia, Turkey, Uganda and Yemen.

13. The session was attended by observers from the following international organizations: Economic Commission for Europe (ECE), International Monetary Fund (IMF), Commission of the European Communities (CEC), Hague Conference on Private International Law, Intergovernmental Organization for International Carriage by Rail (OTIF), Asian Clearing Union (ACU), International Rail Transport Committee (CIT) and International Union of Railways (UIC).

14. The Working Group elected the following officers:

*Chairman:* Mr. José María Abascal Zamora (Mexico)

*Rapporteur:* Mr. Essam Ramadan (Egypt)

15. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.IV/WP.52) and a note by the Secretariat (A/CN.9/WG.IV/WP.53) listing a number of issues possibly to be included in the programme of future work on the legal aspects of EDI.

16. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Possible issues to be included in the programme of future work on the legal aspects of electronic data interchange (EDI).
4. Other business.
5. Adoption of the report.

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

(a) Report of the Secretary-General on the legal value of computer records (A/CN.9/265);

(b) Report of the Secretary-General on electronic data interchange—preliminary study of legal issues related to the formation of contracts by electronic means (A/CN.9/333);

(c) Report of the Secretary-General on electronic data interchange (A/CN.9/350).

## I. PRELIMINARY REMARKS

18. Prior to commencing its discussion of the legal issues of EDI, the Working Group engaged in a general overview of the current work of other international organizations active in the field. A report was made to the Working Group on behalf of the Working Party on Facilitation of International Trade Procedures (WP.4) of the Economic Commission for Europe concerning the action programme on commercial and legal aspects of trade facilitation adopted at the twenty-third session of the Working Party (TRADE/WP.4/R.697).<sup>7</sup> It was recalled that the action pro-

<sup>6</sup>Ibid., Forty-sixth Session, Supplement No. 17 (A/46/17), paras. 311-317.

<sup>7</sup>A summary of the action programme (TRADE/WP.4/R.697) was contained in A/CN.9/350, paras. 28-44.

gramme encompassed the following projects: preparation of an interchange agreement; preparation of a portion of the United Nations Trade Data Directory (UN/TDID) dealing with legal issues; reduction of barriers to international trade that might stem from the commercial practice of transferring rights through the use of negotiable documents; identification of existing legal and commercial barriers; definition of electronic messages and their "signatures"; and coordination with other bodies.

19. A presentation was also made on behalf of the Intergovernmental Organization for International Carriage by Rail (OTIF) on the progress of the DOCIMEL Project that was aimed at replacing the paper-based rail consignment note by an electronic message.<sup>8</sup> It was also indicated that the Commission of the European Communities (CEC),<sup>9</sup> the International Chamber of Commerce (ICC),<sup>10</sup> the International Maritime Committee (CMI),<sup>11</sup> the Baltic and International Maritime Council (BIMCO),<sup>12</sup> the International Road Transport Union (IRU),<sup>13</sup> the United Nations Conference on Trade and Development (UNCTAD) and the Customs Co-operation Council (CCC) had undertaken projects in connection with the legal aspects of EDI.

20. The Working Group also took note of a number of initiatives taken by Governments and national trade facilitation bodies with a view to facilitating the use of EDI. Such initiatives included: review of applicable commercial law and rules applicable to tax, accounting, customs and other regulatory matters, so as to identify legal and regulatory obstacles to the increased use of EDI; establishment of pilot projects on such issues as the use of EDI in public procurement; preparation of model communication agreements for optional use by parties using EDI; drafting of new national legislation specifically designed to accommodate the needs of EDI users, for example as regards presentation of evidence. In that connection, it was stated that while some of the legal issues of EDI (e.g., the admissibility of EDI messages as evidence) might need to be treated differently in different areas of law (e.g., admissibility of evidence in litigation as contrasted with admissibility of evidence for regulatory purposes), some other legal issues of EDI such as liability for failure or error in communication would require a cross-sectoral treatment.

21. The Working Group expressed its appreciation for the information it had received regarding the work currently undertaken by international organizations active in the field and regarding national surveys or revisions of legislation undertaken by national authorities. It was agreed that that information would significantly assist the Working Group in its attempt to determine the practical need for specific legal rules concerning EDI. It was also agreed that those

indications illustrated the need for a close cooperation between all interested organizations so as to harmonize solutions and to avoid duplication of work.

## II. POSSIBLE SCOPE AND FORM OF FUTURE WORK

22. The Working Group preceded its consideration of possible issues of future work with a discussion of the scope and form which that work should take. The possible forms of the work considered included the identification of general legal principles applicable to the use of EDI in trade, the preparation of a legal guide, and, on the legislative level, the elaboration of statutory provisions.

23. According to one view, the Working Group should focus in the initial stage of its work on the identification of general principles of law applicable to the main issues raised by the use of EDI in trade. Those issues included, for example in the area of contract formation, the effect of electronic communications on the questions of offer and acceptance, requirements for verification of receipt of electronic messages, the legal effect of reduced human decision-making, evidentiary considerations, the legal status of network providers (including central data managers), and the determination of applicable law. Along these lines, it was suggested that the Working Group might undertake the preparation of a legal guide that would identify what seemed to be the extremely varied range of legal issues arising in the context of EDI and that would suggest legal principles for optional use by those trading partners who considered establishing an EDI relationship or by those national authorities that were confronted with EDI.

24. In favour of work on the legislative level, it was recalled that the mandate given the Working Group was to consider possible statutory provisions. It was also stated that statutory provisions, because they would offer detailed guidance, would be a more effective tool in assisting States to remove legal obstacles to the increased use of EDI. It was observed that, due to a lack of such detailed guidance, the recommendation adopted by the Commission in 1985 (see above, paragraph 2) with a view to establishing legal principles and to providing guidance to national legislators and regulatory authorities for the removal of legal obstacles to the increased use of EDI had resulted in little progress in the removal of those obstacles. It was pointed out that more progress could probably have been achieved if the general principles contained in the recommendation had been expressed in a more detailed manner, so as to suggest practical and detailed rules as to how paper-based requirements could have been removed and how paper could have been replaced by a functional equivalent for use in an electronic environment. It was widely agreed that, while an attempt to design such detailed rules might have been premature in 1985, and while it might still be premature regarding some aspects of the commercial use of electronics in view of the continuing technical changes, the time might now be appropriate for considering the preparation of detailed rules regarding some other aspects of the use of EDI. It was also agreed that any attempt to design legal rules and principles on EDI should be based on a close observation of commercial practices and aimed at enhancing the use of EDI. It

<sup>8</sup>The DOCIMEL Project was summarized in A/CN.9/350, paras. 49-51.

<sup>9</sup>The work of the Commission of the European Communities within the TEDIS Project was summarized in A/CN.9/333, paras. 15-41 and in A/CN.9/350, paras. 12-26.

<sup>10</sup>The work of ICC was described in A/CN.9/350, paras. 45-48.

<sup>11</sup>The work of CMI was described in A/CN.9/350, paras. 54, 69 and 104-108.

<sup>12</sup>The BIMCO Project on electronic bills of lading was briefly described in A/CN.9/WG.IV/WP.53, para. 87.

<sup>13</sup>The work of IRU was described in A/CN.9/350, paras. 52-53.

was stated that, irrespective of the form that might be taken by the work of the Commission regarding EDI, that work should serve an educative function and should be aimed at demonstrating the merits of EDI techniques as compared to current paper-based practices.

25. The Working Group decided at the outset that the focus of its work should be on legal issues raised by the use of EDI in international trade, in line with the approach taken in previous work by the Commission. It was noted that such a focus, depending upon the form of work, might entail the need to establish a test for internationality and would not exclude the possibility of use in a domestic environment of any rules prepared by the Commission.

26. The Working Group then proceeded with a survey of the legal issues and commercial practices involved with a view to determining whether such issues and practices had reached a degree of maturity that would call for the preparation of legal rules or whether the situation remained so unstable that only general principles could be elaborated. The Working Group also agreed that, after completing that survey, it would consider the question of the form which the work of the Commission should take. In that connection, the Working Group recalled that the specific mandate that had been given to it was to devote the present session not only to identifying the legal issues involved but also to considering possible statutory provisions on those issues, as well as to report to the Commission at its next session on the desirability and feasibility of undertaking further work such as the preparation of a standard communication agreement. It was noted that different forms of work might be appropriate for different issues.

27. On the question of a standard communication agreement, it was stated at the outset of the discussion that it was neither necessary nor appropriate for the Commission, at least at this stage, to develop a standard communication agreement. The reasons given included the fact that a number of communication agreements had already been developed; that work was being carried out within the framework of other organizations on communication agreements, some aimed at sectoral and others at universal use; and the possibility that there may in fact be a need for a variety of communication agreements (e.g., some tailored to specific commercial sectors), rather than for one universal model.

28. As to the specific order in which issues should be discussed at the present session, a suggestion that the discussion generally follow the order in which the issues were presented in the paper before the Working Group was generally accepted, although it was noted that the list was not exhaustive and might require future additions. As to the definition of EDI, there was general agreement that in addressing the subject-matter before it the Working Group would not have in mind a notion of EDI that was limited to the electronic exchange of information between closed networks of users that had become party to a communication agreement. Rather, the Working Group would have in mind a notion of EDI encompassing also open networks that allowed EDI users to communicate without having previously adhered to a communication agreement, thus covering a variety of trade-related EDI uses that might be referred to broadly under the rubric of "electronic commerce".

29. Differing views were expressed as to whether the Working Group should attempt at the outset of its discussion to consider a more specific definition of EDI. One view was that such an exercise would usefully set out the scope of the issues to be considered by the Working Group since it might not be immediately clear whether certain methods of communicating information electronically (e.g., facsimile) were to be considered as falling within the notion of EDI. The prevailing view, however, was that, having the above-mentioned general notion of EDI or "electronic commerce" in mind for the purpose of defining the scope of the Working Group's task, it would be best to leave the matter of a specific definition to a later stage. This order of discussion was felt to be particularly appropriate because the question of the definition of EDI might arise repeatedly with respect to various points and in fact might differ with respect to different issues to be considered by the Working Group, and because the panoramic view of the issues involved would place the Working Group in a better position to consider a definition of EDI.

30. However, without attempting to define EDI at that stage, the Working Group discussed whether the above-mentioned broad notion of EDI should be interpreted as encompassing consumer transactions. After discussion, the Working Group was agreed that, should it recommend the preparation of legal rules on EDI by the Commission, it would also recommend that issues of consumer law be expressly excluded from the scope of those rules.

31. In the same vein, it was stated that the reference to "open networks" should not be interpreted as covering systems open to the public for consumer transactions, such as point-of-sale systems. Rather, "open networks" should be interpreted as those communication systems that were designed to enhance the inter-operability of existing and future closed networks. As an example of such an open network, it was indicated that systems were currently being designed to allow the direct transmission of data between operators connected to different closed networks. It was stated that such systems relied on the use of an "electronic envelope" that could be processed by different network systems and involved the creation of directories (sometimes referred to as "electronic yellow pages") that would allow EDI to be used in a way similar to telex. It was observed that the processing of data by different networks might raise specific legal problems, particularly as regards the issue of liability for failure or error in transmission.

### III. POSSIBLE ISSUES OF FUTURE WORK

#### A. Requirement of a writing

##### 1. *Mandatory requirement of a writing*

32. The Working Group recognized that, at least in some legal systems, rules requiring certain transactions to be concluded or evidenced in writing might constitute impediments to the use of EDI. Differing approaches were considered as to the possible manner in which such writing requirements existing in various laws should be dealt with in the effort to create a legal environment hospitable to the use of EDI. One approach would be to make an effort to do

away with writing requirements altogether so as to facilitate the use of EDI to the maximum possible degree. There was little support for an attempt to eliminate writing requirements generally. Such an approach was considered not only to be difficult to implement, but also of questionable appropriateness and of limited acceptability.

33. Reasons cited for the inadvisability of attempting an across-the-board removal of writing requirements included the continuing use, in most if not all legal systems, of writing requirements for specific purposes such as the evidencing of certain types of contracts and for negotiability; the presence of requirements for a writing to produce specific legal effects, for example, requirements for the issuance of documents under transport conventions (e.g., the Convention for the Unification of Certain Rules Relating to International Carriage by Air, Warsaw, 1929) and requirements that agreements to arbitrate or agreements on jurisdiction be in writing (e.g., the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards); and the fact that the benefits of advances in technology that made the use of EDI possible and raised the possibility of eliminating writing requirements were not uniformly available to all countries, in particular developing countries.

34. In view of the above, there was a widely shared view that the preferable approach to dealing with possible impediments to the use of EDI posed by writing requirements found in national laws would be to extend the definition of "writing" to encompass EDI techniques, thereby facilitating the fulfilment of those requirements through the use of electronic means. It was agreed that the aim of this approach, sometimes referred to as a "functional-equivalent approach", should be to enable, rather than to impose, the use of EDI. It was observed that an extended definition of writing would permit States to adapt their domestic legislation to developments in communications technology applicable to trade law without necessitating the wholesale removal of the writing requirements themselves or disturbing the legal concepts and approaches underlying those requirements. At the same time, it was said that the electronic fulfilment of writing requirements might in some cases necessitate the development of new rules. This was due to one of many distinctions between paper-based documents and EDI, namely, that the latter were readable by the human eye, while the former were not so readable unless reduced to paper or displayed on a screen.

35. It was proposed that a definition of writing along the following lines should be considered:

"Writing includes but is not limited to a telegram, telex and any other telecommunication which preserves a record of the information contained therein and is capable of being reproduced in tangible form."

While questions were raised as to the feasibility of proposing a single formula to cover the many differing circumstances and purposes to which writing requirements were currently applied, and the resulting limits to the extent of possible harmonization, it was generally agreed that a definition of this type merited consideration.

36. It was noted that an extended definition of "writing" would still rely on an analogy between EDI messages and

written documents and that it would not create the entirely new concept that was sometimes referred to as needed to accommodate the most advanced uses of EDI. However, it was generally agreed that such an extended definition would not preclude further investigation from being undertaken to determine which new concept might be appropriate. It was also generally agreed that an extended definition of "writing" would help to address the wide variety of situations where EDI relationships remained comparable to paper-based relationships.

37. Various suggestions for refinements and other observations were made concerning the proposed definition, based in particular on the general concern that the definition should not be drafted narrowly, thereby possibly excluding future advances in technology not currently envisaged. In this connection, it was noted that any requirement of reduction to paper should be excluded, as was done in the proposed definition, as any such requirement would defeat the purpose of EDI. From a similar standpoint, it was suggested that the word "tangible" might be susceptible to a narrow construction and that therefore it might be preferable to use words such as "readable", "legible", or even "audible". A further suggestion along these lines was that the extended definition should not be limited to computer-to-computer communications, but should also encompass techniques such as storage of data on optical discs and through the use of voice imprints.

38. Another proposed solution to the problem of foreclosing advances in technology was to avoid focusing in the definition on particular modes of communication, and instead to focus on the essential element of the record-keeping function that was traditionally fulfilled by writing but could now be fulfilled through the use of EDI techniques. In response to this suggestion, it was stated that some reference to modes of communication was probably unavoidable since the very purpose of extending the definition of writing was to encompass new modes of communication.

39. The attention of the Working Group was drawn to an example of another approach to the recognition of electronic equivalents to paper-based documents. The particular legislation cited prescribed conditions under which EDI messages exchanges by participants in certain closed-networks would be deemed to fulfil writing requirements found in the applicable law. Those conditions included a limitation to traders approved by the Government, as well as the use of approved standard message formats and government-certified communication networks. It was observed that a system of this type raised the question of the extent of the government role, as opposed to the role of private parties, in approving the use of standard message formats.

## 2. Contractual definition of a writing

40. It was recalled that communication agreements often contained stipulations aimed at overcoming possible difficulties that might arise concerning the validity and enforceability of legal acts (particularly contracts) due to the fact that they were formed through an exchange of EDI messages instead of the usual written documents. Such commu-

nication agreements often adopted one or both of the two following approaches to establish the legally binding value of EDI messages. Under the first approach, EDI messages were defined as written documents by mutual agreement of the parties (see A/CN.9/350, paras. 68-76). The second approach relied upon a mutual renunciation by the parties of any rights or claims to contest the validity or enforceability of an EDI transaction under possible provisions of locally applicable law relating to whether certain agreements should be in writing or manually signed to be binding upon the parties (see A/CN.9/350, paras. 77-78).

41. The view was expressed that contractual definitions of "writing" would be of little relevance to the work of the Working Group if its recommendation to the Commission was to undertake the preparation of statutory provisions on the topic. It was further stated that contractual definitions of "writing" would be of limited utility in view of the fact that contractual stipulations could not determine the rights and obligations of third parties. However, it was also recalled that one purpose of a uniform law might be to enable potential EDI users to establish a secure EDI relationship by way of a communication agreement within a closed network. It was thus pointed out that it might be useful to envisage a statutory provision to the effect of eliminating the doubts that might exist in some legal systems as to the validity of privately agreed definitions of "writing". It was also stated that, in some countries, contractual definitions of "writing" were particularly important in view of the fact that they were used in agreements between public authorities such as tax authorities and private EDI users.

42. While the Working Group was generally agreed that the principle of party autonomy should be affirmed as regards the definition of a "writing", wide support was given to a suggestion that a "functional equivalent approach" should be taken regarding the issue of "writing". The functional approach would rely on an analysis of the functions traditionally served by paper documents and allow parties to agree as to which of the traditional functions of the paper would be served by EDI messages. It was stated that the mere indication of parties' freedom to agree on a definition of "writing" that would go beyond the traditional paper-based definitions would not sufficiently guarantee the legal safety of EDI transactions in case of litigation. It was observed that a writing served the following functions: to provide that a document would be legible by all; to provide that a document would remain unaltered over time; to allow for the reproduction of a document so that each party would hold a copy of the same data; to allow for the authentication of data by means of a signature; and to provide that a document would be in a form acceptable to public authorities and courts. It was stated that in respect of all of the above-mentioned functions of paper, electronic records could provide the same level of security as paper and, in most cases, a greater degree of certainty, provided that a number of technical and legal requirements were met.

43. In that connection, it was stated that a distinction should be drawn between EDI messaging and interactive EDI. While EDI messaging performed a number of functions similar to those traditionally performed by means of communication based on paper documents, interactive EDI provided the basis for transactions that involved multiple

parties in a number of quasi-simultaneous relationships and that were hardly conceivable in a paper-based environment. It was suggested that a double set of legal rules might be needed, one of which would adapt existing rules to allow the electronic fulfilment of the functions traditionally served by paper documents, while the second set of rules would be intended to cover the entirely new situation created by the possibility of EDI transactions. At the same time, a concern was expressed that, should the Working Group recommend the preparation of new rules, those new rules should remain subject to the fundamental legal principles of the national legal systems.

## B. Evidential value of EDI messages

### 1. Admissibility of EDI messages as evidence

44. The Working Group commenced its consideration of this item by hearing statements concerning statutory and case law in different legal systems on the question of admissibility of computer records and other forms of electronic-based evidence. This exercise revealed a variety of approaches. In many legal systems, parties to commercial disputes were generally permitted to submit any type of evidence that was relevant to the dispute. Among those countries, however, variations existed as to the exact manner in which electronic-based evidence was admitted and handled. For example, in some countries specific rules had been established governing the introduction of electronic evidence. Such requirements were aimed at establishing the intelligibility, reliability and credibility of the evidence, focusing specifically on the method of entry of the information and the adequacy of protection against alteration. Some jurisdictions required expert certification as a condition for introduction of the evidence. In some countries, the procedures for objecting to the introduction of electronic evidence differed from the procedures involved in objecting to other forms of evidence. In quite a number of countries in this first general group, when a question arose as to the accuracy or value of the electronic evidence, it was left to the court to weigh the extent to which the evidence should be relied upon. The factors to be considered in such an assessment of the quality of electronic-based evidence might include the degree of security in the system that produced the evidence, its management and organization, whether it was operating properly and any other factors deemed relevant to the reliability of the evidence.

45. Under another approach, found in a number of countries, the question of the admissibility and the assessment of computer records and other forms of electronic evidence were entirely left to the discretion of the court.

46. It was reported that, in common law countries, in which an oral and adversarial procedure was generally employed in litigation, emphasis was placed on testimony based on the personal knowledge of witnesses, thus allowing an opponent an opportunity to verify the statements through cross-examination. In those countries, in which there tended to be a more elaborate statutory structure governing the admission of evidence and more limited judicial discretion, secondary sources were generally excluded as "hearsay evidence". In those countries in which

computer records and other forms of electronic-based evidence were considered as hearsay evidence, admissibility was nevertheless possible by way of the "business records" exception to the hearsay rule. In order to be able to benefit from this exception, the proponent of the evidence would typically have to demonstrate that the information was compiled in the normal course of business and would have to describe the chain of events involving the compilation of the information and leading up to the point when the evidence assumed its current form, so as to ascertain the integrity and reliability of the system producing the evidence. In some cases the testimony of an expert might have to be tendered to certify the reliability of the evidence. Opponents of the evidence would be permitted to present conflicting evidence in written, oral or electronic form.

47. The above survey revealed that in most countries a distinction had to be drawn between the admissibility of electronic evidence in judicial proceedings and the acceptance and use of such evidence by administrative authorities. The applicable rules and approaches employed in the two types of forums tended to differ. In the administrative sphere, the focus tended to be on the gathering of information and greater discretion on the part of the administrative authority, with generally less emphasis than in the judicial sphere on evidentiary rules and procedures. At the same time, there were instances in which administrative and regulatory statutes (e.g. tax and securities laws) imposed particular requirements that had potential evidentiary implications. Among the requirements of this type that were most prevalent were obligations imposed on commercial entities to maintain business records for accounting and tax purposes. In some countries the use of EDI for such purposes was expressly sanctioned, subject to conditions such as the intelligibility and unalterability of electronic records. In the legislation of one country that was cited, however, permission to use of EDI was specifically tied to the eventual production of paper documents. It was also reported that in some countries administrative authorities sometimes conducted hearings for which rules of evidence were established. A further observation was that judicial rules of evidence might have a general influence on the evidence-taking conduct of administrative authorities because of the possibility of eventual litigation.

48. Another issue that came up in the discussion that was of pertinence to the admissibility of electronic evidence was the requirement encountered in some instances that the evidence should be "readable". It was agreed that such requirements did not generally pose difficulties in view of the various techniques available for reducing electronic messages and records into forms intelligible to humans. In this regard, the Working Group noted with interest a definition of the word "document" that was used in one country. That definition included in the description of a document any article or material from which sounds, images or writings were capable of being reproduced, with or without the aid of any other article or device.

49. The Working Group also noted the possibility that certain practices of EDI users and intermediaries might conflict with traditional notions in the law of evidence, in particular the notion of an "original" document (see below, paragraphs 60 to 70). It was reported in this regard that

there might be some uncertainty as to what constitutes an original in the EDI context. This uncertainty was attributable to the widespread use, due to security considerations, of encryption keys and codes for the scrambling of messages during transmission. These scrambled messages, which might be considered as "original", typically disappeared upon translation or decoding by the recipient. A further complication from the standpoint of traditional notions of a document as a vessel for storage of information was due to the fact that, once received and decoded, the information might be divided and scattered into various areas of the electronic records of the receiver. This operation was described as one aspect of the process generally referred to as the "dematerialization" of a document. It was observed that, because of these two trends, and against the backdrop of the desire to eliminate paper records, it might be difficult for the parties in an EDI context to come up with an "original" of, for example, an invoice. It was further observed that this phenomenon raised the question of whether the "original" should be considered as being the message in the hands of the sender prior to being transmitted and perhaps encrypted, or the data received by the recipient, irrespective of whether that received message had been brought up on the screen or otherwise acted upon by the recipient. A concern was raised as to whether such practices as automatic deletion of scrambled messages or "dematerialization" might not be equated, in some jurisdictions, with destruction of evidence. In response, it was stated that most legal systems would probably not regard scrambled messages encoded for transmission as "originals". Furthermore, it was stated that, in many legal systems, rules on the admissibility of evidence only required the production of the best available evidence, not necessarily originals (see below, paragraph 61).

50. Having completed its overview of provisions in national law on the admissibility of EDI evidence, the Working Group considered the question of the manner in which assistance could be given to States in removing obstacles to the use of computer records for evidentiary purposes. It was generally felt that, while an agreement could probably be reached within the Working Group as to admissibility of evidence in a strict sense (i.e., the right for parties to produce electronic records in the context of trials or administrative procedures), difficulties would remain as to the criteria to be applied in the weighing of the evidential value of such records by courts or administrative authorities. It was a generally held view that, in view of the significant diversity in national legal approaches to questions of evidence, it would not be advisable to attempt to enunciate detailed models for statutory provisions. Rather, it would be preferable to recommend that, to the degree possible, obstacles to the admission of EDI evidence should be removed. At the same time, the concern was voiced that, in order to be effective in providing guidance, such a recommendation should not be overly general. In this connection, it was suggested that the recommendation should provide more detailed guidance on possible legislative reform than had been provided in the 1985 UNCITRAL recommendation on the legal value of computer records.

51. As to the specific content of a recommendation, reference was made to the need to take into account the different possible circumstances and purposes involved when EDI

evidence was proffered, differences which could play a role in determining the approach to be applied to admissibility. It was said not to be possible to generally separate the nature of the evidential questions to be dealt with from the ultimate question of fact being put to the trier of fact. For example, if the sole issue was whether a party had received notice, the inquiry would be limited to whether the EDI message had been received; if the question was whether the sender was binding itself through the message, the questions of authenticity and verification would have to be considered. The view was expressed that it would also be particularly useful to identify the main issues and highlight the various problems raised by EDI evidence. For example, guidance could be provided as to factors relevant in determining the degree of weight to be afforded to EDI evidence.

52. As to the admissibility of EDI evidence for administrative purposes, a view was expressed that a topic for future work might be to review the criteria used by administrative authorities to assess the admissibility of electronic evidence. The prevailing view, however, was that recommending changes in administrative rules at the national level would not be an appropriate focus of work by the Commission. At the same time, it was recognized that recommendations that were made with respect to the removal of obstacles to the use of EDI at the international level might help to foster the removal of such obstacles in the administrative sphere.

## 2. Burden of proof

53. The Working Group next turned its attention to the question of whether any particular burden of proof considerations arose as a result of the use of EDI. In particular, questions were raised as to the feasibility of uniform application to EDI of the traditional notion found in many countries that the burden of proof lay with the party bringing a matter before the court. It was suggested that that notion might not be applicable if factors were present that would justify a shifting of the burden of proof. One such factor that drew particular attention was inequality of the parties. There was support for the view that, where relevant, and in order to prevent injustice, it would be appropriate to place the burden of proof on the party in control of the EDI network. In this regard, it was observed that the question of burden of proof was of limited relevance in cases in which the operator of an EDI network disclaimed liability, as was said to be typically the case with such networks, and the disclaimer was upheld. Other factors that were cited as possible grounds for shifting of the burden of proof included destruction by a party of EDI records and failure to apply agreed upon security measures related to an EDI transmission. It was suggested that it would not be possible to lay down rules to govern all the possible situations that might arise, though it might be possible and useful to compile a list of such factors that would be relevant to assigning the burden of proof.

54. According to a somewhat different perspective, it was difficult to address the question of burden of proof in the abstract and therefore the focus should be on what was to be proved in any given case, the nature and contractual terms of the underlying transaction, and the value to be

given to the evidence. According to this approach, it could not be said in the abstract that a party that destroyed evidence or failed to carry out security measures would in all cases and as a necessary result of such acts have to shoulder the burden of proof. Such conduct might, rather, only diminish the credibility of that party or the weight of its evidence.

55. It was further observed that the question of burden of proof might, in some cases, be moved off of centre stage, if not avoided, by the contractual terms governing the underlying relationship and the presumptions established by those terms. For example, if the question at issue was whether a payment order was authorized, and the parties had agreed to certain security measures to be applied to the EDI messages involved, the presumption would be that the payment order was in fact authentic, valid and authorized. It was said that such cases demonstrated that the parties could change the normal allocation of burden of proof by defining their obligations, rather than by addressing the question of burden of proof. A view was expressed that the impact of such measures might be a useful topic for study.

56. The attention of the Working Group was also drawn to another approach, found in a number of States, which stressed the collaboration of each of the parties in the production of evidence so as to illuminate a dispute. Under such an approach, the court had the power to order the production of certain types of evidence, and parties that failed to participate in the production of the evidence could be held liable for damages.

57. Finally, the Working Group considered the question of the applicability of the notion of contractual freedom to the allocation of the burden of proof. There was support for the view that contractual freedom in this regard should be generally recognized and that any rules that might be drawn up should be suppletive. It was also pointed out that, as was stated earlier with regard to the general applicability of the notion of burden of proof to the EDI environment, the contractual terms defining an EDI relationship might affect burden of proof issues. At the same time, reference was made to the possibility that there might be certain unavoidable limitations on the contractual freedom of the parties in this area. Such limitations might stem, in particular, from mandatory rules of applicable law. A further observation was that, notwithstanding the principle of freedom of contract, a court considering the allocation of burden of proof might in some cases look beyond what had been agreed upon by the parties.

58. It was also noted that the question of contractual allocation of burden of proof needed to be viewed in the light of the possible relationships involved, including not only the relationship between the sender and the receiver of an EDI message, but also the relationship between the sender or receiver and the operator of the EDI network. With regard to that latter relationship, reference was made to a common practice of network operators to decline liability for losses incurred by users as a result of problems in transmission of messages. The view was expressed that such blanket disclaimers were potentially an abuse of a dominant position and that this was an area in which contractual freedom needed to be curtailed by rule-making.

59. Following the conclusion of the above discussion, the Working Group decided to return to the question of burden of proof at a later stage, after it had considered the remaining issues, some of which might have burden-of-proof implications.

### C. Requirement of an original

60. At the outset, it was noted that a number of issues and solutions that had been discussed in relation to writing requirements and to the question of the admissibility of electronic evidence bore a relation to the question of the applicability in the electronic environment of requirements that documents and other records had to be presented to a court in their original form.

61. The Working Group heard statements concerning the status in various countries of the requirement of an original. Those statements revealed that the extent to which this requirement was applied varied from country to country. In some countries the production of an original was required for a number of specified purposes such as to provide evidence of title (e.g., registration of share certificates and transfer of title), the granting of a security interest by deposit of a document of title with the creditor, transfer of negotiable instruments by way of transfer of the instrument, and various statutory and administrative requirements. In other countries, the requirement of an original was applied more narrowly; for example, an original might be required only to evidence title to land. In the latter group, emphasis was placed on the reliability and durability of the copy, rather than on whether a particular document was the first in a chain of reproduction. It was also noted that the concept of an original might be considered as diluted somewhat by the fact that in many situations the parties agreed that there was more than one "original" (e.g., when a contract was executed in two "original copies"). It was further noted that in many countries requirements for an original were softened by the availability of the principle of "best available evidence" when a required original was unavailable.

62. There was general agreement that the requirement of an original was an obstacle to the wider use of EDI in international trade and that the problem needed to be addressed. However, differing views were expressed as to the extent to which the requirement could reasonably be expected to be eliminated. On the one hand, the view was expressed that even with the introduction of electronic equivalents of paper documents, the need to have, to one extent or another, parallel paper-based records would continue to be maintained for the foreseeable future. On the other hand, the view was expressed that the aim of many parties adopting EDI procedures, particularly in regard to company-to-company, and company-to-administrative authority relationships, was to eliminate the storage of paper records altogether. According to this view, envisaging the parallel storage of paper could mean that the introduction of EDI would increase rather than decrease the total cost of processing and storing information.

63. The Working Group considered two ways in which the requirement of an original might be reduced as an

obstacle to the use of EDI. One approach, similar to the one proposed earlier in the session in connection with the requirement of a writing, was to suggest that, where necessary, the definition of "original" should be expanded so as to include EDI messages and records. That approach did not generate a significant level of interest, in particular because the Working Group generally felt that the notion of an "original" was of little relevance in the EDI context. It was generally felt that the more appropriate notion was that of a "record" that could be translated into readable form. The second possible approach, which was sometimes referred to as the "functional-equivalent approach" and was regarded by the Working Group as preferable, was to identify the purposes and functions of the traditional requirement of an original with a view to determining how those purposes or functions could be fulfilled through EDI techniques. It was noted that in a number of countries this functional approach was being applied to varying degrees or was in the process of being established.

64. With such a functional approach in mind, the Working Group engaged in a review of the traditional purposes and functions of originals, as well as in an overview of the types of functional equivalents that had already been developed. Those purposes centred around the notion that a party bringing suit or otherwise asserting rights based on an underlying document must have the original, or sufficient reason for loss of the original, so as to ensure that that party was indeed endowed with the rights being asserted. Other purposes included ensuring the availability of the best possible evidence, and authentication of transactions. It was also pointed out that there were cases in which the original could not be found and that for such cases legal systems provided ways to recreate the original, thus demonstrating that the need for an original was not absolute.

65. It was reported that, for each of those purposes, electronic equivalents could be developed or were in fact already in use. Examples of this trend that were cited included the electronic trading of securities, in which rights were acquired and transferred without paper, registry systems accommodating electronic filing of security interests, and acceptance by fiscal authorities of electronic filings and of documents such as invoices in electronic form. The view was expressed that, of the purposes of originals, those linked to negotiability presented the greatest degree of difficulty, although here too electronic equivalents could be envisaged.

66. The Working Group noted with interest the relevance and advancement of electronic means of signature and authentication aimed at ascertaining that an EDI message that was received was the same message that had been sent, at verifying the integrity of the message, and at ensuring non-repudiation of the message by the sender. It was reported that a key measure in this regard was the "digital signature", which was well suited in particular in the banking sector. This technique, on which work was continuing to be carried out by a number of organizations, involved the partial or total encryption of a message in order to verify that it was from the purported sender and that it had not been altered, and could be used by the recipient to prevent the sender from denying transmission of the message.

67. Attention was drawn to the need to keep in mind the underlying relationships, and in particular the rights of third parties, that might be affected as electronic equivalents were introduced as replacements for originals. One case that was cited as an example was the power of attorney. It was suggested that any electronic replacement would have to be able to ensure that third parties, including courts, could ensure the continuing existence of the power involved. In this regard, it was suggested that registry systems could serve a useful function when the rights of third parties were involved, although it would be difficult to envisage dealing with all types of possible relationships under a single type of approach.

68. The rights of third parties also came up in connection with questions raised about the functioning and legal implications of electronic filing of security interests. In particular, the question was raised as to the possibility of a conflict between a paper document in the hands of one party evidencing a security interest, and an electronic filing by another party of a security interest in the same property. It was pointed out that in such a case the mere existence of a paper document would not be sufficient to establish a security interest; rather, filing with a central authority would be required, with the outcome resting on which party was first to file. Analogous problems in the securities trade could be solved through similar means. It was also noted that fraud-tainted EDI transmissions might raise the question of the responsibility of the sender and that questions of a similar nature had arisen in the preparation of the draft UNCITRAL Model Law on International Credit Transfers.

69. A question was raised as to the possible limit on the extent to which electronic equivalents could reliably replace originals in view of the fact that the originals of some EDI messages might be considered as existing only in the random access memory (RAM) of computers, rather than on hard or floppy disks where the risk of loss of data would be lower. In response to this concern, it was pointed out that article 10 (a) of the UNCID Rules imposed the obligation on EDI users to ensure that a complete trade data log was maintained of all transfers as they were sent and received, without any modification. It was also suggested that the evidential problem might be solved in such cases pursuant to the principle of best available evidence.

70. It was noted that in some countries, in the absence of legislative modernization to keep pace with clear legislative authority on questions such as the applicability of the requirement of originals in the electronic environment, regulatory decisions at lower levels and *ad hoc* arrangements entered into between companies and administrative authorities were used to facilitate the use of EDI. A concern was raised that such situations might give rise to eventual difficulties and should be regularized through appropriate legislative reform.

#### D. Signature and other authentication

71. The discussion focused on the functions traditionally performed by a handwritten signature on a paper document. It was observed that one function of a signature was

to indicate to the recipient of the document and to third parties the source of the document. A second function of a signature was to indicate that the authenticating party approved the content of the document in the form in which it was issued.

72. It was stated that various techniques (e.g., "digital signature") had been developed to authenticate electronically transmitted documents. Certain encryption techniques could authenticate the source of a message, and also verify the integrity of the content of the message. It was observed that, in considering whether to employ such authentication methods, attention needed to be paid to the costs involved, which might vary considerably according to the extent of computer processing that was required. Such costs needed to be weighed against the presumed benefits in choosing the appropriate mode of authentication. It was suggested that different levels of authentication would probably need to be considered by EDI users for different types of transmissions.

73. The Working Group proceeded with a review of the provisions of some multilateral conventions concerning the definition of "signature" and other means of authentication. It was noted that a number of recent international instruments envisaged functional equivalents to the handwritten signature to be used in the context of electronic transmissions. Those provisions generally provided an extended definition of "signature", such as the following definition found in article 5(k) of the United Nations Convention on International Bills of Exchange and International Promissory Notes:

"Signature" means a handwritten signature, its facsimile or an equivalent authentication effected by any other means."

However, it was noted that other instruments such as the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards still relied on the concept of "agreement in writing", being defined as an agreement "signed by the parties or contained in an exchange of letters or telegrams" (article II).

74. It was further noted that the draft Model Law on International Credit Transfers (article 4) relied on the concept of "authentication" or "commercially reasonable authentication" and provided that the purported sender of a payment order would normally be bound by the payment order if the agreed authentication procedures had been complied with. The view was expressed that the draft Model Law had done away with the concept of "signature" so as to avoid difficulties that might be involved, in either the context of the traditional or of the extended definition of "signature", in assessing whether the signer of a payment order had in fact been duly authorized to send such payment order.

75. The Working Group was generally agreed that there existed a need to eliminate the mandatory requirements of signatures in EDI communications. It was also agreed that there existed a need to promote the use of electronic authentication procedures regarding the source and the content of EDI messages, and that such procedures should be adapted to the functions served by an electronic message. Parties

should be allowed to determine the nature of such authentication procedures within the realm of commercial reasonableness. Wide support was given to the idea that legislative provisions might be needed to establish the principle of "commercial reasonableness". The Working Group was agreed that the issues raised by the notion of signature, as well as by related techniques such as the digital signature, required close cooperation with other organizations active in the field, both at the technical and at the legal level.

## E. Formation of contracts

### 1. Expression of consent in an electronic environment

76. The Working Group focused its initial discussion of the topic on the situation where parties were bound by an agreement that was concluded prior to the establishment of an EDI relationship and that expressly allowed them to conclude future contracts through the exchange of EDI messages. It was noted that such an agreed framework for the conclusion of future EDI contracts could be agreed upon by the parties either in a specific commercial agreement, often referred to as a "master agreement", or by inserting appropriate clauses in a communication agreement. Yet another possibility was adherence by the parties to a specific network arrangement that provided rules as to the formation of contracts within the network system.

77. It was generally felt that, under such a master agreement, parties should encounter no difficulty in concluding legally binding contracts by means of EDI messages. It was stated that, at this early stage of EDI development, parties generally agreed on the need to conclude some form of a master agreement and that, depending on the form of such master agreement, contracts formed by means of EDI messages could be interpreted either as acts of execution of the master agreement or as separate contracts concluded according to procedures determined in the master agreement. However, it was noted that, as EDI further developed, parties might no longer feel a need to agree on a master agreement before they started using EDI to conclude contracts.

78. It was generally felt that, in view of the variety and complexity of national laws as regards the expression and validity of consent in the process of contract formation, as well as in view of the possible revocability of an offer, there existed a need to promote the establishment of a master agreement dealing with those issues prior to the establishment by parties of an EDI relationship. The Working Group was agreed that further discussion might be needed to determine whether uniform statutory provisions should be prepared so as to ensure that in all legal systems parties would be allowed to agree validly on the establishment of such master agreements.

79. The Working Group was also agreed that it should be considered whether there existed a need for a set of legal rules that would apply to the formation of contracts in the absence of a prior master agreement by the parties on the use of EDI. It was observed that, while the legal issues of contract formation might be similar in theory in the context of EDI and in the context of other means of teletransmission, the use of EDI required a degree of legal

certainty that could not rely merely on the assumption that traditional rules would be applicable to EDI by analogy.

80. Among the issues to be considered, it was commonly admitted that the questions of offer and acceptance might be of particular importance in an EDI context since EDI created new opportunities for the automation of the decision-making process leading to the formation of a contract. Such automation might increase the possibility that, due to the lack of a direct control by the owners of the computer, a message would be sent, and a contract formed, that did not reflect the actual intent of one or more parties at the time when the contract was formed. Automation also increased the possibility that, where a message was generated that did not reflect the sender's intent, the error would remain unperceived both by the sender and by the receiver until the mistaken contract had been acted upon. The consequences of such an error in the generation of a message might be greater with EDI than with traditional means of communication, in view of the possibility that the mistaken contract would be automatically executed.

81. The view was expressed that the application of computers in the contract formation process could raise difficulties as to the existence or validity of contracts concluded by EDI, particularly where the contract formation process did not involve any direct human control and did not require any human confirmation. It was suggested that a person having, or deemed to have, final control over the computer application should be deemed to have approved the sending of all messages dispatched by that application. Another suggestion was that, irrespective of whether consent to the formation of a given contract had in effect been expressed, all consequences of the operation of a computer system should be borne by the person who had taken the risk of operating that system.

82. As regards the issue of revocability of an offer, the Working Group recalled that article 16 of the United Nations Sales Convention provided that an offer could normally be revoked if the revocation reached the offeree before dispatch of the acceptance. While support was given to the idea that such a rule should also be applicable to contracts formed in an EDI context, doubts were expressed as to the workability of such a rule, given the speed of EDI transmissions.

83. As an example of a situation where contracts might be formed through EDI messages without a prior agreement being reached between contracting parties, reference was made to the possible establishment of new commercial relationships through the use of EDI directories or "electronic yellow pages" (see above, paragraph 31). It was stated that, in practice, the decision of accepting an offer in such a context typically required human intervention. However, it was observed that it was technically feasible to program a computer so that it would automatically react to an offer by sending a message of acceptance or by adopting any other conduct that amounted to acceptance (e.g., delivery of the goods). It was generally admitted that such pre-programming should constitute a presumption that the programming party had intended to approve the sending of a message of acceptance or to any other conduct of the machine under its control.

84. It was noted that the offeror whose offer had apparently been accepted had no way of perceiving whether the apparent acceptance resulted from human or automatic intervention. More generally, it was stated that both parties should be able to rely on the apparent offer and the apparent acceptance that had been exchanged between their computers. It was suggested that a rule might be elaborated to that effect.

85. Another example of the possible conclusion of a contract without specific and express agreement was the situation in which the computer of the supplier was programmed to investigate the inventory records of the buyer and to dispatch automatically a certain quantity of goods when the quantity held by the buyer went below a certain limit. In such a situation, the supplier's computer, upon establishing that the requirements for the formation of a contract had been met, proceeded automatically to an act of execution of the contract. It was suggested that the computer that had been programmed to react automatically to an offer by an act of acceptance was not, in fact, consenting to the formation of the contract but merely establishing that the will of the offering party had meshed with the will of the accepting party. It was observed that such a theory might lead to reconsidering the traditional notion of consent. It was also stated that there might be a need to state in the form of a rule that, unless otherwise agreed, when a contract was formed as a result of the operation of a computer program, a party that executed the contract should give express notice of the formation of the contract to the other party.

86. After discussion, the Working Group was agreed that any rules on the expression of consent in an electronic environment should be based on the principle of party autonomy. It was also agreed that future work was needed to determine the scope and content of a possible set of legal rules to be applied in the absence of an agreement by the parties (e.g., a bilateral agreement or general rules set forth by a network operator). While the view was expressed that in many legal systems such a conclusion would result from the interpretation of traditional legal rules and that there existed therefore no need to establish new rules, it was observed that such interpretation of traditional rules might not be a solution available in all countries. It was agreed that particular consideration in this respect should be given to the fact that EDI users needed certainty as to applicable legal rules and that the need to rely on interpretation of traditional rules on paper-based transactions might not be satisfactory in that respect. It was also agreed that, when considering the scope and content of possible rules, attention should be given to providing the possibility for computers to express consent and to the obligation for an accepting party to send notice of its acceptance to the offeror.

## 2. Time and place of formation

87. It was noted that when dealing with the issue of time and place of formation of contracts in the context of EDI relationships, two solutions were most commonly found in legal systems (see A/CN.9/333, paras. 72-74): the receipt rule and the dispatch rule. It was recalled that according to the dispatch rule a contract was formed at the moment when the declaration of acceptance of an offer was sent by

the offeree to the offeror. According to the receipt rule, a contract was formed at the moment when the acceptance by the offeree was received by the offeror. That question was one of the important issues that could be settled in a communication agreement, in the absence of mandatory provisions of statutory law. As an example of such a contractual provision, article 9.2 of the "TEDIS European Model EDI Agreement" prepared by the Commission of the European Communities (May 1991) read as follows:

"Unless otherwise agreed, a contract made by EDI will be considered to be concluded at the time and the place where the EDI message constituting the acceptance of an offer is made available to the information system of the receiver."

88. It was recalled that the TEDIS Study on the Formation of Contracts (see A/CN.9/WG.IV/WP.53, para. 68) contained a chapter on the issues of time and place of formation of contracts. The conclusions of that study were that the receipt rule should be promoted as particularly suitable for EDI. It was observed that the transmission of EDI messages might be initiated in different places, such as a place of business of the sender, or the place where the sender held its computers, or any place from where the sender might operate, for example, by means of a portable computer. It was also observed that, during the transmission process, particularly where third-party service providers were involved, EDI messages might travel through places that were irrelevant to the underlying commercial contract. It was thus submitted that only the place where the message had been placed at the disposal of the recipient was sufficiently predictable to provide legal certainty, particularly as to the place of formation of a contract. It was also mentioned that the receipt rule was in line with article 18(2) of the United Nations Sales Convention, with the draft Principles for International Commercial Contracts prepared by the International Institute for the Unification of Private Law (UNIDROIT) and with national legislation in a number of States.

89. After discussion, the Working Group was agreed that any rules on the time and place of the formation of contracts in an electronic environment should be based on the principle of party autonomy. As to the definition of a possible rule to be applied in the absence of a prior agreement between the parties, it was agreed that the main purpose of such a rule should be to provide certainty to all parties involved. Some support was expressed in favour of the theory of receipt. It was agreed that future work would be needed to determine the content of a rule on the time and place of formation of contracts. It was noted that devising the rule might be difficult in view of the possible involvement of several commercial parties and several third-party service providers, each of which might operate computers from different places. It was agreed that exceptions would probably need to be made to the receipt rule for those cases where the place of receipt was not objectively determinable by the parties at the moment when the contract was formed and for those cases where the place of receipt might have no relevance to the underlying transaction. It was suggested that the place of formation of a contract might be determined by reference to an objective event so as to avoid being linked inappropriately to, for example, the place where computers were located.

### 3. General conditions

90. It was recalled that the main problem regarding general conditions in a contract was to know to what extent they could be asserted by one party against the other contracting party (see A/CN.9/333, paras. 65-68). In many countries, the courts would consider whether it could reasonably be inferred from the context that the party against whom general conditions were asserted had had an opportunity to be informed of their contents or whether it could be assumed that the party had expressly or implicitly agreed not to oppose all or part of their application.

91. It was also recalled that EDI was not, at least at the current time, technically equipped, or even intended, to transmit all the legal terms of the general conditions that were printed on the backs of purchase orders, acknowledgements and other paper documents traditionally used by trading partners. EDI techniques currently in use were designed to transmit standardized, coded messages with a specific syntax, and general conditions could typically not be included in such messages. A solution to that difficulty was to incorporate the general conditions in the communication agreement concluded between the trading partners. However, some model agreements had expressly excluded coverage of general conditions, based on the principle expressed in article 1 of the UNCID Rules (see A/CN.9/WG.IV/WP.53, annex) that the interchange agreement should relate only to the interchange of data, and not to the substance of the transfer, which might involve consideration of various underlying commercial or contractual obligations of the parties. It was also noted that in the case of open networks that offered the service of "electronic yellow pages", the rights of the parties to the contracts formed might be governed by statutory rules or by conditions established by the network operator.

92. In light of the above, emphasis was placed on the need to draw a clear distinction between the conditions governing communication through an EDI network and the general conditions applicable to the contract formed between the parties through the use of EDI messages. At the same time, reference was made to the possibility that in some cases conditions of the former type, i.e., those governing the use of EDI communications facilities, might affect substantively the rights and the obligations of the parties under the underlying contract (e.g., with respect to issues such as offer and acceptance).

93. Various methods were mentioned of ensuring the applicability of general conditions to the contract formed by EDI messages, while not detracting from the cost effectiveness of EDI. One suggestion was that general conditions might be covered by a master agreement distinct from the communication agreement, for example a master supply agreement for the sale of goods. Another suggestion was that the EDI message itself could include a reference to general conditions, an approach analogous to one traditionally used in contractual practice. Yet another suggestion was that such references might be tied to a practice such as that reported to be used in one country, where general conditions of sale were published in the official journal or deposited with a governmental authority, and thereby made available for incorporation by reference in individual sales

contracts. An electronic analogue of such an approach could be the establishment of databases in which general conditions could be stored and made electronically accessible, thus facilitating incorporation of the general conditions by way of references in EDI messages. It was suggested that such a database or some other method of transmitting general conditions might be a service that could be offered by value-added networks.

94. A number of general observations were made as to the techniques that had been discussed for the transmission and incorporation of general conditions. These included in particular that the techniques used would have to ensure that the parties were aware of, or at least had the opportunity to familiarize themselves with, the content of the general conditions, that the principle of freedom of contract should be maintained, that the solutions needed to be simple so as not to aggravate "battle of the forms" problems through the use of EDI, and that, at least until such time as technical obstacles to the use of standardized messages for the transmission of general conditions had been overcome, to some extent a hybrid system might have to be envisaged in which paper documents remained the repository of general conditions.

95. While the observation was made that the question of general conditions was a source of some uncertainty as regards the wider use of EDI and that consequently the development of rules in that area might at some future time be usefully considered, the Working Group took the view, subject to further developments in practice, that the question of general conditions was primarily a matter of the rights and obligations agreed upon by the parties. It was also noted that questions related to general conditions had been touched upon in other legal instruments, in particular the United Nations Convention on Contracts for the International Sale of Goods and the draft Principles for International Commercial Contracts prepared by the International Institute for the Unification of Private Law (UNIDROIT).

### F. Liability for failure or error in communication

96. The Working Group noted that legal consequences of a failure or error in EDI communications were sometimes addressed in agreements between parties involved, but that practice in that respect was not well developed and that clauses of that type varied in their scope and in the type of solutions adopted. There was general agreement in the Working Group that statutory provisions on both issues were needed, either as fall-back solutions when agreements by parties did not resolve a question or as statutory provisions protecting legitimate interests of parties. It was pointed out that it might be advisable to define such terms as "damages", "direct damages" and "indirect damages", and to examine further what kind of damages should be addressed in those statutory provisions.

#### 1. Liability and risk of a party

97. The Working Group engaged in a discussion of two related questions that might arise when a message was delayed or not transmitted properly. One question con-

cerned the liability for damages of a party who caused a failure or error in communication. The other question was which party was to bear the risk of loss resulting from a failure or error in communication. Views were expressed that in devising a statutory provision on those questions, appropriate weight should be given to the principle of freedom of contract.

98. A suggestion was made that the question of liability and risk might be addressed by a provision along the following lines:

"Subject to the agreed procedures for authentication or verification, the risk and liability for any faulty transmission and resulting damage rests with the sender."

By way of explanation, it was added that the purpose of the opening phrase in the suggested provision was to make it clear that the provision addressed the situation when security procedures had been agreed upon and the recipient of the message observed those procedures.

99. Under one view, the suggested text presented a suitable basis for further discussions. Under another view the suggested rule was too one-sided in emphasizing the liability of the sender, since loss could be caused not only by negligence of the sender, but instead by negligence of the recipient, by contributory negligence of both of them, or by a third person. It was suggested that the suggested rule would have to be expanded in order to express more clearly the cases in which the liability should not be on the sender. It was also stated that the suggested provision, while possibly suitable when the sender and the recipient were communicating through a direct link without any value-added intervention of a communication network, was not sufficiently adapted to a situation when the parties communicated through a value-added communication network.

100. Several interventions were directed at the need to distinguish the question of liability for loss from the question of which party bore the risk of loss where nobody was liable for the loss. It was pointed out that, while the suggested rule might present a suitable approach to the question of risk, a different approach was needed for a provision on liability. In this light, a provision on liability might be broadly modelled on the approach adopted in article 12 of the draft TEDIS Agreement as reproduced in paragraph 103 of document A/CN.9/350:

"Each party shall be liable for any direct damage arising from or as a result of any deliberate breach of this agreement or any failure, delay or error in sending, receiving or acting on any message. Neither party shall be liable to the other for any incidental or consequential damage arising from or as a result of any such breach, failure, delay or error.

"The obligations of each party imposed by this EDI agreement shall be suspended during the time and to the extent that a party is prevented from or delayed in complying with that obligation by *force majeure*.

"Upon becoming aware of any circumstance resulting in failure, delay or error, each party shall immediately inform the other party(ies) hereto and use their best endeavours to communicate by alternative means."

101. Also mentioned as a possible model for a provision on liability was article 16 of the draft SITPROSA Agreement as reproduced in paragraph 103 of document A/CN.9/350:

"16.1 The risk and liability for any faulty transmission and the resulting damages rests with the Sender:

- a. subject to the exceptions described in clause 16.2; and
- b. subject to the condition that the Sender will not be liable for any consequential damages other than those for which he would be liable in the case of a breach of contract in terms of the Main Contract or which have been specifically agreed to.

16.2 Although the Sender is responsible and liable for the completeness and accuracy of the TDM [Trade Data Message], the Sender will not be liable for the consequences arising from reliance on a TDM where:

- a. the error is reasonably obvious and should have been detected by the Recipient;
- b. the agreed procedures for authentication or verification have not been complied with."

102. It was noted that the issue of liability was closely linked to the observance of commercially reasonable procedures for verification and security of communication. It was said that any statutory rule that might be prepared by the Commission should be more specific concerning those procedures. Articles 6, 7 and 8 of UNCITRAL Rules were mentioned as citing the duty to observe such commercially reasonable procedures. It was further noted that a statutory provision might have to be refined depending on the author of a particular procedure and how the procedure meshed with the method of operation of the communication system.

103. It was observed that the content of a provision might depend on the communication method envisaged. The content of a provision might also depend on whether loss occurred between parties who communicated frequently on the basis of an agreement for the interchange of messages or whether loss occurred between parties who did not communicate regularly.

## 2. Liability of a third party providing communications services

104. The Working Group discussed the liability of EDI network operators, who might cause loss by improper or untimely transmission of, for example, a contract offer, payment order, notice to release goods, or a notice that goods were damaged. In addition, a network operator might cause damage by failing to perform or by incorrect performance of value-added services that the network had undertaken to perform.

105. The Working Group considered the liability of the various types of third-party operators of EDI networks to their users. One type were third parties who only transmitted messages without providing additional value-added services (passive networks). Another type were third parties who provided value-added services such as authentication, verification, archiving, recording or copying. A fur-

ther type, referred to also as central data managers, were third parties whose management of the flow of information was essential for the functioning of a closed EDI network so that each party who wished to join the network had to agree to conduct the transactions through the central data manager. Central data managers could perform, in addition to one or more value-added EDI services (such as authentication, verification, archiving, recording or copying), also other functions such as coordinating and collating the flow of data or netting outstanding claims among participating parties.

106. It was noted that in the context of the TEDIS programme an initial analysis was under way of liability issues concerning two types of operators: (a) network operators whose services were essentially limited to carrying data and (b) operators who intervened in EDI in order to store, authenticate or verify data.

107. It was observed that, in practice, the liability of network operators was to a large measure restricted. In the case of network operators that had a public status (e.g., those that were state-owned, enjoyed a degree of monopoly, or were of special importance to the national economy), the restriction or exclusion of liability was often established in the law or regulation governing the functioning of the network. The responsibility of passive carriers of data (such as telephone, telex or facsimile networks) in particular was low or excluded. In the case of networks that had no such public status, liability restrictions were found in contracts with users of the communications services. In addition to excluding or placing financial limits on liability, liability restrictions generally concerned the basis of liability and the burden of proof. Liability might be restricted also through rules determining that the operator was liable only for direct loss or loss that the operator could reasonably foresee; for example, when a payment order or an acceptance of a contract offer was not transmitted properly, the liability might be limited to the fee paid for the transmission and to the interest lost because payment was made late.

108. It was noted that in devising liability rules it would have to be borne in mind that an EDI message might have to travel through networks of various operators, including operators that were not in a contractual relationship with the sender or the addressee of the message, and that sometimes the user of the communication service did not know through which networks the message would travel.

109. Various interventions were made concerning the need to establish statutory provisions on liability, and concerning the implications such provisions might have for the development and commercial viability of EDI networks. It was stated that mandatory liability rules, comparable to rules governing liability arising from other commercial activities, were necessary to foster observance of proper procedures and technical standards in EDI. It was also stated that liability rules would by necessity be reflected in the costs of network operators, and that a significant increase in those costs would hinder or impede commercial development of EDI. The possibility of insuring liability was emphasized as an important criterion in assessing the feasibility of proposed liability rules. Examples were given

of attempts to establish value-added communications services which eventually failed because it was difficult to assess the extent of the possible liability risk and that, consequently, the liability risk was not insurable at a commercially acceptable insurance premium.

110. It was observed that an operator might offer different fees for a given service, depending on the level of liability accepted by the operator. It was said that it might be acceptable to allow a broad freedom of contract in excluding liability as long as the user had a reasonable choice to pay a higher fee for a higher level of liability. It was added, however, that such freedom of contract was acceptable only if competition existed among network operators.

111. It was observed that, with the increased use of EDI, the likelihood of an error or fraud remaining undetected would diminish. For example, when a given transaction was implemented by a series of messages (e.g., purchase order, functional acknowledgement of the order, acceptance of offer, functional acknowledgement of the acceptance, shipment order, instruction to the carrier), electronic security measures were likely to alert the users in the event of alteration of data at a particular segment of the message chain.

112. After discussion, there was general agreement in the Working Group that in principle the users and the networks should be free to agree on the level of liability of the network. This freedom, however, should be limited by a mandatory provision ensuring that the liability of the network was not excluded or set at an unreasonably low level.

113. The Working Group reviewed the following types of value-added communications services which might give rise to the liability of a network operator: authentication; verification; archiving; recording and copying.

114. As to authentication and verification, it was noted that various methods were in use and that those methods provided different levels of security to the EDI users. The methods ranged from a technically simple verification of the address of the owner of the computer that had sent or received a message to sophisticated "digital signatures". Some of those methods were designed to verify only the source of the message, while others could verify both the source of the message as well as whether the message received was identical to the message sent. It was pointed out that when the user was promised that a particular method of authentication would be used, the user should be entitled to hold the network responsible if the agreed method was not used. It was also pointed out that it was in the public interest that authentication and verification procedures were used since authenticated and verified messages could be relied upon by the user in its dealings with tax, customs or other authorities.

115. It was noted that the nature of the duties and liabilities of the network attendant to recording and archiving functions depended on the extent and purpose of those functions. The network's tasks might be limited to recording and maintaining selected data relating to messages (e.g., the date and hour of the dispatch or receipt of a message, length of message and addressee), or the network

might archive the full content of the messages. The period of time during which information would have to be preserved might vary depending on the needs of the user and the cost involved. For certain types of records, the period of time during which they had to be archived, and security measures that had to be used, were governed by mandatory provisions of national law. A suggestion was made that, in connection with preparing liability rules, it might be useful to recommend harmonization of national rules governing the length of time during which certain records were to be kept. The prevailing view, however, was that such national rules were not limited to records kept in computer-readable form and that harmonization of those rules was beyond the scope of rules on EDI. Particular mention was made of cases where the recorded information related to a right of a person and a change in the record was needed for the transfer of that right (e.g., in the case of an "electronic bill of lading" (see below, paragraphs 119 to 124)). It was said that in such cases the breach of duties of the network could have serious consequences for the parties to the underlying transaction. An observation was made that the transferee of the right recorded by the network might obtain certain rights against the network even in the absence of a contract between the transferee and the network.

116. Another service of network that might give rise to liability consisted in providing copies of records of information to certain persons or users. Two aspects of this service were mentioned. One aspect was a duty to provide a copy in accordance with the conditions set out in the contract between the user and the network. Another aspect was a duty to provide a copy to a court or similar organ that was entitled by law to be provided with certain information.

117. Various observations were made with regard to any statutory liability provision that might be prepared by the Commission. It was suggested that it would be desirable to elaborate one set of rules that would govern various types of services performed by the EDI network operator. One possible approach along those lines would be to base the liability provision on the principle that the obligation of the network was to provide, to the best of its ability, the means to carry out the service ("obligation of means"). Another possible approach would base the provision on the principle that the network guaranteed the performance of the service ("obligation of result"). It was also suggested that the network should not be able to exclude its liability for negligence. Liability based on negligence could be expressed by setting out positive duties owed by the network to the user and by providing that the network was liable if it was in breach of such a duty. Alternatively, liability could be expressed by stating that the network was liable if it failed to take all the measures that could reasonably be required to avoid the damage. As to the damages, suggestions were made that the network should be able to exclude liability for indirect and unforeseeable damages. The view was also expressed that, where several networks were involved in performing a service, the statutory provision should identify the network or networks that were liable to the user.

118. Other factors on which it was suggested that the liability of the network operator might depend included

whether it was the operator of the network or another party who constructed the communications system, whether it was the user or the network operator who decided that a particular communications system would be used, whether the network operator was the only party in control of the communications system, whether the communications system was offered to the user with or without a possibility to adapt the system to particular needs of the user, and whether the user fulfilled its duty to observe agreed security measures.

### G. Documents of title and securities

119. The discussion on the topic of negotiability of documents of title in an EDI environment focused on maritime bills of lading. It was noted that, while technical and contractual solutions relating to electronic transferring of bills of lading and similar documents of title had been found, unresolved practical difficulties remained in some countries with regard to the use of EDI for the purpose of "dematerialized securities trading", i.e., transferring marketable securities such as stocks, shares or bonds.

120. Explanations were given regarding the transfer of title to goods in transit under the "CMI Rules for Electronic Bills of Lading", adopted by the Comité Maritime International (CMI) in 1990. Those Rules applied if the participating parties so agreed. It was pointed out that an electronic bill of lading, in order to be an attractive alternative to a paper-based bill of lading, had to fulfil in particular the following functions: to evidence the contract of carriage; to evidence receipt of goods; to provide a right to control goods and the possibility of transferring that right; to secure reliable information concerning the description of the goods; to allow verification by interested third parties (e.g., insurers) of information concerning goods; and to allow establishment of a security interest in the goods.

121. The Working Group heard an explanation of steps involved in establishing and transferring an electronic bill of lading under the CMI Rules. First, the shipper and the carrier had to agree that they would communicate electronically, that an electronic bill of lading would be used instead of a paper-based one, and that the CMI Rules would apply. Next, after the carrier had confirmed the shipper's "booking note" specifying the shipper's requirements and after the shipper had delivered the goods to the carrier, the carrier would issue a receipt for the goods. The receipt of the goods would contain the description of the quantity, quality and condition of the goods. Together with the receipt, the carrier would transfer to the shipper a secret code ("private key") to be used for securing the authenticity and integrity of any future instruction to the carrier regarding the goods. The private key could be any technically appropriate code, such as a combination of numbers or letters that the parties might agree on. The shipper would then confirm to the carrier agreement with the description of the goods in the receipt. The CMI Rules provided that the shipper, by virtue of being the holder of the private key, had the "right of control and transfer" over goods, i.e., the right to claim delivery of the goods and the right to nominate a consignee. For the transfer of the right to control and transfer the following steps were necessary: a notification from the

current holder of the private key to the carrier of the intention to transfer to another person the right of control and transfer; the carrier's confirmation of that notification; the carrier's transmission to the proposed new holder of the description of the goods; notification by the proposed new holder to the carrier of acceptance of the description of the goods; and cancellation by the carrier of the current private key and issuance of a new private key to the new holder. The new holder of the private key could then transfer its rights regarding the goods to a new holder following the same steps. At the port of destination, the carrier was to deliver the goods in accordance with the delivery instructions as verified by the private key.

122. It was noted that mere possession of the currently valid private key was not sufficient to transfer the right of control and transfer. The carrier, in communicating with the holder of the key, would also verify whether the instruction for transfer was given by the person identified by the previous holder. Such verification of identity would be done by electronic means of authentication in addition to the private key.

123. It was noted that the CMI Rules did not make it possible for two persons to have simultaneous control over goods, one as the owner of the goods and the other as the holder of the security interest in the goods. If a security interest was to be established in favour of a person (e.g., a bank), that person would have to be made the single holder of the right of control and transfer over the goods. A suggestion was made that consideration should be given to a possibility that an owner of goods, while retaining a degree of control over the goods, would establish through EDI a security interest in the goods in favour of a creditor. A related suggestion was to explore the possibility of an electronic transfer of a security interest in goods independently from the transfer of ownership over goods.

124. The Working Group was in agreement that there was a need to review existing statutory rules on documents of title with a view to ascertaining whether new statutory law was needed to enable or facilitate the use of documents of title in an EDI environment. It was pointed out that such future work should be carried out in cooperation with other organizations active on the subject.

## H. Communication

125. The Working Group noted that the legal issues of communication, such as the use of functional acknowledgements, have been addressed in the UNCID Rules and in most communication agreements or user manuals prepared for potential EDI users. It agreed to include this subject on the list of possible future work.

### I. Applicable law and related issues

126. The Working Group was agreed that, in the context of the preparation of a future instrument on the legal issues of EDI, attention should be given by the Commission to the questions of the law applicable to EDI relationships. In this regard, it was suggested that the rule should be established

that parties to an EDI relationship would have complete freedom to determine the law applicable to that relationship. The view was expressed, however, that party autonomy in this regard should be limited by consideration of international public order so that a choice-of-law clause should not be used as a means of avoiding application of fundamental legal principles. Another suggestion was to establish a conflict-of-laws rule providing that, in the absence of a contrary agreement, one national law would be applicable to the possibly different segments of an EDI transaction and providing a method for the determination of that law.

127. It was further suggested that rules on EDI should facilitate access of parties to arbitration. In particular, consideration should be given to EDI procedures for concluding arbitration agreements and to statutory provisions supporting the validity of arbitration agreements.

128. The Working Group was agreed that future work on those issues should develop using the above suggestions as a basis for discussion.

## IV. RECOMMENDATION FOR FUTURE WORK

129. The Working Group was agreed that any future work by the Commission in the field should be aimed at facilitating the increased use of EDI. The Working Group was also agreed that its deliberations had made it clear that there existed a need for legal norms to be developed in the field of EDI. Support was expressed in favour of suggestions that the review of legal issues arising out of the increased use of EDI had also demonstrated that among those issues some would most appropriately be dealt with in the form of statutory provisions. Examples of such issues included: formation of contracts; risk and liability of commercial partners and third-party service providers involved in EDI relationships; extended definitions of "writing" and "original" to be used in an EDI environment; and issues of negotiability and documents of title.

130. At the same time, it was also suggested that other issues arising from the use of EDI were not ready for consideration in the context of statutory provisions and would require further study or further technical or commercial developments. While it was generally felt that it was desirable to seek the high degree of legal certainty and harmonization provided by the detailed provisions of a uniform law, it was also felt that care should be taken to preserve a flexible approach to some issues where legislative action might be premature or inappropriate. As an example of such an issue, it was stated that it might be fruitless to attempt providing legislative unification of rules on evidence applicable to EDI messaging. It was stated that, on some such issues, the Commission might deem appropriate to undertake the preparation of legal rules, legal principles or recommendations.

131. After discussion, the Working Group decided that its recommendation to the Commission would be to undertake the preparation of legal norms and rules on the use of EDI in international trade. It was agreed that such norms and rules should be sufficiently detailed to provide practical

guidance to EDI users as well as to national legislators and regulatory authorities. It was also agreed that the Commission, while it should aim at providing the greatest possible degree of certainty and harmonization, should not, at this stage, make a decision as to the final form in which those norms and rules would be expressed.

132. As regards the possible preparation of a standard communication agreement for worldwide use in international trade, the Working Group was agreed that, at least currently, it was not necessary for the Commission to develop a standard communication agreement (see above, paragraph 27). However, it was noted that in line with the flexible approach recommended to the Commission concerning the form of the final instrument, situations might arise where the preparation of model contractual clauses would be regarded as an appropriate way of addressing specific issues.

133. The Working Group reaffirmed the need for close cooperation between all international organizations active in the field. It was agreed that the Commission, in view of its universal membership and general mandate as the core legal body of the United Nations system in the field of international trade law, should play a particularly active role in that respect. In that connection, it was recalled that the mandate conferred on the Commission by the General Assembly was to "further the progressive harmonization and unification of the law of international trade by:

(a) Coordinating the work of organizations active in this field and encouraging cooperation among them;

(b) Promoting wider participation in existing international conventions and wider acceptance of existing model and uniform laws;

(c) Preparing or promoting the adoption of new international conventions, model laws and uniform laws and promoting the codification and wider acceptance of international trade terms, provisions, customs and practices, in collaboration, where appropriate, with the organizations operating in this field;

(d) Promoting ways and means of ensuring a uniform interpretation and application of international conventions and uniform laws in the field of the law of international trade;

(e) Collecting and disseminating information on national legislation and modern legal developments, including case law, in the field of the law of international trade;

(f) Establishing and maintaining a close collaboration with the United Nations Conference on Trade and Development;

(g) Maintaining liaison with other United Nations organs and specialized agencies concerned with international trade;

(h) Taking any other action it may deem useful to fulfil its functions.<sup>14</sup>

134. It was also agreed that the Secretariat should continue to monitor legal developments in other organizations such as the Economic Commission for Europe, the European Communities and the International Chamber of Commerce, facilitate the exchange of relevant documents between the Commission and those organizations and report to the Commission and its relevant Working Groups on the work accomplished within those organizations.

<sup>14</sup>General Assembly resolution 2205 (XXI), sect. II, para. 8 [*Yearbook* 1968-1970, part one, chap. II, sect. E].

**B. Working paper submitted to the Working Group on International Payments at its twenty-fourth session: possible issues to be included in the programme of future work on the legal aspects of EDI: note by the Secretariat**

**(A/CN.9/WG.IV/WP.53) [Original: English]**

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## INTRODUCTION

1. At its twenty-first session (1988), the Commission considered a proposal to examine the need to provide for the legal principles that would apply to the formation of international commercial contracts by electronic means. It was noted that there existed no refined legal structure for the important and rapidly growing field of formation of contracts by electronic means and that future work in that area could help to fill a legal vacuum and to reduce uncertainties and difficulties encountered in practice. The Commission requested the Secretariat to prepare a preliminary study on the topic.<sup>1</sup>

2. At its twenty-third session (1990), the Commission had before it a report entitled "Preliminary study of legal issues related to the formation of contracts by electronic means" (A/CN.9/333). The report summarized work that had been undertaken in the European Communities and in the United States of America on the requirement of a writing as well as other issues that had been identified as arising in the formation of contracts by electronic means. The efforts to overcome some of those problems by the use of model communication agreements were also discussed. The Commission requested the Secretariat to continue its examination of the legal issues related to the formation of contracts by electronic means and to prepare for the Commission at its twenty-fourth session a report that would analyse existing and proposed model communication agreements with a

view to recommending whether a model agreement should be available for worldwide use and, if so, whether the Commission should undertake its preparation. The Commission expressed the wish that the report would give it the basis on which to decide what work might be undertaken by the Commission in the field.<sup>2</sup>

3. At its twenty-fourth session (1991), the Commission had before it the report it had requested, entitled "Electronic Data Interchange" (A/CN.9/350). The report described the current activities in the various organizations involved in the legal issues of electronic data interchange (EDI) and analysed the contents of a number of standard interchange agreements already developed or being currently developed. It also pointed out that such documents varied considerably according to the various needs of the different categories of users they were intended to serve and that the variety of contractual arrangements had sometimes been described as hindering the development of a satisfactory legal framework for the business use of EDI. It suggested that there was a need for a general framework that would identify the issues and provide a set of legal principles and basic legal rules governing communication through EDI. It concluded that such a basic framework could, to a certain extent, be created by contractual arrangements between parties to an EDI relationship and that the existing contractual frameworks that were proposed to the community of EDI users were often incomplete, mutually incompatible, and inappropriate for international use since they relied to a large extent upon the structures of local law.

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), paras. 46 and 47, and *ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 289.

<sup>2</sup>*Ibid.*, Forty-fifth Session, Supplement No. 17 (A/45/17), paras. 38-40.

4. The report noted that, although many efforts were currently being undertaken by different technical bodies, standardization institutions and international organizations with a view to clarifying the issues of EDI, none of the organizations that were primarily concerned with worldwide unification and harmonization of legal rules had, as yet, started working on the subject of a communication agreement. With a view to achieving the harmonization of basic EDI rules for the promotion of EDI in international trade, the report suggested that the Commission might wish to consider the desirability of preparing a standard communication agreement for use in international trade. It pointed out that work by the Commission in this field would be of particular importance since it would involve participation of all legal systems, including those of developing countries that were already or would soon be confronted with the issues of EDI.

5. The report also suggested that possible future work for the Commission on the legal issues of EDI might concern the subject of the replacement of negotiable documents of title, and more particularly transport documents, by EDI messages. That was the area where the need for statutory provisions seemed to be developing most urgently with the increased use of EDI. The report suggested that the Secretariat might be requested to submit a report to a further session of the Commission on the desirability and feasibility of preparing such a text.

6. The Commission was agreed that the legal issues of EDI would become increasingly important as the use of EDI developed and that the Commission should undertake work in that field.

7. As regards the suggestions reflected above, there was wide support for the suggestion that the Commission should undertake the preparation of a general framework identifying the legal issues and providing a set of legal principles and basic legal rules governing communication through EDI. The Commission was agreed that, given the number of issues involved, the matter needed detailed consideration by a Working Group.

8. As regards the preparation of a standard communication agreement for worldwide use in international trade, support was given to the idea that such a project might be appropriate for the Commission. However, divergent views were expressed as to whether the preparation of such a standard communication agreement should be undertaken as a priority item. Under one view, work on a standard agreement should be undertaken immediately for the reasons expressed in the report, namely that no such document existed or seemed to be prepared by any of the organizations that were primarily concerned with worldwide unification and harmonization of legal rules and that the Commission would be a particularly good forum since it involved participation of all legal systems, including those of developing countries that were already or would soon be confronted with the issues of EDI. The prevailing view, however, was that it was premature to engage immediately in the preparation of a standard communication agreement and that it might be preferable, until the next session of the Commission, to monitor developments in other organizations, particularly the Commission of the European Com-

munities and the Economic Commission for Europe. It was pointed out that high-speed electronic commerce required a new examination of basic contract issues such as offer and acceptance, and that consideration should be given to legal implications of the role of central data managers in international commercial law.

9. After deliberation, the Commission decided that a session of the Working Group on International Payments would be devoted to identifying the legal issues involved and to considering possible statutory provisions, and that the Working Group would report to the Commission at its next session on the desirability and feasibility of undertaking further work such as the preparation of a standard communication agreement. The Commission also took note of the suggestion by the Secretariat to prepare a uniform law on the replacement of negotiable documents of title, and more particularly transport documents, by EDI messages.<sup>3</sup>

10. The present note has been prepared to help the Working Group in structuring its deliberations. The note serves three purposes: the first is to review previous work undertaken by the Commission in relation to EDI and computer records and to suggest possible follow-up; the second is to provide the Working Group with an annotated tentative list of legal issues that might warrant future work by the Commission; the third is to consider possible legal instruments that might be prepared at an international level to facilitate the increased use of EDI in international trade.

## I. PREVIOUS WORK AND POSSIBLE FOLLOW-UP

### A. Recommendation on the legal value of computer records

11. The Commission, at its seventeenth session (1984), decided to place the subject of the legal implications of automatic data processing to the flow of international trade on its programme of work as a priority item.<sup>4</sup> It did so after considering a report of the Secretary-General entitled "Legal aspects of automatic data processing" (A/CN.9/254), which identified several legal issues, relating to the legal value of computer records, the requirement of a writing, authentication, general conditions, liability and bills of lading. The decision of the Commission was made after taking note of a report of the Working Party on Facilitation of International Trade Procedures (hereinafter referred to as "WP.4"), which is jointly sponsored by the Economic Commission for Europe and the United Nations Conference on Trade and Development. The report suggested that, since the legal problems arising in this field were essentially those of international trade law, the Commission as the core legal body in the field of international trade law appeared to be the appropriate central forum to undertake and coordinate the necessary action.<sup>5</sup>

12. At its eighteenth session (1985), the Commission had before it a report by the Secretariat entitled "Legal value of

<sup>3</sup>Ibid., Forty-sixth Session, Supplement No. 17 (A/46/17), paras. 311-317.

<sup>4</sup>Ibid., Thirty-ninth Session, Supplement No. 17 (A/39/17), para. 136.

<sup>5</sup>"Legal aspects of automatic trade data interchange" (TRADE/WP.4/R 185/Rev.1). The report submitted to the Working Party is reproduced in A/CN.9/238, annex.

computer records" (A/CN.9/265). That report came to the conclusion that, on a global level, there were fewer problems in the use of data stored in computers as evidence in litigation than might have been expected. It noted that a more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arose out of requirements that documents had to be signed or be in paper form. After discussion of the report, the Commission adopted the following recommendation:

*"The United Nations Commission on International Trade Law,*

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

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

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

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

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

*"1. Recommends to Governments:*

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

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

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

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

*"2. Recommends to international organizations elaborating legal texts related to trade to take account of the present Recommendation in adopting such texts and, where appropriate, to consider modifying existing legal texts in line with the present Recommendation."*<sup>6</sup>

13. That recommendation (hereinafter referred to as the "1985 UNCITRAL Recommendation") was endorsed by the General Assembly in resolution 40/71, paragraph 5(b), of 11 December 1985 as follows:

*"The General Assembly,*

*"... Calls upon Governments and international organizations to take action, where appropriate, in conformity with the Commission's recommendation so as to ensure legal security in the context of the widest possible use of automated data processing in international trade; ..."*<sup>7</sup>

14. Since 1985, a number of surveys of national legislation have been undertaken by international organizations by way of questionnaires, with a view to updating available information on the legal obstacles to the increased use of EDI. For example, such a survey was recently prepared by the Customs Co-operation Council (CCC).<sup>8</sup> It may also be recalled that WP.4 has decided to develop a questionnaire on the legal barriers to the use of EDI in different legal systems (see A/CN.9/350, para. 112). That questionnaire seems unlikely to be issued before 1993. The Secretariat intends to monitor that survey and to report its results to the Commission or the Working Group.

15. As was recently pointed out in several documents and meetings involving the international EDI community, e.g. in meetings of WP.4, there is a general feeling that, in spite of the efforts made through the 1985 UNCITRAL Recommendation and the 1979 ECE Recommendation (see A/CN.9/333, para. 51), little progress has been made to achieve the removal of the mandatory requirements in national legislation regarding the use of paper and handwritten signatures. It has been suggested by the Norwegian Committee on Trade Procedures (NORPRO) in a letter to the Secretariat that "one reason for this could be that the 1985 UNCITRAL Recommendation advises on the need for legal update, but does not give any indication of how it could be done". In this vein, the Working Group may wish to consider what follow-up action to the 1985 UNCITRAL Recommendation the Commission could usefully take so as to enhance the needed modernization of legislation.

<sup>6</sup>Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17), para. 360.

<sup>7</sup>Resolution 40/71 was reproduced in United Nations Commission on International Trade Law, Yearbook 1985, vol. XVI, part one, sect. D. (United Nations publication, Sales No. E.87.V.4).

<sup>8</sup>See Customs Co-operation Council, document No. 36.548 E (Brussels, 9 March 1991).

## B. Coordination of work

16. At its nineteenth session (1986), the Commission had before it a report of the Secretary-General describing the work of international organizations active in the field of automatic data processing (A/CN.9/279). The Commission approved the suggestion contained in the report that it might undertake leadership in the coordination of activities in this field by requesting the Secretariat to organize a meeting in late 1986 or early 1987 to which all interested intergovernmental and non-governmental international organizations might be invited.<sup>9</sup>

17. The meeting was held at Vienna on 12-13 March 1987. The following organizations attended: Central Office for International Rail Transport; Council of Europe; Economic Commission for Europe; Commission of the European Communities; Hague Conference on Private International Law; International Maritime Organization; Organization for Economic Co-operation and Development; United Nations Commission on International Trade Law.

18. It was recognized at that meeting that cooperation was both important and, in some respects, difficult. It was important because the introduction of automatic data processing in international trade, through the use of computers and their interconnection by telecommunications, created legal problems that could seldom be solved by any one organization. Therefore, cooperation was necessary, not only to ensure that organizations were not working in conflict with one another, but because certain problems can be solved only through efforts taken from several points of view. It was, however, acknowledged that cooperation was sometimes difficult to achieve because of the differences between the organizations as reflected in their fundamental concerns, approach to legal problems, membership and working methods (see A/CN.9/292, paras. 2-8).

19. At its further sessions, the Commission was informed of the progress made in the work of other interested organizations (see A/CN.9/292; A/CN.9/333; A/CN.9/350). It is submitted that while cooperation regarding the legal issues of EDI has become increasingly difficult, it has also become more necessary, given the number of organizations involved, their often technical nature and the number of projects currently undertaken or being considered in connection with the legal implications of EDI. The Working Group may wish to reaffirm the coordinating role of UNCITRAL and to discuss whether it would be appropriate to recommend that a new meeting be convened to which all interested intergovernmental and non-governmental organizations might be invited, as was the case in 1987.

## C. Participation in the drafting of the UNCID Rules

20. The first effort accomplished by the international EDI community to harmonize and unify EDI practices resulted in the adoption of the Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID) by the International Chamber of Commerce (ICC) in 1987 (ICC

Publication No. 452, 1988). UNCID was prepared by a special joint committee of the ICC in which the following organizations were represented: the United Nations Economic Commission for Europe (ECE); the Customs Co-operation Council (CCC); the UNCTAD Special Programme on Trade Facilitation (FALPRO); the Organisation for Economic Co-operation and Development (OECD); the International Organization for Standardization (ISO); the Commission of the EEC; the European Insurance Committee; the Organization for Data Exchange via Teletransmission in Europe (ODETTE) and the secretariat of UNCITRAL.

21. Although the first draft of UNCID was based on the idea of creating a model communication agreement, it was found that, due to the differing requirements of various user groups, the creation of a model communication agreement was an impracticable objective at such an early stage of the development of EDI techniques. It was therefore decided to create a small set of non-mandatory rules on which EDI users and suppliers of network services would be able to base their communication agreements. UNCID was also incorporated into United Nations Rules for Electronic Data Interchange for Administration, Commerce and Transport (UN/EDIFACT) as part of the United Nations Trade Data Interchange Directory. Although UNCID constituted a limited achievement, it also represented a major step in the development of a legal framework for EDI, both because it furnished a basis for preparing individual communication agreements and because it served as a first effort that could later be used to reach a higher level of refinement (see A/CN.9/333, paras. 82-86).

22. The Working Group may wish to consider reviewing the substance of the UNCID Rules and use the results of that examination as a basis for its further deliberations on the legal issues of EDI (see below, chapter III). It is also submitted that such a review of the UNCID Rules might help the Working Group in its consideration of possible statutory provisions and of the desirability and feasibility of undertaking further work such as the preparation of a standard communication agreement (see below, chapter IV, B and C). The text of the UNCID Rules and an introductory note prepared by ICC (ICC Publication No. 452) are reproduced in the annex.

23. The following issues are covered by UNCID: definitions; use of interchange standards; standard of care to be applied by the parties when communicating through EDI; identification and authentication of messages and transfers; acknowledgement of a transfer; confirmation of content of messages; protection of trade data; storage of data. In addition, the introductory note to UNCID outlines the following issues to be considered when drafting a communication agreement: liability; situation of third parties; insurance; time within which a receiver should process the data; secrecy or other rules regarding the substance of the data exchanged; rules of a professional nature; encryption and other security measures; rules on signature; applicable law and dispute resolution.

24. Most of the issues covered by UNCID and the introductory note are discussed below in chapter III. Of those issues addressed by UNCID or the introductory note but

<sup>9</sup>Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17), para. 261.

not addressed in this note, some are of a technical nature or have legal implications mainly outside the area of trade law: use of interchange standards; protection and storage of data; insurance; secrecy or other rules regarding the substance of the data exchanged. Some other issues have legal implications mainly in the area of trade law and would need to be discussed in detail if the preparation of a legal instrument on EDI were to be undertaken: standard of care to be applied by the parties when communicating through EDI; time within which a receiver should process the data; implications of rules of a professional nature such as the rules of the Society for Worldwide Interbank Financial Telecommunication (SWIFT); applicable law and dispute resolution.

## II. DEFINITION OF EDI

25. With a view to getting a clearer idea as to what the modern term "EDI" encompasses, the Working Group may wish to consider existing definitions of EDI. In recent years, the term "Electronic Data Interchange" or its acronym "EDI" has become widely used in practice to describe the use of computers for business applications. However, it must be noted that there currently exists no unified definition of EDI and that the use of the term in the legal field may create some confusion.

26. No statutory or case law definition of EDI has, as yet, come to the knowledge of the Secretariat. However, it may be noted that a number of definitions of EDI can be found in working documents from international organizations and are used as a basis for the work of these organizations. For example, the United Nations Trade Data Interchange Directory (UNTDID) published by the United Nations Economic Commission for Europe (TRADE/WP.4/R.721) contains the following definition:

"Electronic Data Interchange: the computer-to-computer transmission of business data in a standard format."

27. Definitions of EDI are also contained in communication agreements, other contractual stipulations and commentaries thereto. Although they differ slightly as to their wording, most definitions of EDI contained in existing model interchange agreements seem to rely on a combination of two or more of the following elements: the transmission of trade data; between computers; operated by different trading partners; by reference to a standardized syntax or format; through the use of electronic means. Examples of such definitions of EDI in model communication agreements include the following: "the interchange of trade data effected by teletransmission";<sup>10</sup> "the transmission of data structured according to agreed message standards, between information systems, by electronic means";<sup>11</sup> "the transmission of structured data via electronic communication links between the parties".<sup>12</sup> Wording to the same effect can be found in other model communication agree-

ments<sup>13</sup> and commentaries. For example, the commentary developed by the American Bar Association (ABA) reads as follows:

"Electronic data interchange ('EDI') is the method by which business data may be communicated electronically between computers in standardized formats (such as purchase orders, invoices, shipping notices and remittance advices) in substitution for conventional paper documents. . . . Technically stated, EDI is the transmission, in a standard syntax, of unambiguous information between computers of independent organizations."<sup>14</sup>

28. However, some differences may exist as to the extent to which commercial uses of computers should be covered by the term "EDI". For example, the preliminary report entitled "DOCIMEL Rapport de base droit" (March 1991), published by the International Rail Transport Committee (CIT), contains the following indication:

"It seems that [the term 'EDI'] strictly covers the interchange of data but not the processing of these data, which is independent from their actual transmission."

29. Another distinction is drawn in a report prepared for the Organization for Simplification of International Trade Procedures in South Africa (SITPROSA), which reads as follows:

"Electronic Data Interchange is usually defined as the electronic exchange of machine processable, structured data, formatted to agreed standards and transmitted across telecommunications interfaces directly between different applications running on separate computers. Thus defined, it is clear that EDI does not include facsimile transmissions, electronic mail or other forms of free formatted text or images."<sup>15</sup>

30. Such distinctions are not necessarily adopted by legal writers; instead a broader definition of EDI has been suggested, such as the following:

"It is generally admitted that EDI only covers the communication of trade documents (such as purchase orders, invoices, customs declarations or other documents capable of being formatted by reference to international standards) between trading partners or to a public administration. . . . However, the increased use of new information technologies in modern economy makes it clear that the implications of EDI are broader and cannot be limited to certain relationships between trading partners and public authorities. Thus, one must consider as a component of an EDI relationship the use of such automatic processing devices as computer-aided design, for example in the automotive industry, or the use of statistical data banks in the insurance trade. . . .

<sup>10</sup>Article 2(b) of the "CMI Rules for Electronic Bills of Lading" adopted by the International Maritime Committee (CMI) in June 1990.

<sup>11</sup>Article 1 of the "TEDIS European Model EDI Agreement" prepared by the Commission of the European Communities (May 1991).

<sup>12</sup>Article 1.1 of the draft "Model Interchange Agreement" prepared by the Organization for Simplification of International Trade Procedures in South Africa (SITPROSA, March 1991).

<sup>13</sup>Article 1.1 of the "Standard Interchange Agreement" prepared by the Ministry of Communications of the Province of Quebec (Canada, 1990); article 0.a. of the model EDI interchange agreement prepared by the Centre international de recherches et d'études du droit de l'informatique et des télécommunications (CIREDT) (France, 1990).

<sup>14</sup>Introduction to "The commercial use of electronic data interchange—a report" (Chicago, Illinois, American Bar Association, 1990), p. 1. Also published in *The Business Lawyer*, vol. 45, No. 5, June 1990, p. 1661.

<sup>15</sup>G. T. S. Eischen, "Legal issues of the change to electronic data interchange—report of a preliminary investigation", document prepared for SITPROSA in 1989.

Extremely varied relationships between professionals are to be considered when analysing the legal issues of EDI, despite the fact that those relationships do not involve standardized documents only.<sup>16</sup>

31. The two most recent studies prepared for the Commission on the subject (A/CN.9/333 and A/CN.9/350) make use of the term "EDI". It may be noted that in prior reports to the Commission and in the reports of the Commission the subject had been considered under the general heading of "automatic data processing" (ADP), which was the term generally used to describe the use of computers for business applications (see A/CN.9/333, para. 7). The change in terminology from ADP to EDI was not intended to introduce a distinction between the transmission and the processing of data or to exclude consideration of the issues raised by the transmission of any form of free formatted text or image for commercial purposes. It may be noted, however, that communication of data through EDI inherently supposes a degree of standardization in the form of a predefined syntax used in common by all parties to the EDI relationship so that the data can be read and processed by the computers of both the sender and the recipient of the data.

32. References to the legal issues of EDI made in prior reports to the Commission and in the reports of the Commission were meant to cover the legal issues that may arise out of the use of new information technologies involving the interchange of data for commercial or regulatory purposes (to the exclusion of consumer transactions), thus producing legal effects such as the creation of rights and obligations traditionally produced or evidenced by the interchange of paper-based documents. In that connection, the Working Group may wish to consider the emerging concept of "Open-EDI" recently developed by the International Organization for Standardization (ISO) within its Special Working Group on EDI. Open-EDI is defined as follows:

"Electronic data interchange among autonomous parties using public and non-proprietary standards aiming towards global interoperability over time, business sectors, information technology systems and data types."

That definition of Open-EDI relies on the following definition of EDI:

"The automated exchange of predefined and structured data for some 'business' purpose among information systems of two or more parties their number being determined by the 'business operation' or equivalent concerned."<sup>17</sup>

33. The Working Group may wish to consider whether new terminology might be adopted that would reflect more

accurately the scope of the issues currently considered under the term "EDI". It is submitted that wording mentioning "paperless trade" might be more appropriate, although the current practice of EDI seems unlikely to result in complete disappearance of paper-based documents.

### III. POSSIBLE ISSUES OF FUTURE WORK

34. At the outset, the Secretariat wishes to emphasize that the considerations and suggestions set forth in this annotated list of possible issues are of a very tentative nature, due to the early stage of the deliberations. The annotated list summarizes and updates some of the information contained in previous documents with a view to assisting the Working Group in its review of previous work and, in particular, in its consideration of appropriate recommendations to the Commission as to the scope and contents of possible future work on the legal aspects of EDI.

35. Most legal issues presented in this chapter arise from statutory obstacles to the increased use of EDI in international trade and most of these issues are dealt with in communication agreements with a view to overcoming those statutory obstacles by purely contractual means.

36. However, it must be pointed out that not all issues may be dealt with in a satisfactory manner by contractual means. The development of the contractual approach, while helping to better understand the legal issues of EDI, mainly reflects a conception under which the use of EDI for commercial purposes is envisaged essentially, if not exclusively, in the context of closed networks established between individual users or by third-party service providers.

#### A. The requirement of a writing

##### 1. General remarks

37. Legal rules in many States require certain transactions to be concluded or evidenced in writing. In the report that led to the adoption of the 1985 UNCITRAL Recommendation, the requirement of a writing in national statutes as well as in certain international conventions on international trade law was identified as one major obstacle to the increased use of EDI (A/CN.9/265, paras. 59-72).

38. In general, it can be noted that a requirement that contracts be in writing under national legislation may have one of three consequences. In one situation, a writing is required as a condition of validity and, consequently, the non-existence of a writing entails the nullity of the legal act. In a second situation, a writing is required by law for evidentiary purposes. A contract of that kind can be validly concluded by the parties without a writing being required but the enforceability of the contract is limited by a general rule that requires the existence and contents of the contract to be evidenced by a writing in case of litigation. Some exceptions to that rule may exist (see below, paragraph 40). In a third situation, a writing is needed to produce some specific legal result beyond that of merely evidencing the contract. This is for example the case with the air cargo carriage contract

<sup>16</sup>I. Huet, *Aspects juridiques de l'EDI, Echange de Données Informatisées (Electronic Data Interchange)* (Paris, Recueil Dalloz, Chron. pp. 182-183, 1991). The author also suggests to broaden the definition of EDI so as to extend it to transmissions involving third parties such as end consumers.

<sup>17</sup>See J. V. Th. Knoppers, "Results of the work of the International Organization for Standardization (ISO) [& International Electrotechnical Commission (IEC)] on the 'Open-EDI conceptual model' and its importance for EDI developments", text of a presentation made at the World EDI Forum (Brussels, September 1991).

under the 1929 Warsaw Convention.<sup>18</sup> Under this text, the issuance of an air waybill is not required as a condition for entering into a contract for the carriage of goods, but it is required to give the carrier the benefit of the provisions of the Convention providing for limitation of liability of the carrier (see A/CN.9/333, para. 11).

39. Among the reasons for the requirement of a writing are a desire to reduce disputes by ensuring that there would be tangible evidence of the existence and contents of the contract; to help the parties be aware of the consequences of their entering into a contract; to permit third-party reliance on the document; and to facilitate subsequent audit for accounting, tax or regulatory purposes.

40. In those countries where a general rule of civil law (as distinguished from commercial law) is that economic transactions can be proven in litigation only by a writing, there are many exceptions to the rule. For example, a writing is generally not required for transactions of a small amount, or a written document that is not the contract itself but contains some material relating to the substance of the contract may generally be admitted as evidence. Yet another exception may exist where it is impossible for a party to obtain written evidence of the contract.<sup>19</sup> Moreover, the general requirement of a writing is generally considered as an evidentiary requirement of civil law and not of commercial law, where evidence of contracts may be presented to a court in any form.

## 2. Statutory definitions of "writing"

41. What constitutes a "writing" is itself a matter of debate. The word has been defined in some countries, though normally by reference to the mode of imposition on the medium rather than by reference to the nature of the medium itself. For example, under the Interpretation Act 1978 of the United Kingdom, "writing" includes typing, printing, lithography, photography and other modes of representing or reproducing words in a visible form, whilst section 1-201(46) of the Uniform Commercial Code of the United States of America provides that "written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form. It is probably the case that whenever a statute uses the word "writing" without a definition, the legislator originally expected the writing to be on a traditional piece of paper or some other physical medium permitting the words to be read directly by humans.

42. The definition of a writing has often been extended to include a telegram or telex, as in article 13 of the United Nations Convention on Contracts for the International Sale of Goods. In article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration, the definition of a writing has been further extended to encompass "telex, telegrams, or other means of telecommunication which provide a record of the agreement". Article 4(3) of the Convention on the Liability of Operators of Transport Ter-

minals in International Trade provides that "a document . . . may be issued in any form which preserves a record of the information contained therein". A similar idea is expressed in the definition of "notice in writing" in article 1(4)(b) of the 1988 Convention on International Factoring prepared by the International Institute for the Unification of Private Law (UNIDROIT), in which a writing "includes, but is not limited to, telegram, telex and any other telecommunication capable of being reproduced in tangible form".

43. A general study of legislation was conducted by the Commission of the European Communities in the context of the TEDIS (Trade Electronic Data Interchange Systems) programme,<sup>20</sup> which has as one of its purposes the development of an appropriate legal framework for the increased use of EDI. The purpose of the study, in line with the 1985 UNCITRAL Recommendation, was to identify the legal obstacles to the increased use of EDI in the 12 member States of the European Communities. The results of that study are summarized in A/CN.9/333, paras. 15-41. A similar analysis is currently being carried out concerning the national laws of the member States of the European Free Trade Association (EFTA) in the context of the TEDIS programme.

## 3. Contractual definitions of "writing"

44. Communication agreements often contain stipulations aimed at overcoming possible difficulties that might arise concerning the validity and enforceability of legal acts (particularly contracts) due to the fact that they are formed through an exchange of EDI messages instead of the usual written documents. Several communication agreements examined by the Secretariat adopt one or both of the two following approaches to establish the legally binding value of EDI messages. Under the first approach, EDI messages are defined as written documents by mutual agreement of the parties (see A/CN.9/350, paras. 68-76). The second approach relies upon a mutual renunciation by the parties of any rights or claims to contest the validity or enforceability of an EDI transaction under possible provisions of locally applicable law relating to whether certain agreements should be in writing or manually signed to be binding upon the parties (see A/CN.9/350, paras. 77-78).

45. It may be noted that no contractual stipulation attempts to address those categories of contracts which, under certain legal systems, are required to be made in a specific form, generally a written document authenticated by a public authority (see A/CN.9/333, paras. 23-25).

## B. Evidential value of EDI messages

### 1. Statutory and case law on admissibility of evidence

46. A general overview of statutory and case law on evidence, based on the replies given by States and international organizations to a questionnaire circulated by the Secretariat in 1984, is contained in A/CN.9/265, paras.

<sup>18</sup>Convention for the Unification of Certain Rules Relating to International Carriage by Air, Warsaw, 12 October 1929, articles 5 to 9.

<sup>19</sup>For an example of such a rule and some exceptions, see articles 1341, 1347 and 1348 of the French Civil Code.

<sup>20</sup>TEDIS—The legal position of the Member States with respect to Electronic Data Interchange (Brussels, Commission of the European Communities, 1989).

27-48. It indicates that there are three major variations on the general law of evidence which affect the evidential value of computer records. The variations are based on different legal traditions and practices in the fact-finding process in civil or commercial disputes.

47. In a number of legal systems the litigants are in principle allowed to submit to the court all information which is relevant to the dispute. If there is a question as to the accuracy of the information, the court must weigh the extent to which it can be relied upon. In these legal systems there is in principle no obstacle to the introduction of computer records as evidence in judicial or arbitral proceedings.

48. Another group of States establish an exhaustive list of acceptable evidence, which always includes written documents as one of the acceptable forms of evidence. In a few of those States computer records are not admissible as evidence in any court. In other States a computer record might be relied upon to furnish to the court a presumption as to the facts in the case. Moreover, in some of these States the restriction on the use of non-written evidence is found in the civil law governing non-commercial matters. In commercial matters, as well as in criminal trials, non-written evidence may be freely accepted. In those States a computer record may, therefore, be generally acceptable as evidence in all commercial matters.

49. In common law countries an oral and adversarial procedure is generally employed in litigation. As part of that dual tradition, a witness may testify only to what he or she knows personally so as to allow the opponent an opportunity to verify the statements by cross-examination. What he or she knows through a secondary source, e.g. another person, a book or a record of an event, is denominated "hearsay evidence", and, in principle, the tribunal cannot receive it as evidence.

50. Because of the difficulties which the hearsay evidence rule has caused, there are many exceptions to it. One of those exceptions is that a business record created in the ordinary course of commercial activity may be received as evidence even though there may be no individual who can testify from personal knowledge and memory as to the particular record in question. In some common law countries a proper foundation must be laid for the introduction of the record by oral testimony that the record is of a normal nature. In others, the record is automatically accepted subject to challenge, in which case the party relying upon the record must show that it is of the proper kind. Some common law countries have accepted computer print-outs as falling within the business records exception to the hearsay-evidence rule.

51. A more recent study of legal rules on admissibility of evidence was carried out by the Commission of the European Communities in the context of the TEDIS programme (see above, paragraph 43). A summary of the conclusions reached by the TEDIS study is contained in A/CN.9/333, paras. 29-41.

52. The general conclusion of the TEDIS study was that, while there were no major obstacles to the development of

EDI in civil law countries, and therefore no need for fundamental changes of the rules, the common law countries showed theoretical difficulties which made it necessary to adopt statutory law to meet the needs of EDI.

53. The conclusions of the TEDIS study also suggested that a number of obstacles remained as regards the requirement of a writing for accounting, tax or other regulatory purposes. It may be noted that in some States a reform of the law is being contemplated or implemented. This is, for example, the case in France where a recent statute modified the price control regulation under which invoices were to be delivered in written form.<sup>21</sup> It may be expected that the project under consideration by WP.4 to issue a new questionnaire might help in identifying such non-commercial obstacles to the increased use of EDI and any changes currently envisaged by national authorities.

## 2. Contractual rules on admissibility of evidence

54. In earlier days, controversies arose about the validity of privately agreed standards on admissibility of evidence in case of litigation. It now seems to be widely accepted that, under both common law and civil law systems, such private commercial agreements on admissibility of evidence are valid or, at least, not generally prohibited.

55. An overview of contractual provisions on admissibility of EDI messages as evidence is contained in A/CN.9/350, paras. 79-83.

## C. Requirement of an original

### 1. Statutory rules

56. It has been a general rule of evidence that documents and other records had to be presented to a court in their original form so as to ensure that the data presented to the court was the same as the original data. However, in recent years the large savings which can be realized by storing microfilms or computer recordings of original paper documents and destroying the originals has led many States to permit their use as evidence in place of the original. The issues of recording in computer form original paper documents and the question as to whether a computer print-out is to be considered as an original or as a copy of the computer record were discussed in the context of automatic data processing in A/CN.9/265, paras. 43-48.

57. The data as stored in a computer in electronic form cannot be read or interpreted by a human being. Therefore, it cannot be presented to a court unless it takes on a visual form, either on a print-out or on a visual display unit which the court can look at. According to the replies to the 1984 questionnaire, both means of presenting the data to the court are in use.

58. In a few States the question has arisen whether the print-out or the image on the visual display unit is the

<sup>21</sup>Loi de finances rectificative pour 1990 (No. 90-1169 du 29 décembre 1990), article 47 (Journal Officiel du 30 décembre 1990).

original computer record or is a copy of the record stored in computer-readable form. In most States this question either seems not to have arisen or the copy in human-readable form has been accepted on the ground that the original record was not available to the court. Where this question has threatened to preclude the acceptance of computer records as evidence, the rules of evidence sometimes tended to be amended to provide that a print-out could be considered to be an original record.

## 2. Contractual rules

59. Several model communication agreements set forth a contractual definition of an original document, following the "definition strategy" designed to do away with the requirement of a writing (see A/CN.9/350, para. 84). For example, the "Model Electronic Data Interchange Trading Partner Agreement" prepared by the American Bar Association (article 3.3.2.) reads as follows:

"('Signed Documents') shall be deemed for all purposes ... to constitute an 'original' when printed from electronic files or records established and maintained in the normal course of business."<sup>22</sup>

60. It may be noted that, at least in one civil law country, legal writers have expressed doubts as to whether a contractual definition of an "original" could validly deviate from a statutory provision listing a limited number of circumstances where a copy could be substituted for the normally required original with the same evidential value.<sup>23</sup>

## D. Signature and other authentication

61. The issue of authentication of EDI messages has been addressed in previous reports prepared by the Secretariat (see A/CN.9/265, paras. 49-58; A/CN.9/333, paras. 50-59; and A/CN.9/350, paras. 86-89). The contents of those reports are summarized below, in paragraphs 62 to 66.

62. Authentication of a transaction document serves to indicate to the recipient and to third parties the source of the document and the intention of the authenticating party to issue it in its current form. In case of dispute, authentication provides evidence of those matters. Although an authentication required by law must be in the form prescribed, an authentication required by the parties can consist of any mark or procedure they agree upon as sufficient to identify themselves to one another. The most common form of authentication required by law is a manual signature.

63. The 1985 UNCITRAL Recommendation identified the legal requirements of a handwritten signature or other paper-based method of authentication as an obstacle to EDI. In line with that Recommendation and the 1979 ECE Recommendation (see A/CN.9/333, para. 51), which had expressed a similar concern,<sup>24</sup> efforts are being made by the

TEDIS group within the EEC to encourage the removal of mandatory requirements for handwritten signatures in national legislation. Similar efforts are being made in a number of other countries. In spite of such efforts, the most common form of authentication required by national laws remains a signature, which is usually understood to mean the manual writing by an individual of his name or initials. Legal systems increasingly permit the required signatures of some or all documents to be made by stamps, symbol, facsimile, perforation or by other mechanical or electronic means. This trend is most evident in the law governing transport of goods, where all the recent principal multilateral conventions that require a signature on the transport document permit that signature to be made in some way other than by manual signature (see A/CN.9/225, para. 47). Another example of such a definition of "signature" is to be found in article 5(k) of the United Nations Convention on International Bills of Exchange and International Promissory Notes, which reads as follows:

"'Signature' means a handwritten signature, its facsimile or an equivalent authentication effected by any other means."

64. Although a manual signature, or its physical reproduction by mechanical or other means, is a familiar and inexpensive form of authentication and serves well for documents passing between parties that know each other, it is far from being the most efficient or the more secure method of authentication. The person relying on the document often has neither the names of the persons authorized to sign nor specimen signatures available for comparison. Even where a specimen of the authorized signature is available for comparison, only an expert may be able to detect a careful forgery. Where large numbers of documents are processed, signatures are often not even compared except for the most important transactions.

65. Various techniques have been developed to authenticate electronically transmitted documents. If the proper procedures are followed, some authentication techniques in current use for computer-to-computer messages are unlikely to be used successfully by unauthorized persons. Certain encryption techniques authenticate the source of a message, and also verify the integrity of the content of the message. Where such techniques are used, it seems reasonably certain that messages could not be deciphered by third parties in a commercially significant period of time. Previous reports prepared by the Secretariat contain a description of authentication techniques that may permit the verification of both the integrity of the message and the identity of the sender (see A/CN.9/333, paras. 48 and 54-56). When considering such authentication methods, it is submitted that attention needs to be paid to the costs involved, which may vary considerably according to the extent of computer processing needed to operate them. Such costs should be weighed against the presumed benefits in choosing the appropriate mode of authentication.

66. The extent to which such methods would receive legal recognition in States where signature is required by law for a particular document remains a matter of considerable uncertainty. Where the law has not been interpreted by the courts so as to consider an electronic form of authentication as a "signature", it is likely that this uncertainty will be

<sup>22</sup>See note 13.

<sup>23</sup>See A. Bensoussan in *La gazette de la télématique et de la communication inter-entreprises*, No. 11 (spring 1991), p. 20.

<sup>24</sup>See TRADE/WP.4/INF.63; TD/B/FAL/INF.63.

overcome only by legislation. A question for consideration is how far such legislation, when specifically permitting authentication to be made by EDI, should require evidence of conformity with an applicable EDI protocol, at least as a condition of attracting a presumption of authenticity, the onus of proof being shifted to the party asserting the authenticity of the message in cases where the requirements of the protocol are not satisfied.

### E. Formation of contracts

67. The issues of contract formation have been examined in previous reports (see A/CN.9/333, paras. 60-75 and A/CN.9/350, paras. 93-108). The contents of those reports are summarized below, in paragraphs 70 to 78.

68. In addition, it may be noted that a study entitled "La formation des contrats par échange de données informatisées" (hereinafter referred to as the TEDIS Study on the Formation of Contracts) has been recently prepared for the Commission of the European Communities within the TEDIS programme. The French original of that study is expected to be released soon and an English language version is expected to be published before the end of 1992. The content of the TEDIS Study on the Formation of Contracts was communicated to the Secretariat by the Commission of the European Communities and used for the preparation of the present note.

69. Furthermore, it may be noted that a draft "Computer Code" prepared by the Norwegian Research Center for Computers and Law (Oslo) was presented in the context of a recent meeting of the ICC Working Party on "Legal and Commercial Aspects of EDI" (see paragraphs 91 and 92 below). The introduction to that document<sup>25</sup> states that "the draft Computer Code should be regarded as standard terms which may be deviated from by way of contract". However, it must be pointed out that the proposals set out in the draft "Computer Code" are "adapted to open network solutions, where the parties are not involved in a contractual relationship beforehand". That document was also used for the preparation of the present note.

#### 1. Consent, offer and acceptance in an EDI context

70. As a matter of principle, the questions of offer and acceptance may be of particular importance in an EDI context since EDI creates new opportunities for the automation of the decision-making process (see A/CN.9/333, paras. 60-64). Such automation may increase the possibility that, due to the lack of a direct control by the owners of the machines, a message will be sent, and a contract will be formed, that does not reflect the actual intent of one or more parties at the time when the contract is formed. Automation also increases the possibility that, where a message is generated that does not reflect the sender's intent, the error will remain unperceived both by the sender and by the receiver until the mistaken contract has been acted

upon. The consequences of such an error in the generation of a message might therefore be greater with EDI than with traditional means of communication.

71. The variety and complexity of national laws as regards the expression and validity of consent in the process of contract formation, as well as the possible revocability of an offer, illustrate the need for parties to conclude a communication agreement dealing with that issue prior to the establishment of an EDI relationship. An example of such a contractual clause is contained in A/CN.9/350, para. 93.

72. The issues of consent, offer and acceptance have been considered in the above stated TEDIS Study on the Formation of Contracts. That study concludes (see paragraphs 2.3.1.3 and 2.3.1.4) that the use of a computer application in the contract formation process can raise difficulties as to the validity of contracts concluded by EDI, particularly where the contract formation process does not involve any direct human control and does not require any human confirmation. The TEDIS Study on the Formation of Contracts indicates that computers do not benefit from legal recognition as "persons" and thus cannot validly express consent to enter a legally binding relationship. However, it is also suggested that a person having (or deemed to have) final control over the operation of the computer application might be deemed to have consented to all messages dispatched by that application.

73. The TEDIS Study on the Formation of Contracts recommends that a uniform law should be prepared for the use of the member States of the European Communities. As one of the effects of such a uniform law, no defence against the validity of contracts formed through EDI could be based on the means of communication used in the contract formation process. The TEDIS Study on the Formation of Contracts also recommends that the requirements of the law of evidence should be harmonized and that the uniform law should eliminate the mandatory requirements regarding the use of written documents and manual signatures. It is also suggested that the uniform law should contain rules regarding the issues of communication. It is suggested that such rules could be modelled on the UNCID Rules, particularly as regards the identification of the sender of a message and as regards back-up messages. The TEDIS Study on the Formation of Contracts further recommends that the person having (or deemed to have) final control over the operation of the computer system should be held liable for all decisions taken by the computer application. It is suggested that all consequences of the operation of a computer system should be borne by the person who took the risk of operating such a system.

#### 2. Time and place of formation

74. Parties to a contract have a practical interest in knowing when and where a contract is formed. The time when a contract is formed may determine such issues as the moment when the offeror is no longer entitled to withdraw his offer and the offeree his acceptance; whether legislation that has come into force during the negotiations is applicable; the time of transfer of the title and the passage of the

<sup>25</sup>J. Freese, "EDI and national legislation—Teresa (86)", International Chamber of Commerce, document No. 460-10/Int.38 (September 1991).

risk of loss or damage in the case of the sale of identified goods; the price, where it is to be determined by market price at the time of the formation of the contract. The place where the contract is formed may also be relevant for determining the competent court or the applicable law (see A/CN.9/333, para. 69).

75. When dealing with the issue of time and place of formation of contracts in the context of EDI relationships, the parties may in practice have an option between the dispatch rule and the reception rule, which are the two solutions most commonly found in legal systems (see A/CN.9/333, paras. 72-74). It may be recalled that according to the dispatch rule a contract is formed at the moment when the declaration of acceptance of an offer is sent by the offeree to the offeror. According to the reception rule, a contract is formed at the moment when the acceptance of the offeree is received by the offeror. That question is one of the important issues that may generally be settled in a communication agreement, in the absence of mandatory provisions of statutory law. As an example of such a contractual provision, article 9.2 of the "TEDIS European Model EDI Agreement" prepared by the Commission of the European Communities (May 1991) reads as follows:

"Unless otherwise agreed, a contract made by EDI will be considered to be concluded at the time and the place where the EDI message constituting the acceptance of an offer is made available to the information system of the receiver."<sup>26</sup>

(Further examples of such contractual provisions are contained in A/CN.9/350, paras. 99-100.)

76. The TEDIS Study on the Formation of Contracts (see paragraph 68 above) contains a chapter on the issues of time and place of formation of contracts. The conclusions of that study are that the reception rule should be promoted as particularly suitable for EDI. The TEDIS Study on the Formation of Contracts also mentions that the reception rule is in line with article 18(2) of the United Nations Sales Convention and with national legislation in a number of European States.

### 3. General conditions

77. It may be recalled that the main problem regarding general conditions in a contract is to know to what extent they can be asserted against the other contracting party (see A/CN.9/333, paras. 65-68). In many countries, the courts will consider whether it can reasonably be inferred from the context that the party against whom general conditions are asserted has had an opportunity to be informed of their contents or whether it can be assumed that the party has expressly or implicitly agreed not to oppose all or part of their application.

78. EDI is not equipped, or even intended, to transmit all the legal terms of the general conditions that are printed on the back of purchase orders, acknowledgements and other paper documents traditionally used by trading partners. A solution to that difficulty is to incorporate the general conditions in the communication agreement concluded be-

tween the trading partners. An example of such a provision is contained in A/CN.9/350, para. 96. However, some model agreements have expressly excluded coverage of general conditions, based on the principle expressed in article 1 of the UNCID Rules (see annex) that the interchange agreement should relate only to the interchange of data, and not to the substance of the transfer, which might involve consideration of various underlying commercial or contractual obligations of the parties.<sup>27</sup> In that case, general conditions may be covered by a master agreement distinct from the communication agreement, for example a master supply agreement for the sale of goods.

## F. Communication

79. The legal issues of communication have been addressed in the UNCID Rules (see above, paragraphs 23 to 24) and in most communication agreements or user manuals prepared for potential EDI users.

### 1. Use of functional acknowledgements

80. Several of the rules and model communication agreements recently developed include special provisions encouraging systematic use of "functional acknowledgements" and verification procedures. A functional acknowledgement is a device by which the sender of a message can be almost immediately notified that the message was received, and received without defects such as omissions or errors in format or syntax. Acknowledgement of receipt merely confirms that the original message is in the possession of the receiving party and is not to be confused with any decision on the part of the receiving party as to agreement with the content of the message. Nevertheless, an acknowledgement of receipt helps to eliminate a number of problems regarding ambiguities or misunderstandings, as well as errors in the communication process.

81. Communication agreements often differ concerning the characteristics of the functional acknowledgement they require. Furthermore, they differ concerning the consequences they attach to the sending of an acknowledgement or to the failure to acknowledge.<sup>28</sup>

### 2. Liability for failure or error in communication

82. A question that is not directly related to the formation of contracts but that needs to be addressed within the contractual framework of an EDI relationship is the determination of which party is to bear the risk of a failure in communication of an offer, acceptance or other communication intended to have legal effect, such as an instruction to release goods to a third party. It may be noted that model agreements generally address cases both of failure to com-

<sup>27</sup>For an example of an interchange agreement excluding coverage of the general conditions, see the "[United Kingdom] EDI Association standard electronic data interchange agreement", explanatory commentary, August 1990.

<sup>28</sup>See A. H. Boss, "The proliferation of 'Model' interchange agreements", text of a presentation made at the Third International Congress of EDI users.

<sup>26</sup>The final draft of the TEDIS agreement is reproduced in TRADE/WP.4/R.784.

municate and of error in communication under the same provision. Some agreements impose an obligation on the sender to assure the completeness or accuracy of the data transmitted. Other agreements impose on the recipient of the message the obligation to notify the sender if a message is unintelligible or garbled. Examples of such provisions are contained in A/CN.9/350, paras. 102-103.<sup>29</sup>

83. Where parties to an EDI relationship communicate through a third-party service provider such as a value-added network, the contractual arrangements between the parties cannot bind the third party. Parties can only agree on the allocation of risks in the event of non-feasance or malfeasance by the service provider. Within a contractual framework, the rules applicable to the liability of the network operator might be limited to the rules agreed upon by the operator itself and included in the service contract concluded between the operator and its customers. Further difficulties might arise in the situation where a given communication would involve more than one network. In general, reliance on contractual arrangements regarding liability issues might result in an unbalanced situation. Although liability is probably provided for by general provisions of law, the Working Group may wish to consider that there exists a need for the preparation of specific statutory rules on the liability of parties to an EDI relationship.

### G. Documents of title and securities

84. A general question concerning documents of title in an EDI environment is whether negotiability and other characteristics of documents of title can be accommodated in an electronic context. A subsidiary question is whether the issues of documents of title in an electronic context can be addressed within the framework of a contractual arrangement or whether statutory law is needed. In that connection, it may be recalled that the legal regime of documents of title must take into account the fact that title and other proprietary rights may have to be transferred for security purposes and that such rights and security interests need to be regulated with regard to the legal position of creditors and other third parties.

85. The specific issues of the negotiable bill of lading are addressed in the "CMI Rules for Electronic Bill of Lading" adopted by the International Maritime Committee (CMI) in 1990. The CMI Rules envisage a system administered by the carrier, which preserves the function of negotiability in the electronic bill of lading through the use of a secret code ("private key"). Discussions are also taking place within WP.4 with a view to defining some form of an "electronic bill of lading".

86. It may be noted that, prior to the CMI Rules, a private project known as the "Seadocs" system had attempted to achieve the electronic transfer of rights traditionally effected by transmission of a paper bill of lading. The project was intended to accommodate the particular needs of bulk cargo shipping, especially oil. This operated by creating a central authority, which would hold the bill of lading and register the various changes in ownership, so that when

delivery became due the master of the vessel could, by reference to that central register, ensure that a bill of lading was available and that delivery was made to the correct party.<sup>30</sup> It seems that among the reasons that led to the abandonment of the project was the difficulty to assess the risk run by the central authority and to provide appropriate insurance coverage of the liability possibly incurred by the central authority in case of malfunction of the system.

87. A project combining features of the Seadocs project, reliance on the CMI Rules and use of both UNCID and EDIFACT messages is under consideration by the Baltic and International Maritime Council (BIMCO). The main characteristic of the project is that the central register would be operated by BIMCO itself. As it currently stands, the project does not clearly state the rules that would govern the liability of BIMCO in case of a malfunction of the system. It may well be the case that, given the increasing confidence in the technical reliability of EDI, the probability of such a malfunction would be considered much smaller than it would have been only a few years ago. If this were the case, the above-mentioned risk might possibly be self-insured by BIMCO members participating in the system, at least up to a certain limit.

88. The Working Group may wish to consider the usefulness of elaborating statutory provisions that would enable parties to transfer, through an agreed upon electronic communication system, the title to goods while they are in the hands of a maritime carrier. Such an electronic transfer of title would present an alternative to transferring the title to goods by negotiating a traditional bill of lading. The Working Group may wish to bear in mind that the purpose of an electronic transfer of title may be to sell the goods or to establish a security interest in them. An example of an agreed upon electronic communication system designed for transferring the title to goods in transit is that envisaged in the CMI Rules for Electronic Bill of Lading, 1990.

89. Features of an electronic system designed to transfer the title to goods may be the following. Firstly, there would be an agreement between the consignor and the carrier that the carrier will, upon receipt of goods for carriage, establish an electronic record of the information that would normally be included in a bill of lading if one were issued. Secondly, the carrier would undertake to notify the person whom the consignor, i.e., the transferor of title, would identify as the transferee of title that the carrier holds the goods to the order of that transferee. Thirdly, the parties would agree that the carrier's notification concerning the transfer of title will be made only if the transferor and the transferee are in possession of the secret code that had been created by the carrier and given to the transferor of title. Fourthly, the parties would agree that upon effecting a transfer, the carrier will delete the secret code used to verify that transfer and will create another secret code; the new secret code would be given to the transferee, i.e., the current holder of title, in order to enable him to effect a further transfer of title. Fifthly, the carrier would undertake to deliver the goods at the place of destination only if the

<sup>29</sup>For other examples, see A. H. Ross (above, note 28).

<sup>30</sup>See J. Richardson, "Non-negotiable transport documentation", in *Trading with EDI—The legal issues*, H. B. Thomsen and B. S. Whible, eds. (London, IBC Financial Books, 1989), p. 179.

goods are claimed by a transferee that identifies itself by the secret code given to that transferee.

90. A question to be borne in mind in considering any statutory provisions may be the risks and liabilities placed upon the parties involved for any failure in completing the notifications that are necessary for the transfer of title.

#### IV. POSSIBLE INSTRUMENTS OF HARMONIZATION

##### A. Uniform customs and practice

91. A number of suggestions concerning the possible preparation of non-mandatory rules on EDI were made in the context of a recent meeting of the ICC Working Party on Legal and Commercial Aspects of EDI. One suggestion was that there might be a need for the preparation of uniform rules that might possibly take the form of a revision of the UNCID Rules, with the aim of creating an instrument that would eventually acquire a legal value similar to that of the Uniform Customs and Practice for Documentary Credits (UCP). Another suggestion was that the ICC should undertake the preparation of contractual standard terminology ("EDITERMS") drafted along the pattern previously adopted for the INCOTERMS.

92. However, the general feeling expressed at that meeting was that it would be premature to attempt codifying commercial practice regarding EDI, since EDI was still at an early stage of its development and that no commonly admitted practice could, as yet, be identified and recommended for general use.

##### B. Model communication agreement

93. It may be recalled that, under the approach taken in recent years by EDI users in most countries, solutions to the legal difficulties raised by the use of EDI have been sought within contracts. One reason for the development of the contractual approach originates with a conception according to which the use of EDI for commercial purposes is to be envisaged essentially, if not exclusively, in the context of closed networks, created between a limited number of individual users or by third-party service providers (see above, paragraphs 35 to 36). A wider conception of EDI takes into account the possible development of open networks that would allow EDI users to communicate without their having previously adhered to a user group (see above, paragraphs 31 to 32). However, that wider conception of EDI does not preclude the use of closed networks and may envisage the development of contractual solutions to the legal issues of EDI as a first step that can help to resolve many of the present practical difficulties and to better understand the questions that will require the preparation of future statutory law (see A/CN.9/350, para. 66).

94. A number of public and private bodies have developed models for such contracts and thus determined what was described as "the proliferation of model interchange agreements".<sup>31</sup> It may be foreseen that model communica-

tion agreements developed in the entire world are likely to provide, after some time, what has been referred to as "quasi-authoritative sanctioning of electronic trading and [serve] to reflect and unify, as well as suggest appropriate customs and practices".<sup>32</sup>

95. A suggestion contained in earlier documents prepared by the Secretariat (A/CN.9/333 and A/CN.9/350) was to consider the preparation of a model communication agreement for worldwide use. The main reason for preparing such a text was that the existing texts were often incomplete, incompatible and inappropriate for international use since they relied to a large extent upon the structures of local law (see above, paragraphs 3 to 4). As requested by the Commission, the Working Group is to report to the Commission at its next session on the desirability and feasibility of undertaking the preparation of a standard communication agreement (see above, paragraphs 8 to 9). When discussing the issue, the Working Group may take into consideration the fact that WP.4 has entrusted its legal rapporteurs with the task of developing an interchange agreement to be recommended at the international level for optional use. According to the programme of work of the legal rapporteurs, that project should be completed by 1995 (see A/CN.9/350, paras. 32-34).

96. In that connection, two different views were expressed at the twenty-fourth session of the Commission regarding possible options on future work. One view was that the Commission should only monitor the work carried out within the United Nations Economic Commission for Europe and make its decision on future work after reviewing the text that would result from the work of WP.4. It was indicated that such an approach would help to avoid duplication of work and possible waste of United Nations resources. Another view was that the Commission would be a particularly appropriate forum for the preparation of a model communication agreement for worldwide use since it involved participation of all legal systems, including those of developing countries that were already or would soon be confronted with the issues of EDI. It was also pointed out that the preparation of a model communication agreement might serve a useful educational function in that it would help the Commission to decide what issues required the preparation of statutory law.

##### C. Statutory provisions

97. While practical solutions to the legal difficulties raised by the use of EDI are often sought within contracts (see above, paragraphs 35 to 36), it may be recalled that the contractual approach to EDI was developed not only because of its intrinsic advantages such as its flexibility, but also for lack of specific provisions of statutory or case law. The contractual approach is limited in that it cannot overcome any of the legal obstacles to the use of EDI that might result from mandatory provisions of applicable statutory or case law. In that respect, it is submitted that one difficulty inherent to the use of communication agreements results from uncertainty as to the weight that would be carried by some contractual stipulations in case of litiga-

<sup>31</sup>See note 28.

<sup>32</sup>See M. S. Baum and H. H. Perritt Jr., *Electronic contracting, publishing, and EDI law* (New York, Wiley, 1991), p. 104.

tion. Another limitation to the contractual approach results from the fact that parties to a contract cannot effectively regulate the rights and obligations of third parties. At least for those parties absent from the contractual arrangement, statutory law based on a model law or an international convention seems to be needed (see A/CN.9/350, para. 107).

98. The Working Group may wish to consider the desirability and feasibility of preparing a uniform law with the aim of eliminating the legal obstacles and uncertainties discussed above where effective removal of such obstacles and uncertainties can only be achieved by statutory provisions. One purpose of the uniform law would be to enable potential EDI users to establish a secure EDI relationship by way of a communication agreement within a closed network. The second purpose of the uniform law would be to set forth a basic framework for the development of EDI outside such a closed network in an open environment, including a regulation of some of the issues concerning the situation of third parties. The uniform law might contain provisions on all or some of the following issues:

Definitions of such terms as: EDI; EDI message; acknowledgement of receipt; sender; receiver; receiving computer; reception date; third-party service provider; authentication; computer record;

"Writing" (see above, paragraphs 37 to 45);

"Original" (see above, paragraphs 56 to 58);

Admissibility of computer outputs as evidence (see above, paragraphs 46-55);

Signature and other authentication (see above, paragraphs 61 to 66);

Consent, offer, acceptance and revocability in an EDI context (see above, paragraphs 70 to 73);

Time and place of formation of contracts (see above, paragraphs 74 to 76);

Reference to general conditions (see above, paragraphs 77 to 78);

Minimum standard of care to be applied by parties communicating through EDI (see above, paragraphs 23 to 24);

Use of functional acknowledgements and confirmation of contents of EDI messages (see above, paragraphs 80 to 81);

Time within which a receiver should process the data (see above, paragraphs 23 to 24);

Liability for failure or error in communication (see above, paragraphs 82 to 83);

Implications of rules of a professional nature, such as the SWIFT Rules (see above, paragraphs 23 to 24);

Documents of title and security interests (see above, paragraphs 84 to 90);

Applicable law and dispute resolution (see above, paragraphs 23 to 24).

## ANNEX

### Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission

[Text of ICC Publication No. 452, pp. 6-11 and 16-19]

#### *Participants in the work of the Joint Committee*

Intergovernmental and non-governmental international and national organizations having contributed to the preparation of the UNCITD Rules of Conduct:

United Nations Commission on International Trade Law (UNCITRAL)

Special Programme on Trade Facilitation of the United Nations Conference on Trade and Development (UNCTAD/FALPRO)

Working Party on Facilitation of International Trade Procedures on the United Nations Economic Commission for Europe (UN/ECE)

Customs Co-operation Council (CCC)

Organisation for Economic Co-operation and Development (OECD)

Commission of the European Communities (EC)

International Organization for Standardisation (ISO)

European Insurance Committee (CEA)

European Council of Chemical Industries Federations (CEFIC)

Organization for Data Exchange via Teletransmission in Europe (ODETTE)

as well as a regional and several national trade facilitation organizations (NORDIPRO—the originators of the concept—, FINPRO, NCITD, SIMPROFRANCE, SITPRO).

#### *Introductory note*

##### *I. The international trade transaction*

The UNCITD rules are meant to provide a background for users of EDIFACT (Electronic Data Interchange for Administration, Commerce and Transport) and other systems of Electronic Trade Data Interchange, hereafter for short EDI.

Users will have detailed knowledge of the cumbersome procedures involved in an international trade transaction, and the decisive advantages of electronic interchange. For illustration please see annex 1 which shows data flows and message functions. [Annex 1 is not reproduced in this note.]

##### *II. The computer age—towards paperless trading*

It is widely expected that the impact of computerization will be as great as that of the industrial revolution. Computers are already providing all sorts of services at rising speed and diminishing costs. International trade data communication, however, seems to be a missing link. Yet the need is great. Not only do paper documentation and procedures represent as much as 10 per cent of goods value; they are slow, insecure, complicated and growing. The possibilities of cost reduction are in the order of 50 per cent, to the benefit of not only the main parties, but everyone involved, not least the authorities.

This is why a major activity of the Trade Facilitation Working Party of the United Nations Economic Commission for Europe (ECE), over the last decade and a half, has been the creation of the tools that would make electronic interchange of data in international trade a secure, effective and cheap alternative.

EDI is the direct transfer of structured business data between computers by electronic means, i.e. the paperless transfer of business "documentation". (An illustration of this development is given in annex 2.) [Annex 2 is not reproduced in this note.]

The past years have seen an explosion of interest in EDI between national and international trade participants. The technology is available and the momentum is growing. It is estimated that within five years EDI will be commonplace between majors in international trade transactions. But EDI cannot operate to any great extent without a common international standard, and progress has been made in drawing together different standards. Three building blocks are required: common data elements equivalent to the vocabulary; a syntax, which equates to the grammar in a normal language; and standard messages which combine data elements and syntax into a structured business message similar in concept to the paper document. These instruments are being created in the work coordinated by the ECE.

Alongside these technical developments thought and attention has also been given to what may be described as the "legal" aspects of EDI.

### III. The legal background

Because of its physical characteristics, the traditional paper document is accepted as evidence. It is durable, and changes or additions will normally be clearly visible. The electronic document is quite different. It takes the form of a magnetic medium whose data content can be changed at any time. Changes or additions will not appear as such.

The paper and the data communication links are only media for carrying information, however, and it is possible to establish techniques which give electronic data interchange characteristics that make it equal or superior to paper not only as carrier of information, but also as regards the evidential functions.

Firstly EDI in itself presupposes procedures that make this form of communication more secure. In addition to identification this technique can also provide for error detection and correction. Authentication in the sense that the data content is correct can also be established, and privacy can be secured by several means built into the system. Finally, authentication, in the sense that the correct authorized person has issued the message, can also be secured.

That is why ECE, the United Nations Commission on International Trade Law (UNCITRAL) and the Customs Co-operation Council (CCC) have recommended to Governments and organizations responsible for determining documentary requirements, that they undertake and update and overhaul of these requirements to allow for EDI. This will, however, take time. It is also dependent upon a general acceptance of a high level of security in data interchange.

That is why it has been felt desirable to develop a set of internationally accepted rules—UNCID. The first draft was based on the idea of creating a standard for communication agreements. It was found, however, that due to the differing requirements of various user groups this was impracticable. There was on the other hand general agreement on proposals for uniform rules as a code of conduct.

### IV. UNCID

The International Chamber of Commerce (ICC) agreed to establish a Joint Special Committee with participation from other interested organizations and user groups to evaluate and formulate such a set of rules. UNCITRAL, ECE, CCC, the UNCTAD Special Programme on Trade Facilitation (FALPRO), the Organisa-

tion for Economic Co-operation and Development (OECD), the International Organization for Standardisation (ISO), the Commission of the European Communities, the European Insurance Committee and the Organization for Data Exchange via Teletransmission in Europe (ODETTE) were all represented in this Committee in addition to various Commissions of ICC.

In developing the rules the committee based its work on certain vital concepts, *inter alia*, that the rules should:

- (a) aim at facilitating the use of EDI through the establishment of an agreed code of conduct between parties engaged in such electronic interchange;
- (b) apply only to the interchange of data and not to the substance of trade data messages transmitted;
- (c) incorporate the use of ISO and other internationally accepted standards—to avoid confusion;
- (d) deal with questions of security, verification and confirmation, authentication of the communicating parties, logging and storage of data;
- (e) establish a focal point for interpretation that might enhance a harmonized international understanding and therefore use of the code.

Acknowledgement and confirmation illustrate some of the problems found in developing useful rules. In some systems acknowledgement is a mandatory requirement. In others it is taken as good conduct. In others again the sender has to ask for it. UNCID opts for this last solution. In certain cases the sender will also want to know that the content of the transfer has been received in apparent good order and has been understood. The sender may then ask for confirmation. This of course touches on the material content—but only marginally. It should not be confused with the concept of legal acceptance—that is another (third) layer which is wholly outside the UNCID rules.

It was also foreseen that the rules could form part of, or be referred to, in any Trade Data Interchange Application Protocol (TDI-AP) or other specific communication agreement.

### V. Need for specific communication agreements

User groups may be organized in several ways. But they all need some form of communication agreement, although requirements differ according to the groups in question and to what has been included in their "users manual" or "application level protocol", which is an agreement, but of a more technical nature.

Apparently there is a strong need for communication agreements where EDI is used by defined organizations. It is suggested that this need may be even more important in direct open communication.

Several user groups have stressed that the UNCID rules make a useful basis for their communication agreements. UNCID, agreed rules of conduct, give more than a mere starting point. Defining an accepted level of professional behaviour they also secure a common approach.

The details and form of communication agreements differ according to the size and type of the user groups. The agreement may be included in a protocol or form a separate document. It may contain additional rules, e.g. bearing on the substantive elements of the data exchanged, on the underlying agreement and on the professional approach. It is therefore not practical to formulate a standard model.

It may be useful, however, to outline certain elements that should be considered in addition to UNCID, when formulating an agreement:

(1) There is always a risk that something may go wrong—who should carry that risk? Should each party carry its own or would it seem possible to link risk to insurance or to the network operator?

(2) If damage is caused by a party failing to observe the rules, what should be the consequences? This is partly a question of

limitation of liability. It also has a bearing on the situation of third parties.

(3) Should the rules on risk and liability be covered by rules on insurance?

(4) Should there be rules on timing, e.g. the time within which the receivers should process the data etc.?

(5) Should there be rules on secrecy or other rules regarding the substance of the data exchanged?

(6) Should there be rules of a professional nature—such as the banking rules contained in SWIFT?

(7) Should there be rules on encryption or other security measures?

(8) Should there be rules on "signature"?

It would also seem important to have rules on applicable law and dispute resolution.

### Uniform Rules of Conduct (UNCID)

As adopted by the ICC Executive Board at its fifty-first session  
(Paris, 22 September 1987)

#### Article 1—Objective

These rules aim at facilitating the interchange of trade data effected by teletransmission, through the establishment of agreed rules of conduct between parties engaged in such transmission. Except as otherwise provided in these rules, they do not apply to the substance of trade data transfers.

#### Article 2—Definitions

For the purposes of these rules the following expressions used therein shall have the meaning set out below:

(a) Trade transaction: A specific contract for the purchase and sale or supply of goods and/or services and/or other performances between the parties concerned, identified as the transaction to which a trade data message refers;

(b) Trade data message: Trade data exchanged between parties concerned with the conclusion or performance of a trade transaction;

(c) Trade data transfer (hereinafter referred to as "transfer"): One or more trade data messages sent together as one unit of dispatch which includes heading and terminating data;

(d) Trade data interchange application protocol (TDI-AP): An accepted method for interchange of trade data messages, based on international standards for the presentation and structuring of trade data transfers conveyed by teletransmission;

(e) Trade data log: A collection of trade data transfers that provides a complete historical record of trade data interchanged.

#### Article 3—Application

These rules are intended to apply to trade data interchange between parties using a TDI-AP. They may also, as appropriate, be applied when other methods of trade data interchange by teletransmission are used.

#### Article 4—Interchange standards

The trade data elements, message structure and similar rules and communication standards used in the interchange should be those specified in the TDI-AP concerned.

#### Article 5—Care

(a) Parties applying a TDI-AP should ensure that their transfers are correct and complete in form, and secure, according to the TDI-AP concerned, and should take care to ensure their capability to receive such transfers.

(b) Intermediaries in transfers should be instructed to ensure that there is no unauthorized change in transfers required to be retransmitted and that the data content of such transfers is not disclosed to any unauthorized person.

#### Article 6—Messages and transfers

(a) A trade data message may relate to one or more trade transactions and should contain the appropriate identifier for each transaction and means of verifying that the message is complete and correct according to the TDI-AP concerned.

(b) A transfer should identify the sender and the recipient; it should include means of verifying, either through the technique used in the transfer itself or by some other manner provided by the TDI-AP concerned, the formal completeness and authenticity of the transfer.

#### Article 7—Acknowledgement of a transfer

(a) The sender of a transfer may stipulate that the recipient should acknowledge receipt thereof. Acknowledgement may be made through the teletransmission technique used or by other means provided through the TDI-AP concerned. A recipient is not authorized to act on such transfer until he has complied with the request of the sender.

(b) If the sender has not received the stipulated acknowledgement within a reasonable or stipulated time, he should take action to obtain it. If, despite such action, an acknowledgement is not received within a further period of reasonable time, the sender should advise the recipient accordingly by using the same means as in the first transfer or other means if necessary and, if he does so, he is authorized to assume that the original transfer has not been received.

(c) If a transfer received appears not to be in good order, correct and complete in form, the recipient should inform the sender thereof as soon as possible.

(d) If the recipient of a transfer understands that it is not intended for him, he should take reasonable action as soon as possible to inform the sender and should delete the information contained in such transfer from his system, apart from the trade data log.

#### Article 8—Confirmation of content

(a) The sender of a transfer may request the recipient to advise him whether the content of one or more identified messages in the transfer appears to be correct in substance, without prejudice to any subsequent consideration or action that the content may warrant. A recipient is not authorized to act on such transfer until he has complied with the request of the sender.

(b) If the sender has not received the requested advice within a reasonable time, he should take action to obtain it. If, despite such action, an advice is not received within a further period of reasonable time, the sender should advise the recipient accordingly and, if he does so, he is authorized to assume that the transfer has not been accepted as correct in substance.

*Article 9—Protection of trade data*

(a) The parties may agree to apply special protection, where permissible, by encryption or by other means, to some or all data exchanged between them.

(b) The recipient of a transfer so protected should assure that at least the same level of protection is applied for any further transfer.

*Article 10—Storage of data*

(a) Each party should ensure that a complete trade data log is maintained of all transfers as they were sent and received, without any modification.

(b) Such trade data log may be maintained on computer media provided that, if so required, the data can be retrieved and presented in readable form.

(c) The trade data log referred to in paragraph (a) of this article should be stored unchanged either for the period of time

required by national law in the country of the party maintaining such trade data log or for such longer period as may be agreed between the parties or, in the absence of any requirement of national law or agreement between the parties, for three years.

(d) Each party shall be responsible for making such arrangements as may be necessary for the data referred to in paragraph (b) of this article to be prepared as a correct record of the transfers as sent and received by that party in accordance with paragraph (a) of this article.

(e) Each party must see to it that the person responsible for the data processing system of the party concerned, or such third party as may be agreed by the parties or required by law, shall, where so required, certify that the trade data log and any reproduction made from it is correct.

*Article 11—Interpretation*

Queries regarding the correct meaning of the rules should be referred to the International Chamber of Commerce, Paris.

## VI. COORDINATION OF WORK

### A. Assistance by multilateral organizations and bilateral aid agencies in the modernization of commercial laws in developing countries:

note by the Secretariat

(A/CN.9/364) [Original: English]

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#### INTRODUCTION

1. The General Assembly, in resolution 34/142 of 17 December 1979, requested the Secretary-General to place before the United Nations Commission on International Trade Law, at each of its sessions, a report on the legal activities of international organizations in the field of international trade law, together with recommendations as to the steps to be taken by the Commission to fulfil its mandate of coordinating the activities of other organizations in the field.

2. In response to that resolution, detailed reports on the current activities of other organizations related to the harmonization and unification of international trade law have been issued at regular intervals, the last one having been submitted at the twenty-third session in 1990 (A/CN.9/336). At the twenty-fourth session it was reported that the Secretariat was engaged in an exercise designed to determine the extent to which multilateral organizations and bilateral aid agencies were involved in activities whose objective was that of modernizing commercial law in developing countries (A/CN.9/352).

3. The development of international trade law is usually thought of in terms of the preparation of legal texts governing some aspects of the law of international trade by international organizations such as those whose activities have been the subject of prior reports. However, the international community may also affect the development of international trade law when it contributes to the development of domestic commercial law by, for instance, providing

financial and technical assistance for the enactment of legislation to govern certain areas of commercial law. It was the understanding of the Secretariat that various multilateral organizations and bilateral aid agencies had from time to time assisted developing countries to prepare legislation in various aspects of commercial law including such matters as maritime law, commercial arbitration, and intellectual property. It was further the understanding of the Secretariat that projects of that nature had been undertaken at the request of both individual Governments and groups of Governments. It was thought that it would be of great value to all concerned to have a global picture of those activities. In particular, information was desired on the extent to which texts of uniform law prepared at the international level formed the basis for the legal texts prepared under the auspices of multilateral organizations and bilateral aid agencies.

4. Prior to and in preparation for the report on current activities of international organizations related to the harmonization and unification of international trade law to the twenty-fourth session of the Commission (1991) (A/CN.9/352), the Secretariat requested information from selected multilateral organizations and bilateral aid agencies on projects that they might have financed in the last five years or for which they might have given technical assistance for the modernization of the law governing an aspect of economic activity.

5. The details requested of each project included: (1) the identity of the country in which the project was undertaken or, if undertaken for a region or regional organization,

the region, organization and countries directly affected; (2) date when the project was commenced and, if completed, date of completion; (3) subject area covered by the project and type of legal text elaborated; (4) nature and extent of expertise furnished in the execution of the project; (5) whether a uniform or model legal text adopted at the international level on part or all of the subject-matter of the project was (i) incorporated in whole into the project text, or (ii) used as the basis for the project text, or (iii) not used at all in the project text; and (6) whether the law of a particular State, other than the State where the project was undertaken, was incorporated in whole or in part into the project text, or used as the basis for the project text, and the nature of the changes made if any. The organizations were further requested to supply the Secretariat with the legal text where one had been enacted.

6. It was reported to the twenty-fourth session of the Commission that, while a number of multilateral organizations and bilateral aid agencies that had been solicited for information replied to the Secretariat, the information received was inconclusive on the extent to which multilateral organizations and bilateral aid agencies were involved in activities whose objective was that of modernizing commercial law in developing countries (A/CN.9/352, para. 5). After the twenty-fourth session the Secretariat tried again to collect the same kind of information. However, this time the Secretariat wrote to all Resident Representatives of the United Nations Development Programme (UNDP) asking them whether they had information about any projects for revision of laws governing economic activities, including trade and investment, undertaken in recent years with the financial or technical assistance of outside agencies, in their respective countries.

# 1. AREAS IN WHICH ASSISTANCE HAS BEEN GIVEN BY MULTILATERAL ORGANIZATIONS AND BILATERAL AID AGENCIES

7. A review of the information contained in the replies reveals that some multilateral organizations and bilateral aid agencies are involved in rendering assistance in activities whose objective is that of modernizing commercial law in developing countries. The assistance rendered typically takes the form of the provision of experts, as well as funding to be used in the execution of projects. These activities concentrate on the modernization and development of legislation in the following four areas:

1. investment laws
2. intellectual property law
3. maritime legislation
4. laws and regulations in other areas

## 1. Investment laws

8. Work in relation to investment laws is being carried out by the United Nations Centre for Transnational Corporations (CTC), the International Bank for Reconstruction and Development (World Bank) and to a lesser extent the United Nations Industrial Development Organization

(UNIDO) and UNDP. The thrust of the work typically encompasses the development of investment codes that are designed to create a legal framework favourable to domestic and foreign investment. The investment codes deal with such matters as: the provision of the mechanisms for the establishment of investment centres to be charged with the implementation of investment laws, in particular with the responsibility for the promotion, coordination, regulation and monitoring of local and foreign investments in a given country; the investment procedures to be followed by investors in establishing their enterprises in the country; and the provision of incentives and guarantees to be provided to investors in order to encourage them to invest.

## 2. Intellectual property law

9. Work in the area of intellectual property law reported to the Secretariat covers patents, industrial designs, copyright and trade marks. Work in this area is carried out primarily by the World Intellectual Property Organization (WIPO), with some work also being done by the United Nations Educational and Scientific Organization (UNESCO). WIPO cooperates, on request, with individual Governments, or groups of Governments, of developing countries in their efforts to adopt new national laws and regulations or new regional treaties or to improve their existing laws and regulations in the field of intellectual property. The cooperation takes various forms, in particular, the preparation of model provisions, model laws, principles and guidelines which are designed to serve as the basis for the enactment of national legislation or regional treaties.

10. Other projects of WIPO concern the creation of general awareness of the usefulness and importance of intellectual property in the process of development, the promotion of acquisition of technology in developing countries, and the facilitation of the securing by developing countries of legal protection in other countries for their own inventions and other creative works. Still other projects of WIPO involve giving advice in consultations between members of staff of the International Bureau of WIPO or consultants engaged by the International Bureau, on the one hand, and officials of the Governments concerned, on the other hand. The International Bureau of WIPO also assists, on request, Governments of developing countries in designing and implementing medium-term plans and projects on the development of intellectual property law in order to build up, strengthen and improve the effectiveness of intellectual property laws of those countries in the protection of intellectual property rights.

## 3. Maritime legislation

11. Work on maritime legislation is being carried out by the United Nations Conference on Trade and Development (UNCTAD) and often with financial assistance from UNDP to the countries in which the projects are being carried out. The work involves the development of modern maritime codes for the countries involved. In one such project a country was assisted in drafting a merchant shipping act and in another in drafting regulations pertaining to certification of seafarers and other inland waters naviga-

tion. In the three countries reported to the Secretariat as places where such work is being carried out the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) was used as a model on the basis of which the new legislation was drafted. The Secretariat is, however, aware of other cases not reported to it, where similar work is being carried out and the International Convention for the Unification of Certain Rules relating to Bills of Lading (The Hague Rules, 1924) is being used.

#### 4. *Laws and regulations in other areas*

12. Work being carried out in other areas includes the elaboration of legislation in fields such as taxation, insurance, customs, procurement and export and import trade. This work is usually carried out in the context of the general modernization of the commercial sector of a given country with a view to facilitating economic growth and supporting an increased level of private transactions and investments. A project in one country for instance involved the elaboration of a procurement law to govern public sector procurement. In another country a project involved the development of general and special contract conditions to be included in industrial subcontracting agreements, and in yet another country a project involved the modernization and streamlining of the law governing the issuing of trading licences to those wishing to set up business enterprises. In an additional country, a project involved the modernization of a country's insurance law. In the projects reported to the Secretariat the work is being undertaken mostly with the assistance of UNDP, the World Bank and the United States International Development Cooperation Agency (USAID).

## II. RECOMMENDATIONS

13. The activities of multilateral organizations and bilateral aid agencies can play a significant role in the development of international trade law. Moreover, their activities in assisting developing countries to prepare legislation in various areas of commercial law have implications for the harmonization of international trade law. In view of this the Commission may wish to request the Secretariat to continue to monitor the work of these organizations in their work of assisting developing countries in preparing legislation in various aspects of commercial law and to report developments in this area to the Commission at a later date.

14. Furthermore, in view of the importance of the adequacy of the legal framework to the economic development of developing countries and of countries that are moving from a centrally planned to a market economy, the Commission may wish to consider recommending to those multilateral organizations and bilateral aid agencies that are thus far not involved in work concerning the modernization of commercial law that they consider taking a more active part in such activities and to consider including such activities in the terms of reference of their work.

15. The Commission may in addition wish to urge that there should be greater cooperation and consultation between UNCITRAL and the multilateral organizations and bilateral aid agencies when those organizations carry out projects designed to modernize commercial law in developing countries. Such cooperation could include the exchange of information on possible model texts to be used as a basis for the drafting of legislation in such projects and consultation on the appointment of experts to be recruited to work on such projects.

### B. International Chamber of Commerce (ICC) INCOTERMS (A/CN.9/348) [Original: English]

Document A/CN.9/348, which was submitted to the Commission at its twenty-fourth session but not considered for lack of time (see A/46/17, para. 352, *Yearbook* 1991, p. 45), was reproduced in *Yearbook* 1991, pp. 399-434. It was considered by the Commission at its twenty-fifth session (see A/47/17, paras. 159-161, p. 20 above).

## VII. STATUS OF UNCITRAL TEXTS

### Status of conventions: note by the Secretariat

(A/CN.9/368) [Original: English]

1. At its thirteenth session the Commission decided that it would consider, at each of its sessions, the status of conventions that were the outcome of work carried out by it.<sup>a</sup>

2. The present note is submitted pursuant to that decision. The annex hereto sets forth the state of signatures, ratifications, accessions and approvals as of 23 April 1992 to the following conventions: Convention on the Limitation Period in the International Sale of Goods (New York, 1974); Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980); United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg); United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988); United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980); United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991); and Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). The latter Convention, which has not emanated from the work of the Commission, has been included because of the close interest of the Commission in it, particularly in connection with the Commission's work in the field

of international commercial arbitration. In addition, the annex sets forth those jurisdictions that have enacted legislation based on the UNCITRAL Model Law on International Commercial Arbitration.

3. Since the most recent report in this series showing the status of conventions as of 5 June 1991 (A/CN.9/353), the Convention on the Limitation Period in the International Sale of Goods received two additional accessions (Romania and Uganda), the Protocol amending that Convention received two additional accessions (Romania and Uganda), the United Nations Convention on the Carriage of Goods by Sea, 1978 ("Hamburg Rules") has received one additional accession (Zambia) which will bring the Convention into force on 1 November 1992; the United Nations Convention on Contracts for the International Sale of Goods has received two additional accessions (Ecuador and Uganda), the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade was signed by another State (France), and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards has received two additional accessions (Latvia and Uganda). Legislation based on the UNCITRAL Model Law on International Commercial Arbitration has been enacted, within the United States of America, in addition in Oregon.

4. The names of the States that have ratified or acceded to the conventions since the preparation of the last report are in *italics*.

<sup>a</sup>Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 163.

#### 1. Convention on the Limitation Period in the International Sale of Goods (New York, 1974)

| <i>State</i>        | <i>Signature</i> | <i>Ratification<br/>Accession<br/>Approval</i> | <i>Entry into force</i> |
|---------------------|------------------|--|-------------------------|
| Argentina           |                  | 9 October 1981                                 | 1 August 1988           |
| Brazil              | 14 June 1974     |  |                         |
| Bulgaria            | 24 February 1975 |  |                         |
| Belarus             | 14 June 1974     |  |                         |
| Costa Rica          | 30 August 1974   |  |                         |
| Czechoslovakia      | 29 August 1975   | 26 May 1977                                    | 1 August 1988           |
| Dominican Republic  |                  | 23 December 1977                               | 1 August 1988           |
| Egypt               |                  | 6 December 1982                                | 1 August 1988           |
| Germany*            |                  |  |                         |
| Ghana               | 5 December 1974  | 7 October 1975                                 | 1 August 1988           |
| Guinea              |                  | 23 January 1991                                | 1 August 1991           |
| Hungary             | 14 June 1974     | 16 June 1983                                   | 1 August 1988           |
| Mexico              |                  | 21 January 1988                                | 1 August 1988           |
| Mongolia            | 14 June 1974     |  |                         |
| Nicaragua           | 13 May 1975      |  |                         |
| Norway <sup>1</sup> | 11 December 1975 | 20 March 1980                                  | 1 August 1988           |

| <i>State</i>         | <i>Signature</i> | <i>Ratification<br/>Accession<br/>Approval</i> | <i>Entry into force</i> |
|----------------------|------------------|--|-------------------------|
| Poland               | 14 June 1974     |  |                         |
| Romania              |                  | 23 April 1992                                  | 1 November 1992         |
| Russian Federation** | 14 June 1974     |  |                         |
| Uganda               |                  | 12 February 1992                               | 1 September 1992        |
| Ukraine              | 14 June 1974     |  |                         |
| Yugoslavia           |                  | 27 November 1978                               | 1 August 1988           |
| Zambia               |                  | 6 June 1986                                    | 1 August 1988           |

Signatures only: 9; ratifications and accessions: 13\*

\*The Convention was signed by the former German Democratic Republic on 14 June 1974, ratified by it on 31 August 1989 and entered into force on 1 March 1990.

\*\*The Russian Federation continues, as from 24 December 1991, the membership of the former Union of Soviet Socialist Republics (USSR) in the United Nations and maintains, as from that date, full responsibility for all the rights and obligations of the USSR under the Charter of the United Nations and multilateral treaties deposited with the Secretary-General.

#### *Declarations and reservations*

<sup>1</sup>Upon signature Norway declared, and confirmed upon ratification, that in accordance with article 34 the Convention would not govern contracts of sale where the seller and the buyer both had their relevant places of business within the territories of the Nordic States (i.e. Norway, Denmark, Finland, Iceland and Sweden).

### **2. Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980)**

| <i>State</i>                | <i>Accession</i> | <i>Entry into force</i> |
|-----------------------------|------------------|-------------------------|
| Argentina                   | 19 July 1983     | 1 August 1988           |
| Czechoslovakia <sup>1</sup> | 5 March 1990     | 1 October 1990          |
| Egypt                       | 6 December 1982  | 1 August 1988           |
| Germany*                    |                  |                         |
| Guinea                      | 23 January 1991  | 1 August 1991           |
| Hungary                     | 16 June 1983     | 1 August 1988           |
| Mexico                      | 21 January 1988  | 1 August 1988           |
| Romania                     | 23 April 1992    | 1 November 1992         |
| Uganda                      | 12 February 1992 | 1 September 1992        |
| Zambia                      | 6 June 1986      | 1 August 1988           |

In accordance with articles XI and XIV of the Protocol, the Contracting States to the Protocol are considered to be Contracting Parties to the Convention on the Limitation Period in the International Sale of Goods as amended by the Protocol in relation to one another and Contracting Parties to the Convention, unamended, in relation to any Contracting Party to the Convention not yet a Contracting Party to this Protocol.

\*The Protocol was acceded to by the former German Democratic Republic on 31 August 1989 and entered into force on 1 March 1990.

#### *Declarations and reservations*

<sup>1</sup>Upon accession, Czechoslovakia declared that, pursuant to article XII, it did not consider itself bound by article I.

### **3. United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)**

| <i>State</i> | <i>Signature</i> | <i>Ratification<br/>Accession</i> | <i>Entry into force</i> |
|--------------|------------------|-----------------------------------|-------------------------|
| Austria      | 30 April 1979    |                                   |                         |
| Barbados     |                  | 2 February 1981                   | 1 November 1992         |
| Botswana     |                  | 16 February 1988                  | 1 November 1992         |

| <i>State</i>                | <i>Signature</i> | <i>Ratification<br/>Accession</i> | <i>Entry into force</i> |
|-----------------------------|------------------|-----------------------------------|-------------------------|
| Brazil                      | 31 March 1978    |                                   |                         |
| Burkina Faso                |                  | 14 August 1989                    | 1 November 1992         |
| Chile                       | 31 March 1978    | 9 July 1982                       | 1 November 1992         |
| Czechoslovakia <sup>1</sup> | 6 March 1979     |                                   |                         |
| Denmark                     | 18 April 1979    |                                   |                         |
| Ecuador                     | 31 March 1978    |                                   |                         |
| Egypt                       | 31 March 1978    | 23 April 1979                     | 1 November 1992         |
| Finland                     | 18 April 1979    |                                   |                         |
| France                      | 18 April 1979    |                                   |                         |
| Germany                     | 31 March 1978    |                                   |                         |
| Ghana                       | 31 March 1978    |                                   |                         |
| Guinea                      |                  | 23 January 1991                   | 1 November 1992         |
| Holy See                    | 31 March 1978    |                                   |                         |
| Hungary                     | 23 April 1979    | 5 July 1984                       | 1 November 1992         |
| Kenya                       |                  | 31 July 1989                      | 1 November 1992         |
| Lebanon                     |                  | 4 April 1983                      | 1 November 1992         |
| Lesotho                     |                  | 26 October 1989                   | 1 November 1992         |
| Madagascar                  | 31 March 1978    |                                   |                         |
| Malawi                      |                  | 18 March 1991                     | 1 November 1992         |
| Mexico                      | 31 March 1978    |                                   |                         |
| Morocco                     |                  | 12 June 1981                      | 1 November 1992         |
| Nigeria                     |                  | 7 November 1988                   | 1 November 1992         |
| Norway                      | 18 April 1979    |                                   |                         |
| Pakistan                    | 8 March 1979     |                                   |                         |
| Panama                      | 31 March 1978    |                                   |                         |
| Philippines                 | 14 June 1978     |                                   |                         |
| Portugal                    | 31 March 1978    |                                   |                         |
| Romania                     |                  | 7 January 1982                    | 1 November 1992         |
| Senegal                     | 31 March 1978    | 17 March 1986                     | 1 November 1992         |
| Sierra Leone                | 15 August 1978   | 7 October 1988                    | 1 November 1992         |
| Singapore                   | 31 March 1978    |                                   |                         |
| Sweden                      | 18 April 1979    |                                   |                         |
| Tunisia                     |                  | 15 September 1980                 | 1 November 1992         |
| Uganda                      |                  | 6 July 1979                       | 1 November 1992         |
| United Rep. of Tanzania     |                  | 24 July 1979                      | 1 November 1992         |
| United States of America    | 30 April 1979    |                                   |                         |
| Venezuela                   | 31 March 1978    |                                   |                         |
| Zaire                       | 19 April 1979    |                                   |                         |
| Zambia                      |                  | 7 October 1991                    | 1 November 1992         |

Signatures only: 22; ratifications and accessions: 20

#### *Declarations and reservations*

<sup>1</sup>Upon signing the Convention Czechoslovakia declared in accordance with article 26 a formula for converting the amounts of liability referred to in paragraph 2 of that article into the Czechoslovak currency and the amount of the limits of liability to be applied in the territory of Czechoslovakia as expressed in the Czechoslovak currency.

#### **4. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)**

| <i>State</i>                | <i>Signature</i>  | <i>Ratification<br/>Accession<br/>Approval<br/>Acceptance</i> | <i>Entry into force</i> |
|-----------------------------|-------------------|---|-------------------------|
| Argentina <sup>1</sup>      |                   | 19 July 1983  | 1 January 1988          |
| Australia                   |                   | 17 March 1988   | 1 April 1989            |
| Austria                     | 11 April 1980     | 29 December 1987  | 1 January 1989          |
| Bulgaria                    |                   | 9 July 1990   | 1 August 1991           |
| Belarus <sup>1</sup>        |                   | 9 October 1989  | 1 November 1990         |
| Canada <sup>2, 3</sup>      |                   | 23 April 1991   | 1 May 1992              |
| Chile <sup>1</sup>          | 11 April 1980     | 7 February 1990   | 1 March 1991            |
| China <sup>2</sup>          | 30 September 1981 | 11 December 1986  | 1 January 1988          |
| Czechoslovakia <sup>1</sup> | 1 September 1981  | 5 March 1990  | 1 April 1991            |

| <i>State</i>                          | <i>Signature</i>  | <i>Ratification<br/>Accession<br/>Approval<br/>Acceptance</i> | <i>Entry into force</i> |
|---------------------------------------|-------------------|---|-------------------------|
| Denmark <sup>4, 5</sup>               | 26 May 1981       | 14 February 1989  | 1 March 1990            |
| Ecuador                               |                   | 27 January 1992   | 1 February 1993         |
| Egypt                                 |                   | 6 December 1982   | 1 January 1988          |
| Finland <sup>4, 5</sup>               | 26 May 1981       | 15 December 1987  | 1 January 1989          |
| France                                | 27 August 1981    | 6 August 1982   | 1 January 1988          |
| Germany <sup>*, 7</sup>               | 26 May 1981       | 21 December 1989  | 1 January 1991          |
| Ghana                                 | 11 April 1980     |   |                         |
| Guinea                                |                   | 23 January 1991   | 1 February 1992         |
| Hungary <sup>1, 6</sup>               | 11 April 1980     | 16 June 1983  | 1 January 1988          |
| Iraq                                  |                   | 5 March 1990  | 1 April 1991            |
| Italy                                 | 30 September 1981 | 11 December 1986  | 1 January 1988          |
| Lesotho                               | 18 June 1981      | 18 June 1981  | 1 January 1988          |
| Mexico                                |                   | 29 December 1987  | 1 January 1989          |
| Netherlands                           | 29 May 1981       | 13 December 1990  | 1 January 1992          |
| Norway <sup>4, 5</sup>                | 26 May 1981       | 20 July 1988  | 1 August 1989           |
| Poland                                | 28 September 1981 |   |                         |
| Romania                               |                   | 22 May 1991   | 1 June 1992             |
| Russian Federation <sup>**, 1</sup>   |                   | 16 August 1990  | 1 September 1991        |
| Singapore                             | 11 April 1980     |   |                         |
| Spain                                 |                   | 24 July 1990  | 1 August 1991           |
| Sweden <sup>4, 5</sup>                | 26 May 1981       | 15 December 1987  | 1 January 1989          |
| Switzerland                           |                   | 21 February 1990  | 1 March 1991            |
| Syrian Arab Republic                  |                   | 19 October 1982   | 1 January 1988          |
| Uganda                                |                   | 12 February 1992  | 1 March 1993            |
| United States of America <sup>3</sup> | 31 August 1981    | 11 December 1986  | 1 January 1988          |
| Venezuela                             | 28 September 1981 |   |                         |
| Ukraine <sup>1</sup>                  |                   | 3 January 1990  | 1 February 1991         |
| Yugoslavia                            | 11 April 1980     | 27 March 1985   | 1 January 1988          |
| Zambia                                |                   | 6 June 1986   | 1 January 1988          |

Signatures only: 4; ratifications, accessions, approvals and acceptances: 34

\*The Convention was signed by the former German Democratic Republic on 13 August 1981, ratified on 23 February 1989 and entered into force on 1 March 1990.

\*\*The Russian Federation continues, as from 24 December 1991, the membership of the former Union of Soviet Socialist Republics (USSR) in the United Nations and maintains, as from that date, full responsibility for all the rights and obligations of the USSR under the Charter of the United Nations and multilateral treaties deposited with the Secretary-General.

#### *Declarations and reservations*

<sup>1</sup>Upon ratifying the Convention the Governments of Argentina, Belarus, Chile, Hungary, Russian Federation and Ukraine stated, in accordance with articles 12 and 96 of the Convention, that any provision of article 11, article 29 or part two of the Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing, would not apply where any party had its place of business in their respective States.

<sup>2</sup>Upon approving the Convention the Government of China declared that it did not consider itself bound by subparagraph (b) of paragraph 1 of article 1 and article 11 as well as the provisions in the Convention relating to the content of article 11.

<sup>3</sup>Upon ratifying the Convention the Governments of Czechoslovakia and of the United States of America declared that they would not be bound by paragraph 1(b) of article 1.

<sup>4</sup>Upon ratifying the Convention the Governments of Denmark, Finland, Norway and Sweden declared in accordance with article 92(1) that they would not be bound by part two of the Convention (Formation of the contract).

<sup>5</sup>Upon ratifying the Convention the Governments of Denmark, Finland, Norway and Sweden declared, pursuant to article 94(1) and 94(2), that the Convention would not apply to contracts of sale where the parties have their places of business in Denmark, Finland, Sweden, Iceland or Norway.

<sup>6</sup>Upon ratifying the Convention the Government of Hungary declared that it considered the General Conditions of Delivery of Goods between Organizations of the Member Countries of the Council for Mutual Economic Assistance to be subject to the provisions of article 90 of the Convention.

<sup>2</sup>Upon ratifying the Convention the Government of Germany declared that it would not apply article 1(1)(b) in respect of any state that had made a declaration that that state would not apply article 1(1)(b).

<sup>3</sup>Upon accession the Government of Canada declared, in accordance with article 93 of the Convention, that the Convention will extend to Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario, Prince Edward Island and the Northwest Territories.

<sup>4</sup>Upon accession the Government of Canada declared, in accordance with article 95 of the Convention, that with respect to British Columbia, it will not be bound by article 1(1)(b) of the Convention.

#### 5. United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988)

| <i>State</i>             | <i>Signature</i> | <i>Ratification<br/>Accession</i> | <i>Entry into force</i> |
|--------------------------|------------------|-----------------------------------|-------------------------|
| Canada                   | 7 December 1989  |                                   |                         |
| Guinea                   |                  | 23 January 1991                   |                         |
| Russian Federation*      | 30 June 1990     |                                   |                         |
| United States of America | 29 June 1990     |                                   |                         |

Signatures only: 3; ratifications and accessions: 1

Ratifications and accessions necessary to bring the Convention into force: 10

\*The Russian Federation continues, as from 24 December 1991, the membership of the former Union of Soviet Socialist Republics (USSR) in the United Nations and maintains, as from that date, full responsibility for all the rights and obligations of the USSR under the Charter of the United Nations and multilateral treaties deposited with the Secretary-General.

#### 6. United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991)

| <i>State</i> | <i>Signature</i> | <i>Ratification<br/>Accession</i> | <i>Entry into force</i> |
|--------------|------------------|-----------------------------------|-------------------------|
| France       | 15 October 1991  |                                   |                         |
| Mexico       | 19 April 1991    |                                   |                         |
| Philippines  | 19 April 1991    |                                   |                         |
| Spain        | 19 April 1991    |                                   |                         |

Signatures only: 4

Ratifications and accessions necessary to bring the Convention into force: 5

#### 7. UNCITRAL Model Law on International Commercial Arbitration (1985)

Legislation based on the UNCITRAL Model Law on International Commercial Arbitration has been enacted in Australia, Bulgaria, Canada (by the Federal Parliament and by the Legislatures of all Provinces and Territories), Cyprus, Hong Kong, Nigeria, Scotland and, within the United States of America, California, Connecticut, *Oregon* and Texas.

#### 8. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)

| <i>State</i>                        | <i>Signature</i> | <i>Ratification<br/>Accession</i> |
|-------------------------------------|------------------|-----------------------------------|
| Algeria <sup>1, 2</sup>             |                  | 7 February 1989                   |
| Antigua and Barbuda <sup>1, 2</sup> |                  | 2 February 1989                   |
| Argentina <sup>1, 2, 7</sup>        | 26 August 1958   | 14 March 1989                     |
| Australia                           |                  | 26 March 1975                     |
| Austria                             |                  | 2 May 1961                        |
| Bahrain <sup>1, 2</sup>             |                  | 6 April 1988                      |
| Belgium <sup>1</sup>                | 10 June 1958     | 18 August 1975                    |
| Benin                               |                  | 16 May 1974                       |
| Botswana <sup>1, 2</sup>            |                  | 20 December 1971                  |

| <i>State</i>                             | <i>Signature</i> | <i>Ratification<br/>Accession</i> |
|--|------------------|-----------------------------------|
| Bulgaria <sup>1, 3</sup>                 | 17 December 1958 | 10 October 1961                   |
| Burkina Faso                             |                  | 23 March 1987                     |
| Belarus <sup>1, 3</sup>                  | 29 December 1958 | 15 November 1960                  |
| Cambodia                                 |                  | 5 January 1960                    |
| Cameroon                                 |                  | 19 February 1988                  |
| Canada <sup>4</sup>                      |                  | 12 May 1986                       |
| Central African Republic <sup>1, 2</sup> |                  | 15 October 1962                   |
| Chile                                    |                  | 4 September 1975                  |
| China <sup>1, 2</sup>                    |                  | 22 January 1987                   |
| Colombia                                 |                  | 25 September 1979                 |
| Costa Rica                               | 10 June 1958     | 26 October 1987                   |
| Côte d'Ivoire                            |                  | 1 February 1991                   |
| Cuba <sup>1, 2, 3</sup>                  |                  | 30 December 1974                  |
| Cyprus <sup>1, 2</sup>                   |                  | 29 December 1980                  |
| Czechoslovakia <sup>1, 3</sup>           | 3 October 1958   | 10 July 1959                      |
| Denmark <sup>1, 2</sup>                  |                  | 22 December 1972                  |
| Djibouti                                 |                  | 14 June 1983                      |
| Dominica                                 |                  | 28 October 1988                   |
| Ecuador <sup>1, 2</sup>                  | 17 December 1958 | 3 January 1962                    |
| Egypt                                    |                  | 9 March 1959                      |
| El Salvador                              | 10 June 1958     |                                   |
| Finland                                  | 29 December 1958 | 19 January 1962                   |
| France <sup>1</sup>                      | 25 November 1958 | 26 June 1959                      |
| Germany <sup>*, 1</sup>                  | 10 June 1958     | 30 June 1961                      |
| Ghana                                    |                  | 9 April 1968                      |
| Greece <sup>1, 2</sup>                   |                  | 16 July 1962                      |
| Guatemala <sup>1, 2</sup>                |                  | 21 March 1984                     |
| Guinea                                   |                  | 23 January 1991                   |
| Haiti                                    |                  | 5 December 1983                   |
| Holy See <sup>1, 2</sup>                 |                  | 14 May 1975                       |
| Hungary <sup>1, 2</sup>                  |                  | 5 March 1962                      |
| India <sup>1, 2</sup>                    | 10 June 1958     | 13 July 1960                      |
| Indonesia <sup>1, 2</sup>                |                  | 7 October 1981                    |
| Ireland <sup>2</sup>                     |                  | 12 May 1981                       |
| Israel                                   | 10 June 1958     | 5 January 1959                    |
| Italy                                    |                  | 31 January 1969                   |
| Japan <sup>1</sup>                       |                  | 20 June 1961                      |
| Jordan                                   | 10 June 1958     | 15 November 1979                  |
| Kenya <sup>1</sup>                       |                  | 10 February 1989                  |
| Kuwait <sup>1</sup>                      |                  | 28 April 1978                     |
| Latvia                                   |                  | 14 April 1992                     |
| Lesotho                                  |                  | 13 June 1989                      |
| Luxembourg <sup>1</sup>                  | 11 November 1958 | 9 September 1983                  |
| Madagascar <sup>1, 2</sup>               |                  | 16 July 1962                      |
| Malaysia <sup>1, 2</sup>                 |                  | 5 November 1985                   |
| Mexico                                   |                  | 14 April 1971                     |
| Monaco <sup>1, 2</sup>                   | 31 December 1958 | 2 June 1982                       |
| Morocco <sup>1</sup>                     |                  | 12 February 1959                  |
| Netherlands <sup>1</sup>                 | 10 June 1958     | 24 April 1964                     |
| New Zealand <sup>1</sup>                 |                  | 6 January 1983                    |
| Niger                                    |                  | 14 October 1964                   |
| Nigeria <sup>1, 2</sup>                  |                  | 17 March 1970                     |
| Norway <sup>1, 5</sup>                   |                  | 14 March 1961                     |
| Pakistan                                 | 30 December 1958 |                                   |
| Panama                                   |                  | 10 October 1984                   |
| Peru                                     |                  | 7 July 1988                       |
| Philippines <sup>1, 2</sup>              | 10 June 1958     | 6 July 1967                       |
| Poland <sup>1, 2</sup>                   | 10 June 1958     | 3 October 1961                    |
| Republic of Korea <sup>1, 2</sup>        |                  | 8 February 1973                   |
| Romania <sup>1, 2, 3</sup>               |                  | 13 September 1961                 |
| Russian Federation <sup>**, 1, 1</sup>   | 29 December 1958 | 24 August 1960                    |
| San Marino                               |                  | 17 May 1979                       |
| Singapore <sup>1</sup>                   |                  | 21 August 1986                    |
| South Africa                             |                  | 3 May 1976                        |
| Spain                                    |                  | 12 May 1977                       |
| Sri Lanka                                | 30 December 1958 | 9 April 1962                      |
| Sweden                                   | 23 December 1958 | 28 January 1972                   |
| Switzerland <sup>1</sup>                 | 29 December 1958 | 1 June 1965                       |

| <i>State</i>   | <i>Signature</i> | <i>Ratification<br/>Accession</i> |
|--|------------------|-----------------------------------|
| Syrian Arab Republic   |                  | 9 March 1959                      |
| Thailand   |                  | 21 December 1959                  |
| Trinidad and Tobago <sup>1, 2</sup>                                  |                  | 14 February 1966                  |
| Tunisia <sup>1, 2</sup>  |                  | 17 July 1967                      |
| Uganda <sup>1</sup>  |                  | 12 February 1992                  |
| Ukraine <sup>1, 3</sup>  | 29 December 1958 | 10 October 1960                   |
| United Kingdom of Great Britain<br>and Northern Ireland <sup>1</sup> |                  | 24 September 1975                 |
| United Republic of Tanzania <sup>1</sup>                             |                  | 13 October 1964                   |
| United States of America <sup>1, 2</sup>                             |                  | 30 September 1970                 |
| Uruguay  |                  | 30 March 1983                     |
| Yugoslavia <sup>1, 2, 6</sup>  |                  | 26 February 1982                  |

Signatures only: 2; ratifications and accessions: 86

\*The Convention was acceded to by the former German Democratic Republic on 20 February 1975 with reservations <sup>1, 2</sup> and <sup>3</sup>.

\*\*The Russian Federation continues, as from 24 December 1991, the membership of the former Union of Soviet Socialist Republics (USSR) in the United Nations and maintains, as from that date, full responsibility for all the rights and obligations of the USSR under the Charter of the United Nations and multilateral treaties deposited with the Secretary-General.

#### *Declarations and reservations*

(Excludes territorial declarations and certain other reservations  
and declarations of a political nature)

<sup>1</sup>State will apply the Convention to recognition and enforcement of awards made in the territory of another Contracting State.

<sup>2</sup>State will apply the Convention only to differences arising out of legal relationships whether contractual or not which are considered as commercial under the national law.

<sup>3</sup>With regard to awards made in the territory of non-contracting States, State will apply the Convention only to the extent to which these States grant reciprocal treatment.

\*The Government of Canada has declared that Canada will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the laws of Canada, except in the case of the Province of Quebec where the law does not provide for such limitation.

<sup>5</sup>State will not apply the Convention to differences where the subject-matter of the proceedings is immovable property situated in the State, or a right in or to such property.

<sup>6</sup>State will apply the Convention only to those arbitral awards which were adopted after the coming of the Convention into effect.

<sup>7</sup>The present Convention should be construed in accordance with the principles and rules of the National Constitution in force or with those resulting from reforms mandated by the Constitution.

## VIII. TRAINING AND ASSISTANCE

### Training and assistance: note by the Secretariat (A/CN.9/363) [Original: English]

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#### INTRODUCTION

1. At the twentieth session of the Commission (1987), it was decided that increased emphasis should be given both to training and assistance and to the promotion of the legal texts prepared by the Commission, especially in developing countries. It was recognized that the holding of seminars and symposia in developing countries would make those countries conscious of UNCITRAL legal texts and thereby promote and inspire the adoption of the texts. Accordingly, it was noted that "training and assistance was an important activity of the Commission and should be given a higher priority than it had in the past".<sup>1</sup>

2. Pursuant to that decision of the Commission, the secretariat has endeavoured to devise a more extensive programme of training and assistance than had been previously carried out. The programme is designed primarily to acquaint lawyers, government officials and scholars, particularly from developing countries, with the work of UNCITRAL and with the legal texts that have emanated from its work and to promote the adoption and use of those texts. This note sets out activities of the secretariat subsequent to the twenty-fourth session of the Commission (1991) and discusses possible future activities.

#### I. INTERNATIONAL, REGIONAL AND NATIONAL SEMINARS

##### A. Regional seminar on international trade law in Fiji (Suva, 21-25 October 1991)

3. As announced to the twenty-fourth session of the Commission (1991),<sup>2</sup> a regional seminar on international trade law, organized jointly with the South Pacific Forum secretariat, was held at the Forum secretariat headquarters in Suva, Fiji.

4. In November 1990, the Forum Regional Security Committee of the South Pacific Forum, a regional organization with a membership of 15 States, had decided that a seminar on international trade law would be an important event for the region and endorsed the plan to hold the Forum Secretariat/UNCITRAL Seminar on International Trade Law.

5. Sixteen participants, who were mainly senior government officials and therefore well placed in their respective countries to influence decisions relating to acceptance of UNCITRAL legal texts, attended the seminar. They were from the following member States of the South Pacific

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the work of its twentieth session, *Official Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17)*, para. 335.

<sup>2</sup>Report of the United Nations Commission on International Trade Law on the work of its twenty-fourth session, *Official Records of the General Assembly, Forty-sixth Session, Supplement No. 17 (A/46/17)*, para. 338.

Forum: Australia, Cook Islands, Fiji, Kiribati, Micronesia (Federated States of), Nauru, Papua New Guinea, Solomon Islands, Tonga, Tuvalu and Vanuatu.

6. The Forum secretariat provided the facilities necessary for the holding of the seminar, which was financed by a grant of the Government of Australia and by funds of the UNCITRAL Trust Fund for Symposia. Australia further supported the seminar by providing two lecturers; the other lecturers were a Canadian consultant, a lawyer from the region and two members of the secretariat of the Commission.

7. The seminar covered international sale of goods, international transport and storage of goods, international dispute settlement and international payments. The following legal texts were presented for examination and discussion: UNCITRAL Model Law on International Commercial Arbitration (1985); Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958); United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg); United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991); United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980); Convention on the Limitation Period in the International Sale of Goods (New York, 1974) as amended by the 1980 Protocol; and United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988). In addition, the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works and the current work on a legal guide on international countertrade transactions, a model law on procurement, and a uniform law on guarantees and stand-by letters of credit were presented for discussion.

8. During the discussions that followed the lectures, it was widely recognized that the existing legislation of most of the Forum States might well be inadequate to meet present day requirements. Accordingly, the following suggestions were made: (i) that all participants should make appropriate recommendations and reports to their respective Governments; and (ii) that the conclusions and observations of the seminar should be reported to the Forum Regional Security Committee and to the Forum Officials Committee for their consideration of further regional initiatives. Such further initiatives might focus on the desirability of regional uniformity in trade law and on technical assistance in further evaluating the relation between existing national laws and prevailing laws and practices in international trade. As regards international dispute settlement, it was suggested that the Forum States might wish to consider providing a legal climate for arbitrations in their region so as to reduce the need for having their disputes settled in possibly distant jurisdictions outside the region. For that reason the Forum States should adhere to the 1958 New York Convention, enact legislation based on the UNCITRAL Model Law, and consider the establishment of a regional arbitration centre ("Pacific Arbitration Forum") that would use as its institutional rules the UNCITRAL Arbitration Rules.

9. The UNCITRAL secretariat has remained in close contact with the Forum Secretariat and with participants from

the seminar in an effort to maintain the interest generated towards adoption of the texts that have emanated from the work of the Commission.

#### **B. National seminar on international commercial arbitration in Mexico**

(Mexico City, 20-21 February 1992)

10. A seminar on international commercial arbitration was held in Mexico City from 20 to 21 February 1992. The seminar was jointly organized by the Mexican Ministry of External Relations and the secretariat of the Commission. Lectures were given by four Mexican experts, a consultant and a member of the secretariat on various legal texts, including the UNCITRAL Model Arbitration Law and the UNCITRAL Arbitration Rules, and on various issues of international arbitration practice. The seminar was attended by about 80 ministry officials, practitioners and teachers of law.

#### **C. Other seminars and courses**

11. Members of the UNCITRAL secretariat have participated as speakers in the following seminars and courses where UNCITRAL legal texts were presented for examination and discussion: United Nations-UNITAR Fellowship Programme on International Law (The Hague, 5-9 August 1991), Arbitration Seminar (Sydney, 18 October 1991), Annual Australian Seminar on International Trade Law (Canberra, 18 and 19 October 1991), and Seminar on Arbitration (Dhahran, 18 and 19 November 1991).

### **II. POSSIBLE FUTURE ACTIVITIES**

12. The secretariat expects to intensify even further its efforts to organize or co-sponsor seminars and symposia on international trade law, especially for developing countries.

#### **A. Fifth UNCITRAL Symposium**

13. As announced to the twenty-fourth session of the Commission (A/46/17, para. 337), in view of the interest shown in the fourth UNCITRAL Symposium and of the advantages of holding symposia in connection with the sessions of the Commission when they are held at the location of the Commission's secretariat at Vienna, it is intended to organize the fifth UNCITRAL Symposium on International Trade Law on the occasion of the twenty-sixth session of the Commission, in 1993.

#### **B. Tentative plans for seminars**

14. The secretariat has received requests for holding seminars from various States in Africa, Asia and Latin America. Tentative plans have been made for organizing in November 1992 a series of national seminars in Indonesia, the Philippines and, possibly, Malaysia and Thailand. If sufficient funds were available, another such series might next be organized in some countries of Latin America.

### III. TECHNICAL ASSISTANCE

15. The awareness of the UNCITRAL legal texts among many countries, in particular developing countries, is coupled with increasing requests for technical assistance from individual Governments or regional organizations. The secretariat has been requested on a number of occasions to consult with individual countries during their consideration of one of the UNCITRAL texts. This has normally consisted of comments in writing on reports and draft legislation, preparation of "accession kits" or a comparison of the UNCITRAL legal text with the existing law of a given country and a discussion of its advantages and disadvantages in comparison to the existing law. Requests from regional organizations range from review of laws of member States with a view to harmonization and possible unification to provision of a consultant.

### IV. INTERNSHIP PROGRAMME

16. The internship programme is designed to enable persons who have recently obtained a law degree, or who have nearly completed their work towards such a degree, the opportunity to serve as interns in the International Trade Law Branch. Interns are assigned specific tasks in connection with projects being worked on by the secretariat. Persons participating in the programme are able to become familiar with the work of UNCITRAL and to increase their knowledge of specific areas in the field of international trade law. In addition, the secretariat occasionally accommodates scholars and legal practitioners for a limited period of time. Unfortunately, no funds are available to the secretariat to assist the interns to cover their travel and other expenses. The interns are often sponsored by an organization, university or a government agency, or they meet their expenses from their own means. During the past year the secretariat has received three interns.

### V. FINANCIAL AND ADMINISTRATIVE CONSIDERATIONS

17. The programme of training and assistance, in particular the holding of regional or national seminars, depends on the continued availability of sufficient financial resources. No funds for the travel expenses of participants or lecturers are provided for in the regular budget. As a result expenses have to be met by voluntary contributions to the UNCITRAL Trust Fund for Symposia.

18. Of particular value have been the contributions made to the UNCITRAL Trust Fund for Symposia on a multi-year basis, because they have permitted the secretariat to plan and finance the programme without the need to solicit funds from potential donors for each individual activity. Such contributions have been received from Canada and Finland. In addition, the annual contribution from Switzerland has been used for the seminar programme. Other financial contributions were made by Australia and France. As announced to the twenty-fourth session of the Commission, Australia also made a specific contribution to the seminar held in Fiji in October 1991 (A/46/17, para. 338).

19. The Commission may wish to express its appreciation to those States and organizations that have contributed to the Commission's programme of training and assistance by providing funds or staff or by hosting seminars. The Commission may also wish to request the secretariat to continue its efforts to secure the financial, personnel and administrative support necessary to place the programme on a firm and continuing basis. Finally, the Commission may wish to appeal to all States to consider making contributions to the UNCITRAL Trust Fund for Symposia so as to enable the secretariat to meet the increasing demands in developing countries for training and assistance.

## IX. UNITED NATIONS DECADE OF INTERNATIONAL LAW

### UNCITRAL Congress under the theme "Uniform commercial law in the twenty-first century" (New York, 18-22 May 1992)

1. During the third week of the Commission's twenty-fifth session in New York (4-22 May 1992) the UNCITRAL secretariat organized a Congress under the theme "Uniform commercial law in the twenty-first century". The Congress, which formed a part of the twenty-fifth session of the Commission, was designed as the Commission's contribution to the activities of the United Nations Decade of International Law.

2. Participants at the Congress were invited to consider the accomplishments achieved in the progressive unification and harmonization of international trade law during the past 25 years and the needs that can be foreseen for the next 25 years. Over 60 speakers from different regions and legal systems presented a panoramic view of developments in major areas of international commercial law.

3. The Congress was practice-oriented in providing to practising lawyers, corporate counsel, ministry officials, judges, arbitrators, teachers of law and other users of uniform legal texts:

(a) Up-to-date information and practical guidance concerning principal legal texts of universal relevance;

(b) An opportunity to express their opinion on the current state of the unification of the laws and rules governing world commerce;

(c) A forum in which to voice their practical needs as a basis for future work by the Commission and other formulating agencies.

4. The general topic of the first day (Monday, 18 May) was the "Process and value of the unification of commercial law (lessons for the future drawn from the past 25 years)". Mr. José María Abascal Zamora of Mexico, Chairman of the twenty-fifth session of the Commission served as the Chairperson of the morning session. Mr. Boutros Boutros-Ghali, Secretary-General, United Nations, delivered the opening address. Further to a minute of silence in memory of Clive M. Schmitthof, Mr. Aron Broches, former Vice-President and General Counsel of the World Bank, Washington, D.C., and Ambassador André Erdős, Permanent Representative of Hungary, spoke on "The birth of UNCITRAL". Mr. John O. Honnold, Professor, University of Pennsylvania, Philadelphia (Secretary of UNCITRAL 1969-1974), continued with "The goals of unification". He was followed by Mr. Willem C. Vis, Professor, Pace University, White Plains (Secretary of UNCITRAL 1974-1980), who spoke on "The process of preparing universally acceptable uniform legal rules". After

1991); Malcolm Evans, Secretary-General, International Institute for the Unification of Private Law (UNIDROIT), Rome; Michel Pelichet, Deputy Secretary-General, The Hague Conference on Private International Law, The Hague; and Mrs. Dominique Hascher, Secretary, Commission on International Arbitration, International Chamber of Commerce, Paris, spoke on "Methods of improved coordination between formulating agencies". Thereafter, the floor was opened for discussion.

5. Work resumed in the afternoon under the chairmanship of Mr. Rafael Eyzaguirre, Professor and Attorney, Santiago. The first topic of the afternoon session was "Various techniques of unification". It was first addressed by Mr. Sergej Lebedev, Professor, Moscow, who spoke on "Legislative means of unification", and then by Mr. Joachim Bonell, Professor, University "La Sapienza", Rome, who spoke on "Non-legislative means of harmonization". The next topic of that session was "Application and interpretation of uniform legal texts". It was first addressed by Mr. Zhang Yuqing, Department of Treaties and Law, Ministry of Foreign Economic Relations and Trade, Beijing, who spoke on "*Travaux préparatoires*, case collections, commentaries and other aids in interpretation", then by Mr. Howard H. Holtzmann, Judge, Iran-United States Claims Tribunal, The Hague, who spoke on "The cook who eats his own soup: experiences of a judge applying a legal text co-drafted by him", and finally by Mr. Louis Sohn, Professor, George Washington University, Washington, D.C., who spoke on "Proposals for an international tribunal to interpret uniform legal texts". After a short break representatives of the following regional organizations spoke on the "Value of universal unification for regional integration and development": Asian-African Legal Consultative Committee, Organization of American States, Preferential Trade Area for Eastern and Southern African States and European Economic Community. The work of the day was concluded with open discussion on that topic.

6. The general topic of the second day (Tuesday, 19 May) was "From goods to services". The morning session focused on "Sale of goods" and the chairperson was Mr. Sergej Lebedev, Professor, Moscow. The first speaker, Mr. S. Kofi Date-Bah, Commonwealth Secretariat, London, spoke on "The United Nations Sales Convention: an overview and consideration of some practical issues relating to it". He was followed by Mr. Jan Ramberg, Professor, Stockholm University, who spoke on "Novel features of the ICC INCOTERMS 1990". The programme continued

of existing uniform legal texts and suggest topics for future work by UNCITRAL or other formulating agencies. The following speakers took the floor: Messrs. Hans van Houtte, Professor and Attorney, Brussels, Subcommittee International Sales, International Bar Association; Burghard Piltz, Attorney, Gütersloh, Union Internationale des Avocats; Rafael Eyzaguirre, Professor and Attorney, Santiago, President, Inter-American Commercial Arbitration Commission, Inter-American Bar Association; Michael L. Sher, Attorney, New York, the Association of the Bar of the City of New York; and Mrs. Helen Hartnell, Professor, Tulane University, New Orleans, Section on International Law and Practice, American Bar Association. After a short break the floor was opened for discussion.

7. The afternoon session focused on "Supply of services" and it was chaired by Mr. Joko-Smart, Professor and Attorney, Freetown, Sierra Leone. The first speaker was Mr. Roy Goode, Professor, St. John's College, Oxford, who spoke on "Practical questions relating to the UNIDROIT Leasing Convention (1988)". He was followed by Mr. James B. Myers, Attorney, Boston, who spoke on "The UNCITRAL Legal Guide on Industrial Works and the new FIDIC conditions". "Voices of international practice" followed with Messrs. Robert Nicholson, Judge, Perth, The Law Association for Asia and the Pacific (LAWASIA); Richard Lutringer, Attorney, New York, President, American Foreign Law Association; José Ignacio Cruz, Attorney, New York, Mexican Bar Association; Edward V. Lahey, Vice-President and General Counsel, PepsiCo Inc., Westchester-Fairfield Corporate Counsel Association; and Christopher Osakwe, Professor, Los Angeles, International Service Industries Committee, American Bar Association. Open discussion followed after a short break.

8. The general topic of the third day (Wednesday, 20 May) was "From traditional payments to electronic messages". The morning session focused on "Payments, credits and banking", and it was chaired by Mrs. Ana Isabel Piaggi de Vanossi, Professor and Judge, Buenos Aires. The first speaker was Mr. Bradley Crawford, Q.C., Professor and Attorney, Toronto, who spoke on "A banking lawyer's assessment of the UNCITRAL Bills and Notes Convention (1988)". He was followed by Mr. Salvatore Maccarone, Professor and Attorney, Rome, who spoke on "UCP 500: Proposed revision of the ICC Uniform Customs and Practice for Documentary Credits". "Voices of international practice" followed with Messrs. Robert D. Webster, Attorney, New York, Banking Law Committee, International Bar Association; Umberto Burani, Secretary-General, Banking Federation of the European Community; Carlos Zeyen, Attorney, Luxembourg; George A. Hisert, Attorney, San Francisco, Chairman, Letter of Credit Subcommittee, Uniform Commercial Code Committee, California State Bar; and Alejandro M. Garro, Lecturer in Law, Columbia University, New York. After a short break the floor was opened for discussion.

9. The afternoon session focused on "Electronic data interchange (EDI)" and it was chaired by Professor Michael Joachim Bonell, Professor, Rome. The first speaker was Mrs. Amelia H. Boss, Professor, Temple University, Philadelphia, who spoke on "Electronic commerce and the law". She was followed by Mr. José María Abascal Zamora, Pro-

fessor and Attorney, Mexico City, who spoke on "Uniform legal rules needed for EDI". "Voices of international practice" followed with Messrs. Jeffrey B. Ritter, Attorney, Columbus, ECE Working Party on Facilitation of International Trade Procedures (WP.4); Mrs. Sylvia Khatcherian, Attorney, New York, Committee on International Computer and Technology Law, International Bar Association; Papa Moussa Ndiaye, Legal Counsel, International Centre of Foreign Trade of Senegal, Dakar; Ciro Angarita Baron, Professor and Judge, Bogotá; and Olav Torvund, Professor, Oslo, Norwegian Research Center for Computers and Law. After a short break open discussion followed.

10. The general topic of the fourth day (Thursday, 21 May) was "Transport; dispute settlement". The morning session focused on "Transport" and it was chaired by Mr. Rolf Herber, Professor, Hamburg. The first speaker was Mr. Joko-Smart, Professor and Attorney, Freetown, who spoke on "From The Hague to Hamburg: towards modern uniform rules for maritime transport". He was followed by Mr. Jean-Paul Beraudo, President, Court of Appeal, Grenoble, who spoke on "Liability standards in the United Nations Terminal Operators Convention (1991) and other transport conventions". "Voices of international practice" followed with Messrs. O. P. Sharma, Attorney, New Delhi, President, Asia-Pacific Lawyers Association (Indian Chapter); Lennard Rambusch, Attorney, New York, Maritime and Transport Law Committee, International Bar Association; and Geoffrey J. Ginos, Attorney, New York, Section on International Law and Practice, New York State Bar Association. Work resumed after a short break with open floor.

11. The afternoon session focused on "Dispute settlement" and it was chaired by Mr. Gavan Griffith, Solicitor-General of Australia. The first speaker was Mr. Albert Jan van den Berg, Professor and Attorney, Amsterdam, who spoke on "Practical problems in applying the 1958 New York Convention". He was followed by Mr. Ivan Szasz, Professor and Attorney, Budapest, who spoke on "Useful additions to the UNCITRAL Model Arbitration Law". "Voices of international practice" followed with Messrs. Giorgio Bernini, Professor and Attorney, Bologna, President, International Council for Commercial Arbitration; John M. Townsend, Attorney, Washington Law and Corporate Counsel Committees, American Arbitration Association; Mrs. Dominique Hascher, Paris, Secretary, Commission on International Arbitration, International Chamber of Commerce; Jan Paulsson, Attorney, Paris, Users' Council, London Court of International Arbitration; and M.I.M. Aboul-Enein, Director, Cairo Regional Centre for International Commercial Arbitration, Cairo, Egypt. After a short break open discussion followed.

12. The general topic of the fifth day (Friday, 22 May) was "The future role of UNCITRAL". This session was chaired by Mr. Boon Teik Tan, former Attorney-General, Singapore. The first speaker was Mr. Kazuaki Sono, Professor, Sapporo, Assistant General Counsel, International Monetary Fund (Secretary of UNCITRAL 1980-1985), who spoke on "The changing role of UNCITRAL". He was followed by Mr. Gerold Herrmann, Secretary of UNCITRAL, who spoke on "Promoting wider awareness and acceptance of uniform legal texts". Work continued

with "Aspirations and priorities of developing countries—representatives from various regions summarize what developing countries expect from UNCITRAL". Messrs. Abbas Safarian Neamat Abad, Head, Department of Treaties, Ministry of Foreign Affairs, Islamic Republic of Iran, Tehran; Mrs. Ana Isabel Piaggi de Vanossi, Professor and Judge, Buenos Aires; B. M. Koentjoro-Iakti, Assistant to the Minister of Trade of Indonesia, Jakarta; and Robert Rufus Hunja, Permanent Mission of Kenya to the United Nations, New York, took the floor. After a short break the floor was opened for "Final suggestions for the future activities of UNCITRAL".

13. The Congress concluded with the closing speech of Mr. Carl-August Fleischhauer, Under-Secretary-General for Legal Affairs, The Legal Counsel, United Nations.

14. The Congress provided a useful assessment of the progress made to date in the unification and harmonization of international trade law, and discussions that took place will assist the Commission and other organizations involved in the unification and harmonization of international trade law in laying out the future course of their work. The Congress proceedings are expected to be published soon.

# I. TEXTS ADOPTED BY THE UNITED NATIONS CONFERENCE ON THE LIABILITY OF OPERATORS OF TRANSPORT TERMINALS IN INTERNATIONAL TRADE AND THE UNITED NATIONS CONVENTION ON THE LIABILITY OF OPERATORS OF TRANSPORT TERMINALS IN INTERNATIONAL TRADE (Vienna, 2-19 April 1991) (A/CONF.152/13) [Original: English]

1. The General Assembly of the United Nations, having considered chapter II of the report of the United Nations Commission on International Trade Law on the work of its twenty-second session, in 1989 (A/44/17), and annex I to that report, which contained a draft Convention on the Liability of Operators of Transport Terminals in International Trade, decided by its resolution 44/33 of 4 December 1989, that an international conference of plenipotentiaries should be convened at Vienna from 2 to 19 April 1991 to consider the draft Convention prepared by the Commission and to embody the results of its work in an international convention on the liability of operators of transport terminals in international trade.

2. The United Nations Conference on the Liability of Operators of Transport Terminals in International Trade was held at Vienna, Austria, from 2 to 19 April 1991.

3. Forty-eight States were represented at the Conference, as follows: Argentina, Australia, Austria, Belgium, Bolivia, Brazil, Bulgaria, Byelorussian Soviet Socialist Republic, Canada, Chile, China, Denmark, Egypt, Finland, France, Gabon, Germany, Guinea, India, Indonesia, Iran (Islamic Republic of), Iraq, Israel, Italy, Japan, Lesotho, Libyan Arab Jamahiriya, Mexico, Morocco, Netherlands, Nigeria, Oman, Philippines, Republic of Korea, Saudi Arabia, Spain, Sweden, Switzerland, Thailand, Turkey, Ukrainian Soviet Socialist Republic, Union of Soviet Socialist Republics, United Arab Emirates, United Kingdom of Great Britain and Northern Ireland, United States of America, Viet Nam, Yemen and Yugoslavia.

4. The General Assembly requested the Secretary-General to invite representatives of organizations that had received a standing invitation from the General Assembly to participate in the sessions and the work of all international conferences convened under its auspices in the capacity of observers in accordance with General Assembly resolutions 3237 (XXIX) of 22 November 1974 and 31/152 of 20 December 1976; to invite representatives of the national liberation movements recognized by the Organization of African Unity in its region to participate in the conference in the capacity of observers in accordance with General Assembly resolution 3280 (XXIX) of 10 December 1974; and to invite the specialized agencies and the International Atomic Energy Agency, as well as interested organs of the United Nations and other interested international organizations, to be represented at the Conference by observers. In addition, interested non-governmental organizations were invited to be represented at the Conference by observers. The following intergovernmental and non-governmental organizations accepted these invitations and were represented by observers at the Conference:

## *Specialized agencies*

International Maritime Organization

## *Other intergovernmental organizations*

Central Commission for the Navigation of the Rhine  
Intergovernmental Organization for International Carriage by Rail  
International Institute for the Unification of Private Law  
League of Arab States

## *Liberation movements*

Pan Africanist Congress of Azania

## *Non-governmental organizations*

Argentine-Uruguayan Institute of Commercial Law  
European Shippers' Councils  
Latin American and Caribbean Federation of National Associations of Cargo  
Institute of International Container Lessors  
International Air Transport Association  
International Association of Ports and Harbors  
International Chamber of Shipping  
International Maritime Committee  
International Road Transport Union  
International Union of Marine Insurance  
Regional Center for International Commercial Arbitration Cairo

5. The Conference elected Mr. José María Abascal (Mexico) as President.

6. The Conference elected as Vice-Presidents the representatives of the following States: Argentina, Australia, Belgium, Bulgaria, Byelorussian Soviet Socialist Republic, China, Egypt, Gabon, Iran (Islamic Republic of), Italy, Japan, Morocco, Nigeria, Philippines, Spain, Sweden, Thailand, Union of Soviet Socialist Republics, Yugoslavia.

7. The following Committees were established by the Conference:

## *General Committee*

*Chairman:* The President of the Conference

*Members:* The President and Vice-Presidents of the Conference, and the Chairmen of the First and the Second Committees and the Chairman of the Drafting Committee

## *First Committee*

*Chairman:* Mr. Jean-Paul Beraudo (France)

*Vice-Chairman:* Mr. Mahmoud Soliman (Egypt)

*Rapporteur:* Mr. Abbas Safarian Nematabad (Islamic Republic of Iran)

## *United Nations Secretariat*

United Nations Conference on Trade and Development  
United Nations Environment Programme

*Second Committee*

*Chairman:* Ms. Jelena Vilus (Yugoslavia)  
*Vice-Chairman:* Mr. Ken Fujishita (Japan)  
*Rapporteur:* Ms. Sylvia Strolz (Austria)

*Drafting Committee*

*Chairman:* Mr. P. C. Rao (India)  
*Members:* China, Egypt, France, Germany, Guinea, Mexico, Morocco, Nigeria, Philippines, Spain, Ukrainian Soviet Socialist Republic, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America.

*Credentials Committee*

*Chairman:* Mr. Ross Hornby (Canada)  
*Members:* Argentina, Canada, China, Guinea, Iran (Islamic Republic of), Lesotho, Mexico, Ukrainian Soviet Socialist Republic and United States of America.

8. The Secretary-General of the United Nations was represented by Mr. Carl-August Fleischhauer, Under-Secretary-General for Legal Affairs, the Legal Counsel, Office of Legal Affairs of the United Nations. Mr. Eric E. Bergsten, Chief of the International Trade Law Branch of the Office of Legal Affairs of the United Nations, acted as Executive Secretary.

9. The General Assembly, by its resolution 44/33 of 4 December 1989 convening the Conference, referred to the Conference, as the basis for its consideration of the liability of operators of transport terminals in international trade, the draft Convention on the Liability of Operators of Transport Terminals in International Trade contained in annex I to the report of the United Nations Commission on International Trade Law on the work of its twenty-second session (A/CONF.152/5).

10. The Conference assigned to the First Committee the text of articles 1 to 16, and 20, of the draft Convention on the Liability of Operators of Transport Terminals in International Trade. The Conference assigned to the Second Committee articles 17 to 19, and 21 to 25, of the draft Convention.

11. On the basis of the deliberations recorded in the summary records of the Conference (A/CONF.152/SR.1-8), the summary records of the First Committee (A/CONF.152/C.1/SR.1-18) and its report (A/CONF.152/9), and the summary records of the Second Committee (A/CONF.152/C.2/SR.1-4) and its report (A/CONF.152/10 and Add.1), the Conference drew up the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade.

12. That Convention, the text of which is annexed to this Final Act, was adopted by the Conference on 17 April 1991 and was opened for signature at the concluding meeting of the Conference, on 19 April 1991. It will remain open for signature at United Nations Headquarters in New York until 30 April 1992. It was also opened for accession on 19 April 1991.

13. The Convention is deposited with the Secretary-General of the United Nations.

DONE at Vienna, Austria, this nineteenth day of April, one thousand nine hundred and ninety-one, in a single copy in the Arabic, Chinese, English, French, Russian and Spanish languages, each text being equally authentic.

IN WITNESS WHEREOF the representatives have signed this Final Act.

*President*

*Executive Secretary*

## ANNEX

### UNITED NATIONS CONVENTION ON THE LIABILITY OF OPERATORS OF TRANSPORT TERMINALS IN INTERNATIONAL TRADE

#### PREAMBLE

##### *The Contracting States:*

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

Considering the problems created by the uncertainties as to the legal regime applicable with regard to goods in international carriage when the goods are not in the charge of carriers nor in the charge of cargo-owning interests but while they are in the charge of operators of transport terminals in international trade;

Intending to facilitate the movement of goods by establishing uniform rules concerning liability for loss of, damage to or delay in handing over such goods while they are in the charge of operators of transport terminals and are not covered by the laws of

carriage arising out of conventions applicable to the various modes of transport,

Have agreed as follows:

#### Article 1 Definitions

In this Convention:

(a) "Operator of a transport terminal" (hereinafter referred to as "operator") means a person who, in the course of his business, undertakes to take in charge goods involved in international carriage in order to perform or to procure the performance of transport-related services with respect to the goods in an area under his control or in respect of which he has a right of access or use. However, a person is not considered an operator whenever he is a carrier under applicable rules of law governing carriage;

(b) Where goods are consolidated in a container, pallet or similar article of transport or where they are packed, "goods" includes such article of transport or packaging if it was not supplied by the operator;

(c) "International carriage" means any carriage in which the place of departure and the place of destination are identified as being located in two different States when the goods are taken in charge by the operator;

(d) "Transport-related services" includes such services as storage, warehousing, loading, unloading, stowage, trimming, dunnaging and lashing;

(e) "Notice" means a notice given in a form which provides a record of the information contained therein;

(f) "Request" means a request made in a form which provides a record of the information contained therein.

## Article 2

### *Scope of application*

(1) This Convention applies to transport-related services performed in relation to goods which are involved in international carriage:

(a) When the transport-related services are performed by an operator whose place of business is located in a State Party, or

(b) When the transport-related services are performed in a State Party, or

(c) When, according to the rules of private international law, the transport-related services are governed by the law of a State Party.

(2) If the operator has more than one place of business, the place of business is that which has the closest relationship to the transport-related services as a whole.

(3) If the operator does not have a place of business, reference is to be made to the operator's habitual residence.

## Article 3

### *Period of responsibility*

The operator is responsible for the goods from the time he has taken them in charge until the time he has handed them over to or has placed them at the disposal of the person entitled to take delivery of them.

## Article 4

### *Issuance of document*

(1) The operator may, and at the customer's request shall, within a reasonable period of time, at the option of the operator, either:

(a) Acknowledge his receipt of the goods by signing and dating a document presented by the customer that identifies the goods, or

(b) Issue a signed document identifying the goods, acknowledging his receipt of the goods and the date thereof, and stating their condition and quantity in so far as they can be ascertained by reasonable means of checking.

(2) If the operator does not act in accordance with either subparagraph (a) or (b) of paragraph (1), he is presumed to have received the goods in apparent good condition, unless he proves otherwise. No such presumption applies when the services performed by the operator are limited to the immediate transfer of the goods between means of transport.

(3) A document referred to in paragraph (1) may be issued in any form which preserves a record of the information contained therein. When the customer and the operator have agreed to com-

municate electronically, a document referred to in paragraph (1) may be replaced by an equivalent electronic data interchange message.

(4) The signature referred to in paragraph (1) means a handwritten signature, its facsimile or an equivalent authentication effected by any other means.

## Article 5

### *Basis of liability*

(1) The operator is liable for loss resulting from loss of or damage to the goods, as well as from delay in handing over the goods, if the occurrence which caused the loss, damage or delay took place during the period of the operator's responsibility for the goods as defined in article 3, unless he proves that he, his servants or agents or other persons of whose services the operator makes use for the performance of the transport-related services took all measures that could reasonably be required to avoid the occurrence and its consequences.

(2) Where a failure on the part of the operator, his servants or agents or other persons of whose services the operator makes use for the performance of the transport-related services to take the measures referred to in paragraph (1) combines with another cause to produce loss, damage or delay, the operator is liable only to the extent that the loss resulting from such loss, damage or delay is attributable to that failure, provided that the operator proves the amount of the loss not attributable thereto.

(3) Delay in handing over the goods occurs when the operator fails to hand them over to or place them at the disposal of a person entitled to take delivery of them within the time expressly agreed upon or, in the absence of such agreement, within a reasonable time after receiving a request for the goods by such person.

(4) If the operator fails to hand over the goods to or place them at the disposal of a person entitled to take delivery of them within a period of 30 consecutive days after the date expressly agreed upon or, in the absence of such agreement, within a period of 30 consecutive days after receiving a request for the goods by such person, a person entitled to make a claim for the loss of the goods may treat them as lost.

## Article 6

### *Limits of liability*

(1) (a) The liability of the operator for loss resulting from loss of or damage to goods according to the provisions of article 5 is limited to an amount not exceeding 8.33 units of account per kilogram of gross weight of the goods lost or damaged.

(b) However, if the goods are handed over to the operator immediately after carriage by sea or by inland waterways, or if the goods are handed over, or are to be handed over, by him for such carriage, the liability of the operator for loss resulting from loss of or damage to goods according to the provisions of article 5 is limited to an amount not exceeding 2.75 units of account per kilogram of gross weight of the goods lost or damaged. For the purposes of this paragraph, carriage by sea or by inland waterways includes pick-up and delivery within a port.

(c) When the loss of or damage to a part of the goods affects the value of another part of the goods, the total weight of the lost or damaged goods and of the goods whose value is affected shall be taken into consideration in determining the limit of liability.

(2) The liability of the operator for delay in handing over the goods according to the provisions of article 5 is limited to an amount equivalent to two and a half times the charges payable to the operator for his services in respect of the goods delayed, but not exceeding the total of such charges in respect of the consignment of which the goods were a part.

(3) In no case shall the aggregate liability of the operator under both paragraphs (1) and (2) exceed the limitation which would be established under paragraph (1) for total loss of the goods in respect of which such liability was incurred.

(4) The operator may agree to limits of liability exceeding those provided for in paragraphs (1), (2) and (3).

#### Article 7

##### *Application to non-contractual claims*

(1) The defences and limits of liability provided for in this Convention apply in any action against the operator in respect of loss of or damage to the goods, as well as delay in handing over the goods, whether the action is founded in contract, in tort or otherwise.

(2) If such an action is brought against a servant or agent of the operator, or against another person of whose services the operator makes use for the performance of the transport-related services, such servant, agent or person, if he proves that he acted within the scope of his employment or engagement by the operator, is entitled to avail himself of the defences and limits of liability which the operator is entitled to invoke under this Convention.

(3) Except as provided in article 8, the aggregate of the amounts recoverable from the operator and from any servant, agent or person referred to in the preceding paragraph shall not exceed the limits of liability provided for in this Convention.

#### Article 8

##### *Loss of right to limit liability*

(1) The operator is not entitled to the benefit of the limitation of liability provided for in article 6 if it is proved that the loss, damage or delay resulted from an act or omission of the operator himself or his servants or agents done with the intent to cause such loss, damage or delay, or recklessly and with knowledge that such loss, damage or delay would probably result.

(2) Notwithstanding the provision of paragraph (2) of article 7, a servant or agent of the operator or another person of whose services the operator makes use for the performance of the transport-related services is not entitled to the benefit of the limitation of liability provided for in article 6 if it is proved that the loss, damage or delay resulted from an act or omission of such servant, agent or person done with the intent to cause such loss, damage or delay, or recklessly and with knowledge that such loss, damage or delay would probably result.

#### Article 9

##### *Special rules on dangerous goods*

If dangerous goods are handed over to the operator without being marked, labelled, packaged or documented in accordance with any law or regulation relating to dangerous goods applicable in the country where the goods are handed over and if, at the time the goods are taken in charge by him, the operator does not otherwise know of their dangerous character, he is entitled:

(a) To take all precautions the circumstances may require, including, when the goods pose an imminent danger to any person or property, destroying the goods, rendering them innocuous, or disposing of them by any other lawful means, without payment of compensation for damage to or destruction of the goods resulting from such precautions, and

(b) To receive reimbursement for all costs incurred by him in taking the measures referred to in subparagraph (a) from the person who failed to meet any obligation under such applicable law or regulation to inform him of the dangerous character of the goods.

#### Article 10

##### *Rights of security in goods*

(1) The operator has a right of retention over the goods for costs and claims which are due in connection with the transport-related services performed by him in respect of the goods both during the period of his responsibility for them and thereafter. However, nothing in this Convention affects the validity under the applicable law of any contractual arrangements extending the operator's security in the goods.

(2) The operator is not entitled to retain the goods if a sufficient guarantee for the sum claimed is provided or if an equivalent sum is deposited with a mutually accepted third party or with an official institution in the State where the operator has his place of business.

(3) In order to obtain the amount necessary to satisfy his claim, the operator is entitled, to the extent permitted by the law of the State where the goods are located, to sell all or part of the goods over which he has exercised the right of retention provided for in this article. This right to sell does not apply to containers, pallets or similar articles of transport or packaging which are owned by a party other than the carrier or the shipper and which are clearly marked as regards ownership except in respect of claims by the operator for the cost of repairs of or improvements to the containers, pallets or similar articles of transport or packaging.

(4) Before exercising any right to sell the goods, the operator shall make reasonable efforts to give notice of the intended sale to the owner of the goods, the person from whom the operator received them and the person entitled to take delivery of them from the operator. The operator shall account appropriately for the balance of the proceeds of the sale in excess of the sums due to the operator plus the reasonable costs of the sale. The right of sale shall in all other respects be exercised in accordance with the law of the State where the goods are located.

#### Article 11

##### *Notice of loss, damage or delay*

(1) Unless notice of loss or damage, specifying the general nature of the loss or damage, is given to the operator not later than the third working day after the day when the goods were handed over by the operator to the person entitled to take delivery of them, the handing over is prima facie evidence of the handing over by the operator of the goods as described in the document issued by the operator pursuant to paragraph (1)(b) of article 4 or, if no such document was issued, in good condition.

(2) Where the loss or damage is not apparent, the provisions of paragraph (1) apply correspondingly if notice is not given to the operator within 15 consecutive days after the day when the goods reached the final recipient, but in no case later than 60 consecutive days after the day when the goods were handed over to the person entitled to take delivery of them.

(3) If the operator participated in a survey or inspection of the goods at the time when they were handed over to the person enti-

tied to take delivery of them, notice need not be given to the operator of loss or damage ascertained during that survey or inspection.

(4) In the case of any actual or apprehended loss of or damage to the goods, the operator, the carrier and the person entitled to take delivery of the goods shall give all reasonable facilities to each other for inspecting and tallying the goods.

(5) No compensation is payable for loss resulting from delay in handing over the goods unless notice has been given to the operator within 21 consecutive days after the day when the goods were handed over to the person entitled to take delivery of them.

#### Article 12

##### *Limitation of actions*

(1) Any action under this Convention is time-barred if judicial or arbitral proceedings have not been instituted within a period of two years.

(2) The limitation period commences:

(a) On the day the operator hands over the goods or part thereof to, or places them at the disposal of, a person entitled to take delivery of them, or

(b) In cases of total loss of the goods, on the day the person entitled to make a claim receives notice from the operator that the goods are lost, or on the day that person may treat the goods as lost in accordance with paragraph (4) of article 5, whichever is earlier.

(3) The day on which the limitation period commences is not included in the period.

(4) The operator may at any time during the running of the limitation period extend the period by a notice to the claimant. The period may be further extended by another notice or notices.

(5) A recourse action by a carrier or another person against the operator may be instituted even after the expiration of the limitation period provided for in the preceding paragraphs if it is instituted within 90 days after the carrier or other person has been held liable in an action against himself or has settled the claim upon which such action was based and if, within a reasonable period of time after the filing of a claim against a carrier or other person that may result in a recourse action against the operator, notice of the filing of such a claim has been given to the operator.

#### Article 13

##### *Contractual stipulations*

(1) Unless otherwise provided in this Convention, any stipulation in a contract concluded by an operator or in any document signed or issued by the operator pursuant to article 4 is null and void to the extent that it derogates, directly or indirectly, from the provisions of this Convention. The nullity of such a stipulation does not affect the validity of the other provisions of the contract or document of which it forms a part.

(2) Notwithstanding the provisions of the preceding paragraph, the operator may agree to increase his responsibilities and obligations under this Convention.

#### Article 14

##### *Interpretation of the Convention*

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

#### Article 15

##### *International transport conventions*

This Convention does not modify any rights or duties which may arise under an international convention relating to the international carriage of goods which is binding on a State which is a party to this Convention or under any law of such State giving effect to a convention relating to the international carriage of goods.

#### Article 16

##### *Unit of account*

(1) The unit of account referred to in article 6 is the Special Drawing Right as defined by the International Monetary Fund. The amounts mentioned in article 6 are to be expressed in the national currency of a State according to the value of such currency at the date of judgement or the date agreed upon by the parties. The equivalence between the national currency of a State Party which is a member of the International Monetary Fund and the Special Drawing Right is to be calculated in accordance with the method of valuation applied by the International Monetary Fund in effect at the date in question for its operations and transactions. The equivalence between the national currency of a State Party which is not a member of the International Monetary Fund and the Special Drawing Right is to be calculated in a manner determined by that State.

(2) The calculation mentioned in the last sentence of the preceding paragraph is to be made in such a manner as to express in the national currency of the State Party as far as possible the same real value for amounts in article 6 as is expressed there in units of account. States Parties must communicate to the depositary the manner of calculation at the time of signature or when depositing their instrument of ratification, acceptance, approval or accession and whenever there is a change in the manner of such calculation.

### FINAL CLAUSES

#### Article 17

##### *Depositary*

The Secretary-General of the United Nations is the depositary of this Convention.

#### Article 18

##### *Signature, ratification, acceptance, approval, accession*

(1) This Convention is open for signature at the concluding meeting of the United Nations Conference on the Liability of Operators of Transport Terminals in International Trade and will remain open for signature by all States at the Headquarters of the United Nations, New York, until 30 April 1992.

(2) This Convention is subject to ratification, acceptance or approval by the signatory States.

(3) This Convention is open to accession by all States which are not signatory States as from the date it is open for signature.

(4) Instruments of ratification, acceptance, approval and accession are to be deposited with the Secretary-General of the United Nations.

#### Article 19

##### *Application to territorial units*

(1) If a State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with

in this Convention, it may, at the time of signature, ratification, acceptance, approval or accession, declare that this Convention is to extend to all its territorial units or only to one or more of them, and may at any time substitute another declaration for its earlier declaration.

(2) These declarations are to state expressly the territorial units to which the Convention extends.

(3) If, by virtue of a declaration under this article, this Convention extends to one or more but not all of the territorial units of a State Party, this Convention shall be applicable only if

(a) The transport-related services are performed by an operator whose place of business is located in a territorial unit to which the Convention extends, or

(b) The transport-related services are performed in a territorial unit to which the Convention extends, or

(c) According to the rules of private international law, the transport-related services are governed by the law in force in a territorial unit to which the Convention extends.

(4) If a State makes no declaration under paragraph (1) of this article, the Convention is to extend to all territorial units of that State.

#### Article 20

##### *Effect of declaration*

(1) Declarations made under article 19 at the time of signature are subject to confirmation upon ratification, acceptance or approval.

(2) Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

(3) A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the expiration of six months after the date of its receipt by the depositary.

(4) Any State which makes a declaration under article 19 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification by the depositary.

#### Article 21

##### *Reservations*

No reservations may be made to this Convention.

#### Article 22

##### *Entry into force*

(1) This Convention enters into force on the first day of the month following the expiration of one year from the date of deposit of the fifth instrument of ratification, acceptance, approval or accession.

(2) For each State which becomes a Contracting State to this Convention after the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession, this Convention enters into force on the first day of the month following the expiration of one year after the date of the deposit of the appropriate instrument on behalf of that State.

(3) Each State Party shall apply the provisions of this Convention to transport-related services with respect to goods taken in charge by the operator on or after the date of the entry into force of this Convention in respect of that State.

#### Article 23

##### *Revision and amendment*

(1) At the request of not less than one third of the States Parties to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

(2) Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended.

#### Article 24

##### *Revision of limitation amounts*

(1) At the request of at least one quarter of the States Parties, the depositary shall convene a meeting of a Committee composed of a representative from each Contracting State to consider increasing or decreasing the amounts in article 6.

(2) If this Convention enters into force more than five years after it was opened for signature, the depositary shall convene a meeting of the Committee within the first year after it enters into force.

(3) The meeting of the Committee shall take place on the occasion and at the location of the next session of the United Nations Commission on International Trade Law.

(4) In determining whether the limits should be amended, and if so, by what amount, the following criteria, determined on an international basis, and any other criteria considered to be relevant, shall be taken into consideration:

(a) The amount by which the limits of liability in any transport-related convention have been amended;

(b) The value of goods handled by operators;

(c) The cost of transport-related services;

(d) Insurance rates, including for cargo insurance, liability insurance for operators and insurance covering job-related injuries to workmen;

(e) The average level of damages awarded against operators for loss of or damage to goods or delay in handing over goods; and

(f) The costs of electricity, fuel and other utilities.

(5) Amendments shall be adopted by the Committee by a two-thirds majority of its members present and voting.

(6) No amendment of the limits of liability under this article may be considered less than five years from the date on which this Convention was opened for signature.

(7) Any amendment adopted in accordance with paragraph (5) shall be notified by the depositary to all Contracting States. The amendment is deemed to have been accepted at the end of a period of 18 months after it has been notified, unless within that period not less than one third of the States that were States Parties at the time of the adoption of the amendment by the Committee have communicated to the depositary that they do not accept the amendment. An amendment deemed to have been accepted in

accordance with this paragraph enters into force for all States Parties 18 months after its acceptance.

(8) A State Party which has not accepted an amendment is nevertheless bound by it, unless such State denounces the present Convention at least one month before the amendment enters into force. Such denunciation takes effect when the amendment enters into force.

(9) When an amendment has been adopted in accordance with paragraph (5) but the 18-month period for its acceptance has not yet expired, a State which becomes a State Party to this Convention during that period is bound by the amendment if it enters into force. A State which becomes a State Party after that period is bound by any amendment which has been accepted in accordance with paragraph (7).

(10) The applicable limit of liability is that which, in accordance with the preceding paragraphs, is in effect on the date of the occurrence which caused the loss, damage or delay.

*Article 25*  
*Denunciation*

(1) A State Party may denounce this Convention at any time by means of a notification in writing addressed to the depositary.

(2) Subject to paragraph (8) of article 24, the denunciation takes effect on the first day of the month following the expiration of one year after the notification is received by the depositary. Where a longer period is specified in the notification, the denunciation takes effect upon the expiration of such longer period after the notification is received by the depositary.

DONE at Vienna, this nineteenth day of April one thousand nine hundred and ninety-one, in a single original, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic.

IN WITNESS WHEREOF the undersigned plenipotentiaries, being duly authorized by their respective Governments, have signed the present Convention.

## II. UNCITRAL MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

### CHAPTER I. GENERAL PROVISIONS\*

#### Article 1

##### *Sphere of application\*\**

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

(2) This law applies to other entities that as an ordinary part of their business engage in executing payment orders in the same manner as it applies to banks.

(3) 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. A payment order issued for the purpose of effecting payment for such an order is considered to be part of a different credit transfer;

(b) "Payment order" means an unconditional instruction, in any form, 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.

Nothing in this paragraph prevents an instruction from being a payment order merely because it directs the beneficiary's bank to hold, until the beneficiary requests payment, funds for a beneficiary that does not maintain an account with it;

\*The Commission suggests the following text for States that might wish to adopt it:

#### Article Y

##### *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.

(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;

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

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

(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) "Receiving bank" means a bank that receives a payment order;

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

(h) "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;

(i) "Authentication" means a procedure established by agreement to determine whether a payment order or an amendment or revocation of a payment order was issued by the person indicated as the sender;

(j) "Banking day" means that part of a day during which the bank performs the type of action in question;

(k) "Execution period" means the period of one or two days beginning on the first day that a payment order may be executed under article 11(1) and ending on the last day on which it may be executed under that article;

(l) "Execution", in so far as it applies to a receiving bank other than the beneficiary's bank, means the issue of a payment order intended to carry out the payment order received by the receiving bank;

(m) "Interest" means the time value of the funds or money involved, which, unless otherwise agreed, is calculated at the rate and on the basis customarily accepted by the banking community for the funds or money involved.

#### Article 3

##### *Conditional instructions*

(1) When an instruction is not a payment order because it is subject to a condition but a bank that has received the instruction executes it by issuing an unconditional payment order, thereafter the sender of the instruction has the same rights and obligations under this law as the sender of a payment order and the beneficiary designated in the instruction shall be treated as the beneficiary of a payment order.

(2) This law does not govern the time of execution of a conditional instruction received by a bank, nor does it affect any right or obligation of the sender of a conditional instruction that depends on whether the condition has been satisfied.

#### Article 4

##### *Variation by agreement*

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

## CHAPTER II. OBLIGATIONS OF THE PARTIES

## Article 5

*Obligations of sender*

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

(2) When a payment order or an amendment or revocation of a payment order is subject to authentication other than by means of a mere comparison of signature, a purported sender who is not bound under paragraph (1) is nevertheless bound if

(a) the authentication is in the circumstances 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 a purported sender is bound under paragraph (2) if the authentication is not commercially reasonable in the circumstances.

(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) a present or former employee of the purported sender, or

(b) a person whose relationship with the purported sender enabled that person to gain access to the authentication procedure.

The preceding sentence does not apply if the receiving bank proves 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, the sender is not bound by an erroneous duplicate of, or an error or discrepancy in, a payment order if

(a) the sender and the receiving bank have agreed upon a procedure for detecting erroneous duplicates, errors or discrepancies in a payment order, and

(b) use of the procedure by the receiving bank revealed or would have revealed the erroneous duplicate, error or discrepancy.

If the error or discrepancy 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 is bound only to the extent of the amount that was intended. Paragraph (5) applies to an error or discrepancy in an amendment or a revocation order as it applies to an error or discrepancy in a payment order.

(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 beginning of the execution period.

## Article 6

*Payment to receiving bank*

For the purposes of this law, payment of the sender's obligation under article 5(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 banking 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 banking 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 a central bank at which the receiving bank maintains an account, or

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

a. the rules of a funds transfer system that provides for the settlement of obligations among participants either bilaterally or multilaterally, or

b. a bilateral netting agreement with the sender; or

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

## Article 7

*Acceptance or rejection of a payment order by receiving bank other than the beneficiary's bank*

(1) The provisions of this article apply to a receiving bank other than the beneficiary's bank.

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

(a) 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;

(b) when the bank gives notice to the sender of acceptance;

(c) when the bank issues a payment order intended to carry out the payment order received;

(d) when the bank debits an account of the sender with the bank as payment for the payment order; or

(e) when the time for giving notice of rejection under paragraph (3) has elapsed without notice having been given.

(3) A receiving bank that does not accept a payment order is required to give notice of rejection no later than on the banking day following the end of the execution period, unless:

(a) where payment is to be made by debiting an account of the sender with the receiving bank, there are insufficient funds available in the account to pay for the payment order;

(b) where payment is to be made by other means, payment has not been made; or

(c) there is insufficient information to identify the sender.

(4) A payment order ceases to have effect if it is neither accepted nor rejected under this article before the close of business on the fifth banking day following the end of the execution period.

## Article 8

*Obligations of receiving bank other than the beneficiary's bank*

(1) The provisions of this article apply to a receiving bank other than 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 11, either to the beneficiary's bank or to an 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) A receiving bank that determines that it is not feasible to follow an instruction of the sender specifying an intermediary bank or funds transfer system to be used in carrying out the credit transfer, or that following such an instruction would cause excessive costs or delay in completing the credit transfer, shall be taken to have complied with paragraph (2) if, before the end of the execution period, it inquires of the sender what further actions it should take.

(4) When an instruction is received that appears to be intended to be a payment order but 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 11.

(5) When a receiving bank detects that there is an inconsistency in the information relating to the amount of money to be transferred, it shall, within the time required by article 11, give notice to the sender of the inconsistency, if the sender can be identified. Any interest payable under article 17(4) for failing to give the notice required by this paragraph shall be deducted from any interest payable under article 17(1) for failing to comply with paragraph (2) of this article.

(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 9

##### *Acceptance or rejection of a payment order by beneficiary's bank*

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

- (a) 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;
- (b) when the bank gives notice to the sender of acceptance;
- (c) when the bank debits an account of the sender with the bank as payment for the payment order;
- (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 or other competent authority; or
- (h) when the time for giving notice of rejection under paragraph (2) has elapsed without notice having been given.

(2) A beneficiary's bank that does not accept a payment order is required to give notice of rejection no later than on the banking day following the end of the execution period, unless:

- (a) where payment is to be made by debiting an account of the sender with the beneficiary's bank, there are insufficient funds available in the account to pay for the payment order;
- (b) where payment is to be made by other means, payment has not been made; or

(c) there is insufficient information to identify the sender.

(3) A payment order ceases to have effect if it is neither accepted nor rejected under this article before the close of business on the fifth banking day following the end of the execution period.

#### Article 10

##### *Obligations of beneficiary's bank*

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

(2) When an instruction is received that appears to be intended to be a payment order but 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 11.

(3) When the beneficiary's bank detects that there is an inconsistency in the information relating to the amount of money to be transferred, it shall, within the time required by article 11, give notice to the sender of the inconsistency if the sender can be identified.

(4) When the beneficiary's bank detects that there is an inconsistency in the information intended to identify the beneficiary, it shall, within the time required by article 11, give notice to the sender of the inconsistency if the sender can be identified.

(5) Unless the payment order states otherwise, the beneficiary's bank shall, within the time required for execution under article 11, give notice to a beneficiary who does not maintain an account at the bank that it is holding funds for its benefit, if the bank has sufficient information to give such notice.

#### Article 11

##### *Time for receiving bank to execute payment order and give notices*

(1) In principle, a receiving bank that is obligated to execute a payment order is obligated to do so on the banking day it is received. If it does not, it shall do so on the banking day after the order is received. Nevertheless, if

- (a) a later date is specified in the payment order, the payment order shall be executed on that date, or
- (b) the payment order specifies a date when the funds are to be placed at the disposal of the beneficiary and that date indicates that later execution is appropriate in order for the beneficiary's bank to accept a payment order and execute it on that date, the order shall be executed on that date.

(2) If the receiving bank executes the payment order on the banking day after it is received, except when complying with subparagraph (a) or (b) of paragraph (1), the receiving bank must execute for value as of the day of receipt.

(3) A receiving bank that becomes obligated to execute a payment order by virtue of accepting a payment order under article 7(2)(e) must execute for value as of the later of the day on which the payment order is received and the day on which

- (a) where payment is to be made by debiting an account of the sender with the receiving bank, there are sufficient funds available in the account to pay for the payment order, or

(b) where payment is to be made by other means, payment has been made.

(4) A notice required to be given under article 8(4) or (5) or article 10(2), (3) or (4) shall be given on or before the banking day following the end of the execution period.

(5) 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 next day the bank executes that type of payment order.

(6) If a receiving bank is required to perform an action on a day when it does not perform that type of action, it must perform the required action on the next day it performs that type of action.

(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 12* *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 day on which the payment order ought to have been executed under subparagraph (a) or (b) of article 11(1).

(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 the credit transfer is completed and the beginning of the day when the funds are to be placed at the disposal of the beneficiary.

(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 earlier than the time specified in paragraph (1) or (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 in respect of which an effective revocation order has been or is subsequently received is not entitled to payment for that payment order. If the credit transfer is completed, the bank shall refund any payment received by it.

(6) If the recipient of a refund is not the originator of the credit transfer, it shall pass on the refund to its sender.

(7) A bank that is obligated to make a refund to its sender is discharged from that obligation to the extent that it makes the refund direct to a prior sender. Any bank subsequent to that prior sender is discharged to the same extent.

(8) An originator entitled to a refund under this article may recover from any bank obligated to make a refund hereunder to the extent that the bank has not previously refunded. A bank that is obligated to make a refund is discharged from that obligation to the extent that it makes the refund direct to the originator. Any other bank that is obligated is discharged to the same extent.

(9) Paragraphs (7) and (8) do not apply to a bank if they would affect the bank's rights or obligations under any agreement or any rule of a funds transfer system.

(10) If the credit transfer is completed but a receiving bank executes a payment order in respect of which an effective revocation order has been or is subsequently received, the receiving bank has such rights to recover from the beneficiary the amount of the credit transfer as may otherwise be provided by law.

(11) The death, insolvency, 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.

(12) The principles contained in this article apply to an amendment of a payment order.

(13) 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 13* *Assistance*

Until the credit transfer is completed, each receiving bank is requested to assist the originator and each subsequent sending bank, and to seek the assistance of the next receiving bank, in completing the banking procedures of the credit transfer.

#### *Article 14* *Refund*

(1) If the credit transfer is not completed, 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 except when a prudent originator's bank would not have otherwise accepted a particular payment order because of a significant risk involved in the credit transfer.

(3) A receiving bank is not 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. A receiving bank is not considered to have been directed to use the intermediary bank unless the receiving bank proves that it does not systematically seek such directions in similar cases. The sender that first specified the use of that intermediary bank has the right to obtain the refund from the intermediary bank.

(4) A bank that is obligated to make a refund to its sender is discharged from that obligation to the extent that it makes the refund direct to a prior sender. Any bank subsequent to that prior sender is discharged to the same extent.

(5) An originator entitled to a refund under this article may recover from any bank obligated to make a refund hereunder to the extent that the bank has not previously refunded. A bank that is obligated to make a refund is discharged from that obligation to the extent that it makes the refund direct to the originator. Any other bank that is obligated is discharged to the same extent.

(6) Paragraphs (4) and (5) do not apply to a bank if they would affect the bank's rights or obligations under any agreement or any rule of a funds transfer system.

### Article 15

#### *Correction of underpayment*

If the amount of the payment order executed by a receiving bank is less than the amount of the payment order it accepted, other than as a result of the deduction of its charges, it is obligated to issue a payment order for the difference.

### Article 16

#### *Restitution of overpayment*

If the credit transfer is completed, 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 the difference from the beneficiary as may otherwise be provided by law.

### Article 17

#### *Liability for interest*

(1) A receiving bank that does not comply with its obligations under article 8(2) is liable to the beneficiary if the credit transfer is completed. The liability of the receiving bank is to pay interest on the amount of the payment order for the period of delay caused by the receiving bank's non-compliance. If the delay concerns only part of the amount of the payment order, the liability shall be to pay interest on the amount that has been delayed.

(2) The liability of a receiving bank under paragraph (1) may be discharged by payment to its receiving bank or by direct payment to the beneficiary. If a receiving bank receives such payment but is not the beneficiary, 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) An originator may recover the interest the beneficiary would have been entitled to, but did not, receive in accordance with paragraphs (1) and (2) to the extent the originator has paid interest to the beneficiary on account of a delay in the completion of the credit transfer. The originator's bank and each subsequent receiving bank that is not the bank liable under paragraph (1) may recover interest paid to its sender from its receiving bank or from the bank liable under paragraph (1).

(4) A receiving bank that does not give a notice required under article 8(4) or (5) shall pay interest to the sender on any payment that it has received from the sender under article 5(6) for the period during which it retains the payment.

(5) A beneficiary's bank that does not give a notice required under article 10(2), (3) or (4) shall pay interest to the sender on any payment that it has received from the sender under article 5(6), from the day of payment until the day that it provides the required notice.

(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 10(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. In particular, it may not reduce its liability by an agreement fixing the rate of interest.

### Article 18

#### *Exclusivity of remedies*

The remedies in article 17 shall be exclusive, and no other remedy arising out of other doctrines of law shall be available in respect of non-compliance with articles 8 or 10, except any remedy that may exist when a bank has improperly executed, or failed to execute, a payment order (a) with the specific intent to cause loss, or (b) recklessly and with actual knowledge that loss would be likely to result.

## CHAPTER IV. COMPLETION OF CREDIT TRANSFER

### Article 19

#### *Completion of credit transfer\**

(1) A credit transfer is completed when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. 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. Completion does not otherwise affect the relationship between the beneficiary and the beneficiary's bank.

(2) A credit transfer is completed 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 governing the underlying obligation to recover the amount of those charges from the originator.

\*The Commission suggests the following text for States that might wish to adopt it:

If a credit 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.

### III. SUMMARY RECORDS OF MEETINGS OF THE COMMISSION DEVOTED TO THE PREPARATION OF THE UNCITRAL MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

#### Summary record of the 467th meeting

Monday, 4 May 1992, at 10.30 a.m.

[A/CN.9/SR.467]

*Temporary Chairman:* Mr. HERRMANN (Secretary of the Commission)

*Chairman:* Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 11.10 a.m.*

#### International payments: draft Model Law on International Credit Transfers

##### OPENING OF THE SESSION

1. The TEMPORARY CHAIRMAN said that the twenty-fifth session of the United Nations Commission on International Trade Law (UNCITRAL) would be important not only because it marked the Commission's silver jubilee, but also because the Commission expected to complete its work on two major texts, namely, the draft Model Law on International Credit Transfers and the draft Legal Guide on International Countertrade Transactions. The Commission would also consider a number of other important issues.

2. The Congress on International Trade Law would be held during the last week of the session. The UNCITRAL secretariat had prepared an interesting programme for the Congress, which included over 60 speakers. The secretariat had decided that no official conclusions should be drawn and no resolutions should be adopted at the Congress, which should rather take the form of a free-wheeling dialogue. At its next session, the Commission could consider how to make the best use of the positive results of the Congress in its future programme of work.

##### ELECTION OF OFFICERS

3. *Mr. Abascal Zamora (Mexico) was elected Chairman by acclamation.*

4. *Mr. Abascal Zamora (Mexico) took the Chair.*

##### ADOPTION OF THE AGENDA (A/CN.9/355)

5. *The agenda was adopted.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

6. The CHAIRMAN said that, at its twenty-fourth session, the Commission had briefly considered article 16 of the draft Model Law on International Credit Transfers, and had decided to resume

consideration of the article as well as the proposal made by the United Kingdom and Finland to replace the existing article with the text contained in paragraph 278 of the UNCITRAL report (A/46/17). In connection with article 16, he drew the Commission's attention to the definition of "interest" contained in paragraph 92 of the Commission's report.

7. Mr. GREGORY (United Kingdom) said that article 16 was based on the principle that, when a credit transfer was completed but some delay had occurred, the bank that caused the delay was obliged to pass interest down the chain to the beneficiary. Article 16 also dealt with liability for failure to comply with certain other obligations contained in the draft Model Law, such as the obligation of banks to give notice, in certain circumstances, of discrepancies that they might detect in payment orders that they received. In that case, the principle was different: the interest passed from the bank that failed to comply with the notification requirement back to its sender. The Commission should bear in mind that article 16 dealt with two situations, namely, the need to pass interest to the beneficiary for delay in execution and the need to pass interest back to a sender when a receiving bank failed to comply with the notification provision.

8. After reviewing the provisions of article 16 as set out in annex I to document A/46/17, he said that the new version prepared by the United Kingdom and Finland was intended to reflect the decisions taken by the Commission on articles 1 to 15, and also to make the existing provisions of article 16 more logical.

9. Introducing the revised text of article 16(1) (as set out in document A/46/17, para. 278), he said that none of the changes were substantive. The first sentence, rather than referring to a receiving bank's "failure to execute", as in the current text (set out in annex I to document A/46/17), referred to failure "to comply with its obligations under article 7(2)". The requirement in article 7(2) that the receiving bank should issue a payment order consistent with payment received established the essential chain of obligations. The changes made the first sentence of article 16(1) more precise.

10. While the second sentence was unchanged, the third sentence was completely revised. The current text, which stipulated the mechanics of the discharge of liability, belonged more logi-

cally in article 16(2); the revised text stated what should be done if too little had been paid, a point currently dealt with in article 16(5). He proposed that the Commission should adopt article 16(1) as revised.

11. Mr. BURMAN (United States of America) said that while his delegation would withhold its position on a possible problem in article 16(2) until it was clear how the full text of article 16 would read, he wished to suggest the possibility of including in paragraph 2 language already approved in two previous articles, regarding the protection of the rights of parties to a credit transfer who might be precluded from the non-payment of interest that was authorized in article 16(2).

12. Mr. EL-SHARKAWY (Egypt) asked whether, as new article 16 (2 bis) implied, the liability of a receiving bank under article 16(1) was an objective liability, which did not require any proof of fault.

13. The CHAIRMAN said that, indeed, the Working Group had intended it to be an objective liability.

14. Mr. FUJISHITA (Japan) said that he saw two problems with both the current and the revised texts. He noted that in the current text of article 16 all reference to damages—the cost of reissuance of payment orders and the cost of lawyers' fees—had been deleted, and he wondered why that had been done, in view of the crucial provision in current article 16(8) regarding the exclusiveness of remedies for damages. If the current version of article 16 was retained, a reference to such damages would have to be added in article 16(1). If, however, the United Kingdom/Finland revision of article 16 was adopted, in which current paragraph 8 was deleted, he could support the revised text of paragraph 1 as proposed.

15. Another problem arose in the third sentence of new article 16(1) the liability referred to was, pursuant to the first sentence, contingent upon completion of the credit transfer under article 17(2). However, in a case where the beneficiary's bank received only a partial payment order, the credit transfer would presumably still be considered completed under the terms of article 17(2), making that bank liable. As he recalled it, it had been decided not to include the "partial completion" concept in article 16(1) because of such a possibility.

16. The CHAIRMAN said that any specific reference to damages had been deleted from the current text of article 16, because it had been felt that the cost of issuance of a new payment order was too small to be worth mentioning, and because the payment of lawyers' fees had been deemed to be a matter for national legislation and not for the Model Law. At one point, a footnote to that effect had been part of the article.

17. As to partial payment orders, which were dealt with in current article 16(5), the matter would have to be considered in conjunction with both article 14 and article 17(1).

18. Mr. BERGSTEN (Consultant to the Secretariat) said that the provisions concerning the discharge of the obligation of the originator to the beneficiary were currently in article 16(2).

19. Mr. GREGORY (United Kingdom) said that earlier references to legal expenses had indeed been deleted, but not merely because they were only a minor element or a matter for national legislation. They had been deleted because of a change of philosophy at the last meeting of the Working Group. Article 16 had gone from being a fault-based provision involving the concept of damages to a provision which depended only on an objective failure to comply, rather than on fault or loss or assessment of loss. Article 16 dealt with interest which was earned by a delaying

bank and which must be passed down. He agreed that current paragraph 1 had to be seen in the light of current paragraph 8, where it would be appropriate to discuss Japan's wish to reintroduce the reference to damages. Revised paragraph 1 dealt only with interest.

20. The second question raised by Japan regarding the possibility of partial completion of a payment order would come under article 17; and article 16(1) was currently based on article 17 as drafted by the Working Group. In any case, the basic principle on which all were agreed was that article 16(1) applied if the beneficiary's bank accepted a payment order which was the result of the chain of liability that began with the originator's payment order.

21. Mr. LOJENDIO (Spain) said that one point remained unclear in both the current and the revised texts of article 16(1), which established a distinction between the obligation to pay interest and the liability to the beneficiary. It was not clear, from the third sentence of the current text, who would be liable to the beneficiary. It seemed logical that the bank which received the interest would be liable, but that had to be spelt out clearly, as did the fact the beneficiary could claim a remedy from either the bank that had failed to comply or the receiving bank.

22. Mr. SCHNEIDER (Germany) said that article 16(1) raised two problems. First, he did not see why the receiving bank should be liable only to the beneficiary and not to the originator or the issuing bank. His delegation believed the obligation involved was a contractual one, although the Working Group considered it a statutory duty. Even so, given the right of the beneficiary to ask for damages in a case of delayed payment from either the originator or the receiving bank, a serious problem could arise for the originator if the beneficiary opted for the first course, because the originator at the moment had no way to claim reimbursement from the receiving bank. The beneficiary should not have sole rights in the matter.

23. Secondly, the concept of objective liability was not clearly defined in article 16. If a receiving bank was deemed to have been unjustly enriched as a result of its failure to execute a payment order, then it should be given the possibility of showing that it had not been so enriched. In his view, a receiving bank should be liable only where its failure to execute an order was negligent or intentional. He did not support the notion of objective liability.

24. The CHAIRMAN said that, in view of the current practice of receiving banks passing orders for payment and the corresponding interest on to the next receiving bank in the chain, the Working Group, in article 13(1), provided for the right of the originator of a payment to receive interest from a receiving bank which failed to execute the order.

25. As far as objective liability was concerned, the Working Group had concluded that a receiving bank which failed to execute an order incurred liability, which was limited, however, to the payment of interest and did not extend to other indirect or consequential damages.

26. Mr. VASSEUR (Observer, Banking Federation of the European Community) said that his organization, which spoke for almost all Western European banks, had difficulty with the idea that a receiving bank should be liable for interest if it failed to execute a payment order. That position assumed that the bank had had the money at its disposal and had unjustly enriched itself. However, the bank might have been advancing the money and, although it had undertaken to execute a payment order, it might not actually have had the originator's funds at its disposal. He wished to know whether article 16 contemplated such a situation.

27. The CHAIRMAN said that, in considering the question of liability, the Working Group had dwelt not on the notion of unjust

enrichment, but on the extent of liability. It had felt that if a bank undertook to execute an order, it had an objective liability and was therefore liable for the payment of interest whether or not it had actually received the funds in question.

28. Mr. SCHNEIDER (Germany) said that article 13(1) covered a situation in which a transfer had not been completed, while article 16(1) contemplated a situation in which a payment order was executed but not in due time. In the latter case, article 16(1) provided that interest should be paid only to the beneficiary and not to the originator. In his view, the provision for the payment of interest should also extend to the originator.

29. As for the concept of objective liability, he recalled that the Working Group had earlier proposed that there should be a series of exceptions covering, for example, cases where, on account of war, it was impossible to execute an order. The Commission should either reopen consideration of exceptions to liability or embrace the concept of liability where there was fault.

30. The CHAIRMAN, while noting the suggestion of the representative of Germany that the Commission should reopen consideration of exceptions to liability, pointed to the differences between the situations provided for in articles 16(1) and 13(1), and proposed that the matter should be referred to the Drafting Group.

31. Mr. EL-SHARKAWY (Egypt) said that the question of unjust enrichment simply did not arise, since there should be no need to prove negligence or fault.

32. Ms. KOSKELO (Observer for Finland) said that the situation adverted to by the representative of Germany, in which a beneficiary claimed interest from the originator of an order on account of a delay in transfer, had been contemplated in paragraph (2 *ter*) of the proposed revised version of article 16.

33. With regard to the determination of liability, there were very good reasons for using the yardstick of objective liability. The

conceptual framework of damages and unjust enrichment did not inform article 16. The Working Group had simply concluded that a party which was holding funds was in a position to benefit from those funds and therefore had an obligation to pay compensation for its failure to execute. The reason for such failure was irrelevant.

34. Mr. GREGORY (United Kingdom) said that he fully shared the view just expressed by the representative of Finland concerning the basis for liability. The Model Law was being codified in an age of high-speed electronic transfers, and the Commission should not necessarily be bound by concepts of municipal law such as unjust enrichment and negligence. Objective liability based on the simple calculation of interest would be a much easier system to operate.

35. Mr. LE GUEN (France) agreed that the receiving bank should be objectively liable for payment of interest where it failed to execute a payment order, without regard to unjust enrichment or fault. Several grounds for the liability of receiving banks, including liability for losses due to variations in the foreign exchange rate, had been eliminated from the draft text. That was all the more reason why the liability regime retained in the draft should be stricter.

36. He cautioned that any changes to draft articles 16, 17, and, to some extent, 18 might have consequences for the remainder of the text, on which broad agreement had already been reached.

37. Mr. FELSENFELD (United States of America) said that he shared the views expressed by the representatives of the United Kingdom, Finland and France. The draft Model Law proposed a harmonious, realistic and rational system based on the premise that a bank which held funds beyond the time during which it was authorized to do so was liable for interest. If the originator's bank did not hold funds, it would not be so liable. To provide for exceptions would be to introduce unnecessary turmoil into the system.

*The meeting rose at 1 p.m.*

### Summary record of the 468th meeting

Monday, 4 May 1992, at 3 p.m.

[A/CN.9/SR.468]

*Chairman:* Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.10 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

#### Article 16

1. The CHAIRMAN said that, owing to a lack of support in the Commission, the representative of Germany had agreed to withdraw his objection to the notion of objective liability, on condition that his delegation's views were reflected in the record.

2. The Commission must determine whether paragraph (1) of article 16 should use the wording originally proposed by the Working Group on International Payments, as set out in annex I to the Commission's report on the work of its twenty-fourth session (A/46/17), or that proposed by the United Kingdom and

Finland (A/46/17, para. 278). In addition, the representative of Germany had raised the question of extending liability to the originator when a financial transfer was not completed, a situation contemplated in paragraph (2 *ter*) of the United Kingdom/Finnish proposal.

3. Mr. FUJISHITA (Japan) said that his delegation would have no objection to paragraphs (1) and (2 *ter*), provided that the points he had raised at the previous meeting were dealt with properly when the Commission considered articles 16(8) and 17(1).

4. The CHAIRMAN suggested that the Commission should adopt paragraph (1) and that paragraphs (1) and (2 *ter*) of the United Kingdom/Finnish proposal should be referred to the Drafting Group for further review.

5. *It was so decided.*

6. The CHAIRMAN suggested that the Commission should adopt paragraph (2).

7. *It was so decided.*

8. Mr. GREGORY (United Kingdom), referring to paragraph (2 *bis*) of the United Kingdom/Finnish proposal, said that the purpose of article 16 was to provide a structure in which the obligations in the Model Law that were essential to the operation of a credit transfer would have some liability attached to them. Paragraph (2 *bis*) was therefore necessary to explain that one of the failures that could incur liability under paragraph (1) was the failure to pay. He noted, however, that the word "pay" did not cover the debiting of a sender's account at the receiving bank, which could be done at any time.

9. If a rule obliged a bank to pay in a timely fashion, the appropriate time for such payment was when funds were available in the account. The rule was meant to apply to a bank that received money but held on to it even though it had issued a payment order consistent with the one received. Such a rule would clarify the obligations referred to in paragraph (1).

10. Mr. FELSENFELD (United States of America) said he was sympathetic to the objectives of the representative of the United Kingdom, but felt that paragraph (2 *bis*) would not accomplish them. He had a number of objections to that paragraph; for example, the paying bank must make payment to any receiving bank that accepted a payment order whether or not the sending bank had been paid. He was not sure what sanctions should apply if such was not the case. The reference to a delay caused by failure to pay was also unclear. A bank that issued a payment order that was accepted must cover that payment order, and failure to do so constituted a violation of the obligation. Whether or not failure to pay caused delay was irrelevant to the transaction. Finally, the Commission had already decided that no specific penalty would be provided for banks that were unable to pay.

11. Ms. KOSKELO (Observer for Finland) said that paragraph (2 *bis*) was not intended to deal with situations where a sending bank failed to execute a payment order already accepted by a receiving bank. The need for that paragraph arose from the fact that a bank that had received and accepted a payment order could delay the credit transfer in two ways: by executing the payment order too late, or by issuing its own payment order but failing to make payment available to the next bank. In the latter case, the next bank would not accept the order and delay would result.

12. The CHAIRMAN pointed out that article 4(6) established that when a bank accepted a payment order, the sending bank must pay the receiving bank for that payment order. Article 7(2) established the obligations of banks. If a bank accepted a payment order, the normal assumption was that that bank had the necessary funds. However, it could not hold up the transaction if funds were not available; having accepted the original payment order, it must then issue a new order. By failing to do so the bank was flouting its responsibilities.

13. Mr. BURMAN (United States of America) said that paragraph (2 *bis*) could pose real problems. The observer for Finland had said that the paragraph was not meant to deal with the case of a sending bank that failed to pay. In a credit transfer, however, a receiving bank that accepted a payment order and issued a new order of its own became by that very act a sending bank. The non-payment or delayed payment of such orders by receiving banks was in fact an illusory problem. The so-called failure to pay was actually credit, and billions of dollars went through banks' books without any "cover" ever having been provided. Article 4(6) established an obligation to pay and that obligation need not be expanded.

14. To include paragraph (2 *bis*) in article 16 would interfere with the credit decisions made by receiving banks and would introduce complications into high-volume, high-speed credit transfers. In practice, receiving banks never matched incoming and outgoing payment orders on a one-to-one basis. Such an obligation would be very cumbersome to legislate.

15. Mr. JONES (United Kingdom) said that he was familiar with the practical problems raised by the United States representative. However, paragraph (2 *bis*) sought to impose an obligation that would prevent banks from issuing payment orders unless they could pay for them. The problem was in fact exacerbated by high-speed financial transfers, which were slowed tremendously by large numbers of transactions without cover. Consequently, his delegation's proposal sought to create a situation in which most payment orders were drawn on available credit and the flow of transactions was not slowed by a lack of credit.

16. Ms. KOSKELO (Observer for Finland) said that the new rule would not interfere with the credit decisions of receiving banks. If a receiving bank was willing to execute a payment order even though it had not been paid or had received assurance that it would get cover, no problem arose, except in the rare case where a receiving bank was not willing to give credit to the sender. The problem addressed in the proposal arose when a receiving bank was not prepared to execute a payment order without the assurance of cover: in that situation, a delay would be caused by the sending bank's failure to make cover available.

17. As to the objection that the new rule would create an operational burden arising from the need to match payments and payment orders, she stressed that the proposed rule merely sought to impute liability. Thus it did not imply the introduction of any features in the actual processing of payment orders.

18. Mr. DE BOER (Observer for the Netherlands) said that he favoured the United Kingdom/Finnish proposal. His delegation had submitted a proposal at the previous session that would have had the same result. Any delay that was caused because a bank had issued a payment order and had not provided cover must have a remedy. The draft Model Law had a lacuna in that respect.

19. Mr. JANSSEN (Observer for Sweden) supported the views expressed by the observer for the Netherlands.

20. Mr. JONES (United Kingdom) said that the practical problems raised by the representative of the United States of America were not relevant to article 16. His delegation did not see any difference between a situation in which funds were actually available and one in which credit was given. While he agreed that payments were not matched on an individual basis, his delegation's proposal did not require any matching whatsoever. What was important was whether the receiving bank had actually received sufficient funds by any means; if so, and if it decided to accept payment and make another payment, it must not hold onto those funds.

21. Mr. BURMAN (United States of America) said that, unfortunately, ideas that sounded logical were colliding with commercial reality. The Commission was displaying an inclination to overregulate; and seeking to give some kind of legal imprimatur to the shadowy concept of cover. In the commercial world a wide variety of payment orders were executed because a bank along the chain, following its own commercial judgement, chose to accept and execute them. In the real world payment orders from a variety of countries often did not have money behind them. If the Commission's purpose was to promote trade and commerce, it should not revive the concept of cover. If it tried to overregulate the system, it would not have any influence in the growing world of computer-assisted banking.

22. Mr. FELSENFELD (United States of America) said that the draft Model Law had always been based on the simple idea that every credit transfer, whether there was cover or not, could be accepted or rejected by the receiving bank without restriction. There was no lacuna in the draft Model Law in that respect. In asking for cover, the receiving bank itself could create a delay; such a course of action would not be consistent with good credit practice or with the theme of the draft Model Law.

23. The CHAIRMAN said that the text of paragraph (2 *bis*) had gained very little support. Therefore, if he heard no objection, he would take it that the Commission decided not to include paragraph (2 *bis*) in article 16.

24. *It was so decided.*

25. Mr. BERGSTEN (Consultant to the Secretariat) said that since article 7(3) had been deleted at the previous session, the reference to that article in paragraph (3) of article 16 should also be deleted. In paragraph (4), the reference to article 9 should read "paragraphs (2), (3) or (4)".

26. Mr. BHALA (United States of America) said that paragraphs (3) and (4) of article 16 dealt with notification duties that sometimes arose in the event of inconsistencies in payment orders. While the Commission had already considered certain aspects of that issue, it might wish to revert to it at some point.

27. *Paragraphs (3) and (4) were adopted.*

28. Ms. KOSKELO (Observer for Finland), speaking with reference to article 16(5), said that she had difficulty with two aspects of the text proposed by the Working Group which were addressed in the proposal put forward by her delegation and that of the United Kingdom. Paragraph (5) provided for liability to the beneficiary for interest that was not placed at the disposal of the beneficiary on the payment date, so that liability in the case of partial delay would arise only if a payment date was specified in the payment order. That represented a deviation from the general rule set out in article 16(1), which made a bank liable for interest regardless of whether the order contained a designated payment date.

29. The last sentence of paragraph (5) also constituted a deviation from paragraph (1). All that needed to be said was that if only part of the amount to be transferred had been delayed, interest should be paid on the amount that was delayed.

30. Mr. GREGORY (United Kingdom) agreed with the views expressed by the representative of Finland.

31. Mr. EL-SHARKAWY (Egypt) noted that paragraph (5) provided for the same penalty as paragraph (1). However, while the liability in paragraph (1) was not based on fault but was an objective liability, that in paragraph (5) was based on fault because the amount in question was less than the amount of the payment order the receiving bank had accepted. The Model Law should differentiate between the two situations.

*The meeting was suspended at 4.30 p.m. and resumed at 4.55 p.m.*

32. The CHAIRMAN recalled that the Working Group had not discussed the principle reflected in the last sentence of paragraph (5). He therefore welcomed the solution which the United Kingdom/Finnish proposal offered to the problem of payment orders for lesser amounts.

33. Mr. DUCHEK (Austria) said that the United Kingdom/Finnish proposal was preferable to the Working Group's text. The

expression "the receiving bank's improper action" was imprecise and should be avoided.

34. Mr. AZZIMAN (Morocco) said that he shared the concerns expressed by previous speakers. He had difficulty understanding the difference between a total and a partial failure to execute a payment order; the liability would be the same in both cases. He therefore supported the United Kingdom/Finnish proposal to reflect both situations in paragraph (1).

35. Mr. CHATURVEDI (India) said that his delegation's understanding of the proposal was that the last sentence of paragraph (5) should become the last sentence of paragraph (1); if that was correct, his delegation would support the proposal.

36. Mr. LE GUEN (France) agreed with the representative of Morocco: both situations should be reflected in paragraph (1).

37. The CHAIRMAN said that, if he heard no objections, he would take it that the Commission wished to delete paragraph (5).

38. *It was so decided.*

39. The CHAIRMAN said that paragraph (6) dealt with the liability of the beneficiary's bank towards the beneficiary under the applicable law. Once a credit transfer had been completed with the acceptance of the payment order by the beneficiary's bank, the relationship between the bank and the beneficiary no longer fell within the scope of the Model Law. The purpose of article 16(6), then, was to ensure that the beneficiary's bank, in complying with the obligations imposed on it under articles 9(1) and 9(5) was not exempt from the liability provided for in article 16.

40. Mrs. AUGIER (France) expressed reservations concerning paragraph (6) which related to the notion of "completion" of a credit transfer as defined in article 17. Her delegation wished to ensure that a transfer would not be regarded as completed until the funds were available to the beneficiary.

41. Mr. LIM (Singapore) suggested that the reference to article 9(1) or (5) should be moved to the beginning of paragraph (6) in order to make it clear that the liability in question related to the obligations under those paragraphs.

42. *Paragraph (6) was adopted.*

43. Mr. AL-NASSER (Saudi Arabia) said that the commercial banks in his country felt that paragraph (7) should be deleted, as it reflected an issue that was covered by the principle of contractual freedom.

44. Mr. CHATURVEDI (India) said that his delegation favoured the retention of the paragraph.

45. Mr. LIM (Singapore) noted that the paragraph had been omitted from the United Kingdom/Finnish proposal. If the intention was to give parties maximum contractual freedom, then the paragraph ought to be deleted, since it would limit the possibilities for varying the provisions of article 16.

46. Mr. GREGORY (United Kingdom) said that the authors of the proposal had not intentionally omitted paragraphs (6) and (7) from their redraft of article 16; new versions had not yet been submitted.

47. Mr. VASSEUR (Banking Federation of the European Community) said that the organization which he represented hoped that the Model Law would provide for maximum contractual freedom. Accordingly, the last sentence of paragraph (7) should be deleted, and it should be clearly stated that a bank could agree to

increase or reduce its liability to an originator or beneficiary. As such decisions were related to cost, it should be left to the bank and the client to negotiate the scope of the bank's liability.

48. Drawing attention to paragraph 4 of the secretariat's comments on article 16 (A/CN.9/346), he noted that a comparison was made with conventions on the international carriage of goods. It would appear that where the carriers were jointly liable, the system of liability could be set aside by agreement between the parties. Such an arrangement would be appropriate with regard to the liability of a bank.

49. Furthermore, where an originator gave a formal payment order, requiring execution in a particular manner by a specific intermediary, the bank should not incur any special liability, and that, too, should be provided for in the text.

50. Lastly, the Banking Federation of the European Community wished to see the provisions of prior article 13 (A/46/17, para. 250) incorporated either into article 16 or into a separate article, so as to ensure that a bank would be exempted from all liability in case of *force majeure*.

51. The CHAIRMAN said that the Commission would in due course discuss the possible reintroduction of prior article 13. With regard to conventions on the international carriage of goods, to which the previous speaker had referred, all such conventions, to the best of his knowledge, provided for the liability of the various carriers to the shipper, but did not permit the carriers to agree to increase or reduce their liability to the shipper or the owner of the goods. In fact, carriers were prohibited from setting lower limits on their liability, to the detriment of the shipper or the owner of the goods, than those provided for in the convention.

52. Ms. KOSKELO (Observer for Finland) said that paragraph (7) had indeed been deliberately omitted, as the first two sentences of the paragraph were covered by article 3, and as article 16 (*ter*) provided that the bank's liability would be mainly to the beneficiary.

53. Mr. DE BOER (Observer for the Netherlands) said that if the provisions of paragraph 7 were deleted, circumstances might arise where a bank could reduce its liability to an absolute minimum. Such a situation would undermine the whole consensus that had been achieved on the Model Law. The paragraph was therefore not superfluous and should be retained.

54. The CHAIRMAN said he agreed with the representative of Finland that, in the light of the provisions of article 3 concerning freedom of contract, paragraph (7) was to some extent superfluous. However, he felt that the last sentence of the paragraph should be retained, even if the circumstances it covered were unusual. There was a possibility that a bank might attempt to reduce its liability to a non-bank beneficiary, and the prohibition in question was therefore required.

55. Mr. BURMAN (United States of America) said that the retention of paragraph (7) should be discussed further. It might also be necessary to return to paragraph (7) once a decision had been taken on paragraph (8), which also concerned liability.

56. Mr. AZZIMAN (Morocco) said that the final sentence of paragraph (7) was a useful measure which afforded protection to customers. The general liability of banks under the Model Law was already somewhat limited and the way should not be left open for further restrictions to be imposed. Furthermore, the clauses limiting liability might well be subject to different interpretations in different countries. The provision should therefore be maintained.

57. Mr. EL-SHARKAWY (Egypt) said that the final sentence of paragraph (7) was based on the assumption that a contractual relationship existed between the bank in question and the beneficiary. He could not imagine how such a relationship was possible.

58. The CHAIRMAN pointed out that the sentence in question referred not only to a beneficiary, but also to an originator, and that a contractual relationship between a bank and an originator was perfectly feasible.

59. In view of the broad support expressed for paragraph (7), he urged delegations having reservations to remember the spirit in which the Working Group had drafted the Model Law and asked whether they would be willing to accept the retention of paragraph (7) on the understanding that the Drafting Group would consider the necessity of the first two sentences in the light of the provisions of article 3 concerning freedom of contract.

60. Mr. CHATURVEDI (India) said that his delegation would prefer to retain paragraph (7) as it stood.

61. Mr. SCHNEIDER (Germany) said that the issue at hand was not merely a drafting matter; the full text should be maintained. The second sentence in particular was important in the context of the harmonization of provisions governing general conditions within the European Community.

62. The CHAIRMAN said that the Drafting Group would be asked to address the concern expressed by the representative of Germany.

63. Mr. BURMAN (United States of America) said that it should be made clear in the Commission's report that the inclusion of the second sentence of paragraph (7), and the fact that that provision did not appear elsewhere, should not be taken to mean that banks were not permitted to use standard terms of dealing with respect to other matters dealt with in other paragraphs.

64. The CHAIRMAN said that the Drafting Group would be asked to take note of that concern. Perhaps a reference thereto could be included in article 3, which was the most appropriate place.

65. Ms. KOSKELO (Observer for Finland) said that the question raised in the second sentence of paragraph (7) had also been discussed at the Commission's twenty-fourth session in connection with article 3. On that occasion, it had been decided not to include a reference to standard terms of dealing and to leave the question open. If a specific reference was made to standard terms of dealing, the question might arise as to how that provision related to other parts of the Model Law, thereby creating difficulties when the Model Law was adopted by national legal systems. It would therefore be best to omit the provision and leave the matter for individual countries to determine.

66. The CHAIRMAN suggested that the second sentence of paragraph (7) should be retained, in keeping with the decision of the Working Group, and that further consideration should be given to the possibility of including other stipulations in the standard terms of dealing. The Commission should also consider the possibility that, by stipulating very low interest rates, a bank could eliminate its liability under article 16(7). In that case, either the sentence referring to freedom of contract in the definition of interest could be deleted, or appropriate language could be included in paragraph (7) of article 16.

*The meeting rose at 6 p.m.*

## Summary record of the 469th meeting

Tuesday, 5 May 1992, at 10 a.m.

[A/CN.9/SR.469]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 10.05 a.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

1. The CHAIRMAN, in inviting the Commission to resume consideration of article 16(7) of the draft Model Law, as set out in annex I to document A/46/17, recalled that some fears had been expressed that banks might stipulate derisory interest rates in order to evade their obligation under article 16 to pay interest for failure to execute a payment order. He wished to suggest the deletion of the reference to the contractual freedom of the parties contained in the words "unless otherwise agreed" (A/46/17, para. 89), since the concept of contractual freedom was already covered in article 3. Banks would thus be precluded from stipulating that their liability to clients was less than provided for in article 16(7).

2. Mr. GREGORY (United Kingdom) said that, while he agreed in principle with the Chairman's suggestion, he had a conceptual difficulty with the idea that the definition of a word might be varied by agreement.

3. Mr. CRAWFORD (Canada) shared the doubt just expressed by the representative of the United Kingdom concerning the varying of a definition. The words "unless otherwise agreed" had a very important function, since without them banks would be governed only by the uncertain provision that interest should be calculated at the rate and on the basis customarily accepted by the local banking community (para. 89). He could not see how such a provision would work in practice. Moreover, the requirement to have recourse to customary practice would impose severe limitations on the contractual freedom of banks. If the Commission were to concern itself with the ability of banks to partially remove the remedy of interest provided for in the draft Model Law by stipulating derisory interest rates, it would be embarking on the topic of consumer protection, a field expressly disavowed in the draft Model Law.

4. The CHAIRMAN said that the alternative to his suggestion to delete the words "unless otherwise agreed" from article 16 *bis* would be to retain the principles agreed to in article 16(7), according to which banks would have total freedom to make stipulations in respect of interest in accordance with article 3. Article 16(7) permitted banks to provide for higher limits on their liability to clients, but prohibited them from discriminating against non-bank originators by requiring that the interest should be defined in accordance with article 2.

5. Mr. CRAWFORD (Canada) said that he had no objections to article 16(7), since it provided an acceptable minimum level of protection to clients by prohibiting banks from paying derisory interest or no interest at all. The Commission's final text should, at the same time, protect contractual freedom as far as possible. The definition of "interest" contained two equally important elements: an agreed interest rate and an ascertainable interest rate. The fear had been expressed that banks might attempt to impose derisory interest rates for the purposes of article 16(7). He would be reluctant to preclude the possibility for the parties to agree on the rate, merely in order to forestall such attempts. The danger of such attempts being made was not sufficiently grave as to warrant the distortion of two sound articles.

6. Mr. GREGORY (United Kingdom) wondered whether, in defining "interest", it was not possible to preserve the element of contractual freedom while adding some formulation such as "subject to article 16(7)".

7. The CHAIRMAN asked whether the Commission wished to retain article 16(7) and the definition of interest in their current form.

8. Mr. OLSZOWKA (Poland) supported the suggestion of the representative of the United Kingdom to add the words "subject to article 16(7)".

9. Mr. CHATURVEDI (India) said that both article 16(7) and the definition of "interest" should be left unchanged.

10. Mr. LIM (Singapore) said he would welcome clarification from the representative of the United Kingdom as to how the addition of the words "subject to article 16(7)" would overcome the problem of the definition of interest.

11. Mr. GREGORY (United Kingdom) said that the problem was one which he had raised earlier: that of a definition subject to variation by agreement. The words "unless otherwise agreed", however, served a specific purpose in the case at hand, since they referred to the basis on which interest was to be calculated. The current definition provided for either an ascertained rate or an agreed rate. If banks must be given the capacity to stipulate rates of interest by agreement, then it should be possible to restrict the types of such agreement to ensure that they were not contrary to the principle set forth in article 16(7).

12. Mr. CRAWFORD (Canada) said that, since users who received derisory interest as compensation should be able to seek remedy under the second part of the definition of interest, he would suggest the addition of another sentence to article 16(7) along the following lines: "When fixing the rate of interest, the bank may not by agreement bargain for a rate lower than that calculated on the basis customarily accepted."

13. Mr. BURMAN (United States of America) said that, in view of its time constraints, the Commission should be quite clear as to what it wished to accomplish before referring a matter to the Drafting Group.

14. Mr. EL-SHARKAWY (Egypt) said that article 16(7) should be read in conjunction with article 16(1). Under paragraph (1), liability was determined by the rate of interest. It might be possible to use the LIBOR rate in effect on the date on which the payment of interest was due.

15. The CHAIRMAN proposed that the Drafting Group should be invited to prepare an appropriate text which would maintain the contractual freedom of parties to fix interest rates, while guarding against abuse of article 16(7) in the form of derisory interest rates. If he heard no objection, he would take it that the Commission accepted his proposal.

16. *It was so decided.*

17. The CHAIRMAN referred the Commission to article 16(8) as set out in annex I to document A/46/17.

18. Mr. EL-SHARKAWY (Egypt) asked why article 16(8) had precluded recourse to remedies in other laws and doctrines which were favourable to the beneficiary. He suggested that the remedies in the draft Model Law should be exclusive except where the remedies in other legal systems were more favourable to the beneficiary.

19. The CHAIRMAN said that such agreement as existed on paragraph (8) had been reached after strenuous debate. The Bank representing the interests of the banking community had conceded the principle of objective liability to non-bank originators and beneficiaries. In return, it had been agreed that, unless they themselves agreed otherwise, the liability of banks would be limited to the payment of interest, and would not include consequential damages. The implications of removing that protection were enormous in view of the unforeseeable nature of possible damages.

20. Mr. CHATURVEDI (India) said he agreed with the representative of Egypt that certain other remedies, particularly judicial instances, should not be precluded. He would therefore suggest the deletion of the second sentence of paragraph (8).

21. The CHAIRMAN said that paragraph (8) established, firstly, that liability existed even where no contract provided for a bank's liability to the user. Secondly, it provided that the liability set forth in article 16 was the exclusive liability of the bank. Finally, it contained the principle that liability for interest was limited to cases of negligence or wilful failure to execute a payment order. Removal of the second sentence of the paragraph, in his view, would reopen the whole question of liability in the draft Model Law.

22. Mr. GRIFFITH (Observer for Australia) said the principle that a bank should not be liable for the payment of interest except where it had been negligent represented a compromise, even though some representatives had had difficulty with the concept of recklessness. He felt that the text in its current form could be adopted by the Commission.

23. Mr. EL-SHARKAWY (Egypt) said that paragraph (8) should be part of article 16, only if the remedies referred to in that paragraph dealt exclusively with the liability of the receiving bank to pay interest in accordance with paragraph (1) of the article. If that was not the case, paragraph (8) should be a separate article, especially since it referred to "remedies provided in this law". Moreover, it might be preferable to allow the parties to seek remedies provided by national legislation, particularly when such legislation was more favourable to the beneficiary.

24. Mr. HOLEC (Czechoslovakia) fully endorsed the views expressed by the representative of Australia. His delegation could not accept the use of the word "recklessly" in the second sentence of article 16(8), and he proposed that the Commission should use more customary wording.

25. Mr. BISCHOFF (Observer for Switzerland) supported the proposal made by the representative of Australia. The Model Law would be incomplete without the principle contained in paragraph (8), particularly in the second sentence of the paragraph. However, he considered the wording at the end of the second sentence to be incompatible with the principle of liability for fault. He therefore proposed that the word "recklessly" should be replaced by the words "through gross negligence" or similar wording.

26. Mr. BHALA (United States of America) said that his delegation did not support the views of the representative of Australia. The Commission should avoid taking a hasty decision to conclude its consideration of article 16. His delegation had never accepted

the second sentence of paragraph (8), and it did not agree with the representative of Switzerland that the Model Law would be incomplete if that sentence was deleted. The representative of India had very wisely suggested that such remedies should be left to national law. His delegation was inclined to support the proposal by the United Kingdom and Finland to delete paragraph (8) and replace it with an article 16 *bis*.

27. Mr. EL-SHARKAWY (Egypt) said that he was still uncertain whether or not article 16 dealt with remedies other than the liability of a receiving bank to pay interest to the beneficiary for its failure to execute its sender's payment order in the time required. It was not clear how payment of interest could be the sole remedy, especially since there was no agreement between the parties regarding the rate of interest to be paid.

28. Mr. LIM (Singapore) said that his delegation supported the views expressed by the representative of Australia. Paragraph (8) seemed to be based on formulas used in other liability conventions such as the Convention for the Unification of Certain Rules relating to International Carriage by Air (the "Warsaw Convention") and the United Nations Convention on the Carriage of Goods by Sea (the "Hamburg Rules"). Paragraph (8) provided for certain limits on liability, subject to agreement. Such limits could still be circumvented by an allegation that a bank had improperly executed a payment order or had committed fraud or engaged in reckless behaviour. That provision was similar to the formula contained in the Warsaw Convention.

29. Mr. KOMAROV (Russian Federation) said that different countries applied different criteria for establishing liability for failure to execute contractual or non-contractual obligations. The solution contained in the draft Model Law reflected the general trend towards international unification. It was preferable that the remedies provided in the draft Model Law should be exclusive, and that the question of liability should not be dealt with by national law.

30. The exceptions referred to in the last sentence of article 16(8) referred to cases in which a bank failed to execute a payment order or had executed it improperly. The question of execution or non-execution should be linked not so much to payment orders as to the bank's obligations under the Model Law, since, in addition to the bank's obligations to execute payment orders, the bank was subject to other obligations stipulated in the Law. If the provision contained in the second sentence of paragraph (8) was interpreted literally, the conclusion could be drawn that all those other obligations were not covered by the provisions of paragraph (8).

31. Mr. DUCHEK (Austria) said that the provisions of paragraph (8) were not similar to the provisions concerning liability in the Warsaw Convention or the Hamburg Rules. In those instruments, liability involved only two parties, while the draft Model Law dealt with a triangular relationship involving the originator, the banking chain and the beneficiary. Under the provisions of paragraph (8), the beneficiary could not address a complaint to the bank that had caused the delay in payment and the additional loss. The risk would therefore be borne by the beneficiary in cases where the originator was unable to pay, or by the originator. It was therefore questionable whether the provisions contained in paragraph (8) were justified in all circumstances.

32. His delegation was in favour of deleting the second sentence of paragraph (8) and leaving the question of liability to national legislation. His delegation supported the proposal made by the United Kingdom and Finland.

33. Mr. SANDOVAL (Chile) said that his delegation was in favour of retaining paragraph (8) as it stood.

34. Mr. ROJANAPHAUR (Thailand) said that his delegation was in favour of retaining the second sentence of paragraph (8) without change.

35. Mr. SCHNEIDER (Germany) said that, if the second sentence of paragraph (8) was deleted, the Commission would have to reopen its debate on all the other issues. It was true, however, that the Commission was discussing a compromise that had never been precisely defined. In a previous draft of the Model Law, it had been explicitly stated that there should be no remedies for consequential damages. That stipulation had been eliminated because other remedies had to be taken into account.

36. The second sentence of paragraph (8) was so important that it should be made a separate article. However, that sentence required some clarification, and he proposed that the words "which would increase the liability of the bank" should be inserted between the words "doctrines of law" and "shall be available". While it would be possible to increase such liability by contract, there should be no increase in liability without the bank's agreement.

37. Mr. ZHAO Chengbi (China) said that his delegation was in favour of retaining the current wording of paragraph (8).

38. Mr. CRAWFORD (Canada) said that he agreed entirely with the points made by the representative of Germany. The representatives of the United States and Austria had expressed concerns about the possible misinterpretation of the second part of the second sentence of paragraph (8). However, he did not believe that either delegation objected to the idea that the interest remedy should be exclusive. Perhaps the Commission should consider deleting the second part of the second sentence.

39. The CHAIRMAN said that the representatives of Austria and the United States were in favour of deleting not only the second part of the second sentence of paragraph (8), but the second sentence in its entirety. Moreover, the representative of the United States had expressed support for paragraph 16 bis, proposed by the United Kingdom and Finland.

*The meeting was suspended at 11.30 a.m. and resumed at 11.50 a.m.*

40. Mr. CHATURVEDI (India) said he agreed with the Canadian representative that the last part of the second sentence of paragraph (8) posed real problems, as it referred to matters which were difficult to prove. He would therefore prefer either that the second sentence should be deleted entirely, or that it should end with the words "executed a payment order".

41. Mr. OLSZOWKA (Poland) said that his delegation would prefer to leave the text of paragraph (8) as it stood.

42. Mr. EL-SHARKAWY (Egypt) said that a choice must be made between either adopting paragraph (8) as drafted or leaving the entire matter to the remedies available under national law, as those were the only ways to maintain the balance achieved in the paragraph between the various interests involved.

43. Mr. GRIFFITH (Observer for Australia) suggested that the last part of the second sentence of paragraph (8) should be amended to read: "(b) recklessly and with particular knowledge that damage might result."

44. Mr. BURMAN (United States of America) said that, because of the nature of international credit transfers, it was necessary to establish the limitations of liability carefully. The goal was to impose on banks the minimum amount of liability possible; as it stood, however, the second sentence would make possible the imposition of far too much liability.

45. The CHAIRMAN suggested that an effort might be made to find a substitute for the word "recklessly" in the English text, as it appeared to convey the idea of fault or negligence, although the French and Spanish equivalents of the word did not.

46. Mr. BURMAN (United States of America) suggested that the last part of the second sentence should be amended to read: "(a) with the actual intent to cause loss, or (b) with gross recklessness and with actual knowledge that damage is likely to result."

47. Mr. FUJISHITA (Japan) said that if the second sentence were retained, he would oppose any effort to change its wording. A similar distinction had been established in the case of transport agreements; he could therefore see no objection to the wording of the second part of the sentence.

48. Mr. GREGORY (United Kingdom) supported the amendment suggested by the Australian representative. The term "gross recklessness" suggested by the United States representative had no meaning in English law. He noted that paragraph (8) did not provide that remedies should be available, but only that those remedies should be exclusive and that no other remedy should be available except where provided for under national law.

49. The CHAIRMAN stressed that the Commission was working on an international instrument, which made it inappropriate to use concepts specific to a given legal system. The word "recklessly" for example, was not to be interpreted with reference to the concept of "negligence" as used specifically in civil-law systems. Terms used in international instruments tended to be descriptive in nature rather than strict legal concepts. By such means, international uniformity was achieved.

50. The word "recklessly" had first come into use in the context of transport agreements. The word had been much debated, precisely because it was not known how a court would interpret it. Until the term came before the courts, it carried only the Commission's own interpretation. There was no international case-law to guide the Commission's work, and therefore any term it selected should be descriptive and provide guidance to the courts on the Commission's intentions. He recalled the proposal to include a rule of uniform interpretation, typical of the international conventions drafted recently.

51. Mr. LE GUEN (France) favoured keeping article 16(8) as currently drafted, for all of the reasons already given. Paragraph (8) struck a balance, and if the balance were changed, that might reopen the discussion of the entire draft Model Law.

52. He felt that a compromise solution might be to adopt the wording proposed by the delegation of Australia. If for the common-law countries it was necessary to stress the exceptional nature of the liability stipulated in the second sentence of paragraph (8), he would be in agreement with the wording "with actual knowledge".

53. Mr. EL-SHARKAWY (Egypt) also felt that the second sentence of paragraph (8) should be retained, pointing out that the terms used in (a) and (b) were widely used in several international conventions, and well known in both the common-law and the civil-law systems. In the latter, "intent to cause loss" equated with "fraud", and "recklessly" with "gross negligence".

54. Mr. FELSENFELD (United States of America) withdrew his delegation's earlier suggestion to add the word "gross" before "negligence", but stressed that "actual" when applied to "knowledge" was an important concept under United States law. While it would certainly be possible for the Drafting Group to find a different word conveying the same sense, the problem was in the concept itself of "actual knowledge", as it contrasted with what in United States legal usage would be called "constructive knowledge".

55. He cautioned against drawing analogies with transportation conventions. Transportation and international banking were totally different. International banking transfers involved hundreds of thousands of payment orders, while transportation involved far fewer transactions, much lower speed of transaction and much greater clarity of information. All parties to a transportation transaction were aware of the risks they were taking.

56. He also raised the question of the relationship of article 16(8) to the provisions of article 13, the so-called "money back guarantee". The latter was a major new obligation undertaken by the banks, and it was his understanding that the *quid pro quo* for that obligation was the establishment of a severe limit on the liability which might arise for the banks in the ordinary course of payment transfers.

57. Mr. LIM (Singapore) said that the representative of the United Kingdom had already summarized the position with regard to the common-law countries, except for the United States. "Recklessness" was a concept well known in such countries. Although it might be argued that in the context of international instruments courts should not interpret the wording in their own local legal context, in the absence of any new definition, that was precisely what they would do.

58. With regard to the wording proposed by the United States, he had no objection to adding "actual" before "intent". On the other hand, he wondered whether it would be contradictory to add "actual" before "knowledge", since the very concept of "recklessness" meant that a party did not care what the outcome would be.

59. With regard to adding "gross" before "recklessness", he was aware that in the United States the concept of "recklessness" had caused problems in the courts, in that aggrieved parties in litigation had attempted to induce juries to exceed limits on liability by alleging recklessness. Adding the concept of "gross" might help in such cases, but he felt that in common-law jurisdictions it would not make any difference at all.

60. The CHAIRMAN said that according to the Hamburg Rules, the carrier was liable only to the extent that the loss, damage or delay in delivery resulted from an act or omission of the carrier done with the intent to cause such loss, damage or delay, or recklessly and with knowledge that such loss, damage or delay would probably result. He wondered whether such wording might be appropriate for the present Model Law.

61. Mr. SCHNEIDER (Germany) said that he was concerned with the actual meaning of "recklessly". If recklessness was a reduced form of intent, the concept could be deleted. If on the other hand, it was a qualified form of negligence, then that was a matter for concern, but he considered nevertheless that it should be deleted, since it was not desirable to refer to negligence in the text.

62. If the majority wished to retain the concept of "recklessness", then there was a need to discuss what was meant by "knowledge". Knowledge might be obtained in any random way, but he felt that the Model Law should specify that what was meant by "knowledge" was "specific information given by the sender that loss might occur".

63. Mr. GREGORY (United Kingdom) said that his delegation would be able to accept some wording along the lines of the Hamburg Rules, and indeed it might be desirable for the wording in the two instruments to be similar. He felt, however, that such wording did not address the concern of the United States with the issue of constructive knowledge, knowledge imputed to someone who did not, in fact, possess it.

64. Mr. GRIFFITH (Observer for Australia) pointed out that the Hamburg Rules specified either "with intent" or "recklessly", while the draft Model Law specified both concepts. He felt that the points made by the United States on "actual knowledge" were valid, and wondered whether the Drafting Group could adapt the wording of the Hamburg Rules to include the concept of "actual knowledge".

65. The CHAIRMAN suggested that the Commission might take advantage of the experience gathered in drafting the United Nations Convention on International Bills of Exchange and International Promissory Notes. In that Convention, a person was considered to have knowledge of a fact if he had actual knowledge of that fact or could not have been unaware of its existence. The latter portion of the definition was intended to deal with the problem of constructive knowledge, covering, for example, the case of a person who, aware that knowing something might cause him harm, closed his eyes to the knowledge. It might resolve the problem raised by the United States and Germany.

66. He hoped that consideration of that definition of knowledge and of other points would enable the Commission to reach a rapid conclusion and move on to other important issues.

*The meeting rose at 1 p.m.*

## Summary record of the 470th meeting

Tuesday, 5 May 1992, at 3 p.m.

[A/CN.9/SR.470]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.10 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

### Article 16 (*continued*)

1. Mr. GREGORY (United Kingdom) said that his delegation felt it would be useful for the Commission to continue its consideration of paragraph (8) of article 16, on the basis of the proposal

made by the representative of the United States of America to add the word "actual" before the words "intent" and "knowledge" and to change the words "might result" to "would be likely to occur". The word "recklessly" would remain unchanged.

2. Mr. SCHNEIDER (Germany) said he was not sure that that proposal really helped to define the term "knowledge". It was not necessary to work out a detailed definition of that concept as long as the Commission considered that the term "recklessly" implied

intent. However, the concept of knowledge could give rise to problems in a large bureaucracy or in groups of companies if, for example, the knowledge of one person in a corporation was assumed to be the knowledge of the whole corporation or the director of a holding company was supposed to know what was going on in the company's subsidiaries. The concept of knowledge should be mentioned in connection with the payment order by stipulating that a bank must be informed of any special risk; if it received specific information to that effect from the originator or sender, the bank could decide whether or not to accept a payment order. The phrase "actual knowledge" was far too broad.

3. Mr. CRAWFORD (Canada) said that the German proposal did not seem to solve the problem that the representative of Germany had raised. A reference to specific information provided by the sender would not solve the real problem of trying to determine what a corporation really knew. It would be unwise to rule out from the text doctrines that might exist in various systems of national law or to impute knowledge where it was generally accepted that it did not exist. The Commission would have to decide whether information given to a clerk by the sender of a payment order constituted knowledge of the corporation and whether everything that was said at the point of contract was part of the contract. The Commission should try to identify a responsible act that would credibly bind the bank or corporation to extraordinary terms. The matter should be referred to the Drafting Group.

4. Mr. EL-SHARKAWY (Egypt) agreed that the words "actual intent" should not be used, since actual intent or knowledge could not be proved in the case of legal entities like banks or corporations. Paragraph (8) should be retained as it stood.

5. Mr. GREGORY (United Kingdom) said that the rule in question applied only where a country wished to make additional remedies available. The Commission should not stray too far into the area of corporate knowledge. It had been concerned about excluding constructive knowledge, and by agreeing to use the words "actual knowledge" it had addressed that concern. It was inappropriate to try to define actual knowledge further, given the complexity of corporate structures in the banking world. Nor was it appropriate to take into account information received from the sender, since information could be received from a variety of sources. If the information was known to the bank, it ought to bring the bank within the scope of the rule.

6. Mr. CHATURVEDI (India) said that his delegation did not support the proposal to add the word "actual" because it sought to make the scope of judicial review, remedy and intervention more exclusive. That course was inappropriate and did not accord with India's judicial system.

7. Mr. VASSEUR (Banking Federation of the European Community) recalled that there had been a case involving Manufacturers Hanover Trust when the United States courts had determined that the bank could not be held responsible for a transfer made by one office without the knowledge of the office responsible for transfers. He felt that paragraph (8) should be retained as it stood.

8. The CHAIRMAN said that the proposed amendment seemed to be acceptable to the Commission. It accorded with the objective of making a bank responsible if it failed to fulfil its obligations.

9. The concern expressed by the representative of Germany related to a different problem which should be considered by the Commission. It pertained not to liability as such, but to another requirement for the existence of liability, which would make the sender responsible for sending information.

10. Mr. FELSENFELD (United States of America) said that the problem raised by the representatives of Germany and Canada

was not easily solved. One solution that had been found successful was to have the bank acknowledge in writing that it knew of the risk involved.

11. Mr. CHATURVEDI (India) said he agreed with the representative of the United States and therefore opposed the addition proposed by the representative of Germany since it would further curtail the scope of remedies a customer or sender could secure from a bank for its fault.

12. Mr. CRAWFORD (Canada) suggested that the German proposal might be incorporated elsewhere in the draft Model Law. It was really a specific application of the freedom envisaged in article 3 for the rights and obligations of parties to a credit transfer to be varied by their agreement. By giving a written acknowledgment of specific risk that it was undertaking, a bank would be operating outside the scope of the Model Law. The idea of a special contract to accomplish a specific result within a specific time was useful, but went too far. The Commission's objective was to isolate reprehensible conduct by a bank.

13. Mr. LOJENDIO (Spain) said that the problem could be resolved under paragraph (7), which made provision for a bank to assume greater liability.

14. Mr. DE BOER (Observer for the Netherlands) said that if the remedies were exclusive, as stated in paragraph (8), the exclusivity related to the specific subject, and if there was no remedy for a given subject there was no exclusivity.

15. Mr. CHATURVEDI (India) concurred with the Observer for the Netherlands. The exclusivity referred to in paragraph (8) applied only to the situation described in the Model Law.

16. Mr. LIM (Singapore) agreed that paragraph (8) as drafted might imply the existence of other remedies; however, if the word "remedy" was interpreted to mean "liability", that could mean that no liability could be maintained other than that covered by the Model Law.

17. Mr. AZZIMANE (Morocco) said that misinterpretation of paragraph (8) could be avoided if the phrase "the remedies provided in this law" was replaced by "the liability remedies provided in this article". Paragraph (8) would thus be better integrated with the whole of article 16 and there would be no risk of confusing the remedies specified in that article with other actions not related to liability.

18. Mr. PELICHET (Observer for The Hague Conference on Private International Law) endorsed the suggestion made by the representative of Morocco, which would avoid any confusion between the remedies mentioned in paragraph (8) and the "rights ... as may otherwise be provided by law" mentioned in articles 11(7) and 15.

19. Mr. EL-SHARKAWY (Egypt) said that if remedies other than the payment of interest existed, paragraph (8) should constitute a separate article. He agreed that the paragraph should refer to remedies "in this article" rather than "in this law".

20. Mr. BEROSTEN (Consultant to the Secretariat) drew attention to paragraph 40 of the comments on article 16 in document A/CN.9/346, referring to additional remedies that could be added to the text of the article or to the application of remedies generally available in the legal system.

21. Article 4(6) dealt with the obligations of sending banks. In executing a payment order, a receiving bank was of course obliged to send its own payment order and thus became a sending bank. The question before the Commission was whether it should

not in that capacity be obliged to pay interest to its own receiving bank if its payment order was accepted and it did not then make it good promptly. There appeared to be no such obligation in the Model Law, nor was it entirely clear that the exclusivity statement in paragraph (8) precluded the payment of such interest, which members would no doubt agree should be payable.

22. With respect to the "duty to assist" mentioned in article 12, he referred to members to paragraph 5 of the comments on that article (A/CN.9/346) and noted that the Commission had decided at its twenty-fourth session that there should be no penalties set out in the Model Law for failure to assist.

23. Mr. GREGORY (United Kingdom) said he understood that a receiving bank was not liable, as a receiving bank, for any delay caused by a failure to pay. Yet if paragraph (8) stipulated that remedies were exclusive, there would be no requirement to pay interest that was otherwise due. That was a problem that required attention and was not addressed in paragraph (1).

24. Mr. BURMAN (United States of America) said his delegation was still not convinced that a problem existed, but thought that the proposal put forward by the representative of Morocco might resolve the issue quickly.

25. Mr. CHATURVEDI (India), supported by the representative of France and the Observer for the Netherlands, said that his delegation could support the Moroccan proposal. There would then be no need to clarify article 4(6), since article 16 would be self-contained.

26. Mr. GREGORY (United Kingdom) was not sure the proposal achieved the desired result. The operative sentence of paragraph (8) was the second one, beginning "these remedies shall be exclusive ...", and the proposed change did nothing to alter it.

27. Mr. BURMAN (United States of America) said that in order to clarify paragraph (8) the Drafting Group might wish to add a reference to other legal remedies similar to the references in articles 11(7) and 9(1).

28. Mr. LIM (Singapore) thought that the problem raised by the representative of the United Kingdom could be solved by adding "in respect of liability under this article" after the word "remedies" in the second sentence of paragraph (8), although that did not deal with the problem posed by article 12.

29. Mr. CRAWFORD (Canada) said that as no remedy was provided in articles such as 4(6), article 16 had no bearing on them. Each jurisdiction had its own remedies. If remedies were not relevant to article 16, then the article needed no modification. Moreover, if the "obligation to repay" that was mentioned in several articles was self-executing, then there was no need to address it in article 16; if it was not, then there was a need to enforce remedies in article 16.

30. There was also some confusion over the terms "right", "obligation", "duty" and "remedy", which seemed to be used with overlapping meanings. The Drafting Group might also have difficulty in distinguishing those terms.

31. The CHAIRMAN said that the exclusivity of remedies under article 16 should not affect the obligations under article 4(6), and it would therefore be desirable to eliminate any ambiguities. As for the enforcement of remedies for failure to assist, it seemed that the Commission preferred to leave the matter to the applicable law in each State.

32. The CHAIRMAN said that the Commission appeared to want the remedies provided for to be exclusive to situations covered by the provisions of article 16, with the Model Law not seeking to exclude any remedies for failure to comply with the provisions of article 4(6). He therefore suggested that the Drafting Group should consider paragraph (8), taking into account the proposal made by the representative of Morocco.

33. *It was so decided.*

34. The CHAIRMAN said that another question arising in connection with article 16(8) resulted from article 11(5) and (6), under which the Model Law provided for a refund to be passed on to the benefactor in cases where a delay had occurred in a transfer from the originator to the benefactor. There were two possible solutions: either the Commission could stipulate that a refund with interest should be made, or it could remain silent on the matter. However, the decision concerning the exclusive nature of article 16 could lead to ambiguity in the context of article 11(5) and (6).

35. Mr. GREGORY (United Kingdom) said that his understanding was that the Commission sought to relate article 16(8) only to situations covered by article 16. That meant that the Commission should remain silent as to any remedies which might be available for failure to comply with refund obligations under article 11(5) and (6). He therefore wondered whether the Chairman was now proposing to include an additional provision in article 11 stipulating that interest should be payable for failure to comply with refund requirements.

36. The CHAIRMAN said that he was not making any such suggestion. It was simply that there had been no discussion of provisions other than article 4(6) to which article 16(8) might relate.

37. Mr. CRAWFORD (Canada) said that the whole question of the intended scope of article 16 needed to be considered. It was by no means certain that in its present form the article would preclude a court from awarding general damages in addition to the specific amount of repayment due. Throughout its discussions on the Model Law, the Commission had always taken the view that interest should be the only penalty imposed on banks which were late in fulfilling their obligations. Article 16 did not fully accomplish that objective, in that it did not extend the exclusivity function of paragraph (8) to every obligation contained in the Model Law. Unless the scope of article 16 was extended, it would remain open to national courts to award damages in excess of the amount required for repayment plus interest.

38. Mr. CHATURVEDI (India) said that in his view there had been sufficient discussion of the matter. The Commission had decided that exclusivity should apply only to article 16 and therefore articles 4(6) and 11(5) were not affected. The matter should now be left to the Drafting Group.

39. The CHAIRMAN recalled that, during the discussion on paragraph (1), the representative of Japan had accepted the paragraph on the understanding that his proposal concerning the cost of the issuance of new payment orders would be considered when the Commission took up paragraph (8).

40. Mr. FUJISHITA (Japan) said that his delegation did not support the retention of paragraph (8). If the paragraph was to be retained, the provision on damages which could not be recovered under paragraph (1) should include not only interest, but also legal fees and the cost of reissuing the credit transfer. The United Kingdom representative had explained earlier that liability provisions had been omitted from the redraft of article 16 because the article provided for an objective type of liability, an argument for which he found little justification.

41. Mr. CHATURVEDI (India) said that he supported the Japanese proposal.

42. The CHAIRMAN said that, after reviewing the report of the Commission's previous session (A/46/17), he had concluded that the attribution of legal fees had been omitted because it was considered to be a matter which fell within the purview of national, rather than international, law. At the urging of one delegation, it had been agreed that a footnote should be inserted, drawing the attention of national legislators to the need to attribute legal fees and other costs to the party which had failed to comply with a legal obligation. The footnote, however, was missing from the text, and he wondered what the reason for that was.

43. Mr. FUJISHITA (Japan) said he understood the Chairman to mean that each country that was party to a dispute was free to award legal fees; accordingly, he withdrew his proposal.

#### Article 17

44. The CHAIRMAN said that article 17(1) defined the moment of completion of a credit transfer as the moment when the beneficiary's bank accepted the payment order, thus releasing the bank from any further obligations towards the beneficiary. That was an objective definition which was acceptable to all parties to the transfer.

45. Mr. VASSEUR (Banking Federation of the European Community) said that at a previous meeting, he had drawn attention to the issue of *force majeure*, which was not taken into account by the text as currently drafted. Prior article 13, however, to which the secretariat had referred in paragraph 47 of its comments on article 16 (A/CN.9/346), had envisaged exemptions from the liability of banks under certain circumstances, such as the interruption of communication facilities or equipment failures, suspension of payments by another bank, emergency conditions, and so on. His organization wanted to see that article reinstated in the Model Law. As a general rule, agreements between banks, or between banks and clients, contained *force majeure* provisions.

46. The CHAIRMAN, after reading out the text of prior article 13, said that the Working Group had decided to delete that text on the grounds that, even if a delay resulted from *force majeure*, the bank would still be holding the funds, which would be generating interest, and the beneficiary should retain the interest.

47. Mr. AL-NASSER (Saudi Arabia) proposed that paragraph (1) should be amended as follows: "The credit transfer takes place

when the beneficiary's bank accepts the payment order and the bank becomes indebted to the beneficiary for the amount of the payment order".

48. Mr. SCHNEIDER (Germany) said that he shared the views expressed by the representative of the Banking Federation of the European Community. Not only footnotes, but whole articles sometimes disappeared. Articles 13 and 16 had once been combined; in the process of separating them, the provision on interest rates had been lost.

49. The CHAIRMAN said that prior article 13 had not simply disappeared. According to the report of the Working Group on International Payments on the work of its twenty-second session (A/CN.9/344), the Working Group had decided to delete the article because, as liability existed only for interest, according to the Model Law, there was no need to maintain a rule on exemption.

50. Mr. LE GUEN (France) said that his delegation had difficulty with the first sentence of paragraph (1). The notion that a credit transfer was completed when the beneficiary's bank accepted the payment order was not in keeping either with French law or with article 2 of the Model Law (Definitions). Under article 2, a transfer was defined by its purpose, namely, to place funds at the disposal of the beneficiary; however, article 17(1) did not deal with the final stage of the transaction and was therefore in conflict, not only with article 2, but also with the title of the Model Law. Problems also arose with regard to article 18 (Conflict of laws) since, if the relationship between the beneficiary and the bank remained outside the scope of the Model Law, an entirely new set of rules could be introduced in the course of the transaction.

51. The CHAIRMAN said that the initial draft of article 2 had contained a bracketed sentence to the effect that a credit transfer was completed when the beneficiary's bank accepted the funds. It had been decided, however, that a rule on completion did not belong in an article on definitions, and the sentence had been moved to article 17. Consideration had been given to designating as the moment of completion the moment when the transferred funds were credited to the beneficiary's account; however, banking practices varied widely in different countries. Furthermore, the question of when to place the funds at the disposal of the beneficiary was for the bank to decide, and it would be difficult for a third party to determine that moment objectively.

*The meeting rose at 6 p.m.*

### Summary record of the 471st meeting

Wednesday, 6 May 1992, at 10 a.m.

[A/CN.9/SR.471]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 10.10 a.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

1. The CHAIRMAN invited the Commission to continue its consideration of article 17 of the draft Model Law, as set out in annex I to document A/46/17.

2. Mr. LE GUEN (France) thanked the Chairman for the explanations he had given the previous day on the background to article 17. Although aware of the dangers involved in reopening the discussion of article 17, he nevertheless felt that the article had to be improved. While it had been said that the operation of posting to an account was not a reliable criterion for determining the moment of completion of a credit transfer, article 5 did indeed

rely on that criterion, and he felt that it could be used in article 17 as well.

3. Mr. CHATURVEDI (India) supported the position of France. The first sentence of article 17(1) was inadequate, in that a credit transfer was completed only when the money actually reached the beneficiary.

4. Mr. VASSEUR (Observer, Banking Federation of the European Community) said that European banks viewed the provisions of article 17 with disfavour, because those provisions were unnatural. Whether a transaction involved a small cash payment between individuals, or an electronic funds transfer through the banking system, it was completed only when the money was actually in the hands of the beneficiary. Article 17(2) was particularly unnatural, in stating that "the obligation is discharged when the beneficiary's bank accepts the payment order". Under French legislation, and also under Swiss law, a credit transfer was completed only when the funds were at the disposal of the beneficiary. At the UNCITRAL session in Vienna in 1991, many countries, including Italy, Sweden, Canada, China and Finland had wanted to replace the notion of acceptance of the order with that of payment of the funds to the beneficiary. The Bank for International Settlements and the International Law Association had also had reservations with regard to article 17.

5. He had been led to believe that the real purpose of article 17 was to protect the originator against bankruptcy of the beneficiary's bank. If that were so, then it would be sufficient to specify in article 17 that a credit transfer was completed when the funds were made available to the beneficiary, on the understanding that the risk of bankruptcy of the beneficiary's bank was a risk borne by the beneficiary.

6. The Banking Federation had interviewed several large companies in France and Belgium, not one of which had agreed that a credit transfer could be regarded as completed when their own bank accepted the payment order. The eight cases defined in article 8(1) had also engendered major uncertainty, on the grounds that it would be very difficult for the beneficiary to know when his bank had actually accepted the order. A further question was that of the burden of proving when the order had been accepted. The Commission should not forget that the text which it was drafting was only a model law, and thus not binding on States, which could decide to accept or reject it or parts of it as they chose. He was sure that numerous States would reject article 17 as it stood.

7. The CHAIRMAN explained that his remarks the previous day had covered the main reasons for the wording of article 17, but that there were also others. However, protection of the originator against the risk of bankruptcy of the beneficiary's bank was not one of them. The intention of the article was to give a clear and objective definition of the point in time when the credit transfer was deemed to be completed, and to define who carried the burden of proof.

8. Mr. AZZIMAN (Morocco) supported the position of France and the Banking Federation.

9. Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) said that article 17(1) should be rewritten to state that a credit transfer was completed only when the funds were available to the beneficiary, for two reasons: firstly, internal consistency within the Model Law itself, namely consistency between articles 2 and 17, and secondly, avoidance of two different legal procedures, covering international and domestic credit transfers respectively.

10. Mr. MOORE (Nigeria) supported the view that a credit transfer was not completed until the beneficiary had received the funds.

11. Mr. SCHNEIDER (Germany) said he did not understand why there was a move to change article 17. Two different reasons had been given. On the one hand, there was the question of the underlying obligation, which could be said to have been discharged only when the beneficiary was in a position to earn interest on the funds in question.

12. On the other hand, article 17 also covered something very different, namely the moment at which the transaction itself was completed. If article 17 were changed, it would then be necessary for the Commission to return to all the other articles and check them all once more. For example, under article 13, the so-called "money-back guarantee" would continue to exist for the originator's bank, if article 17 were changed, until the money was actually in the beneficiary's account. He was sure that German banks would never agree to such a result from article 17.

13. The main point at issue could be found in article 10, the date of execution for value. He was willing to reconsider article 10, but had seen no reason so far to change article 17.

14. The CHAIRMAN agreed that to change the rule enshrined in article 17 would cause repercussions in many other articles.

15. Mr. EL-SHARKAWY (Egypt) said that the definition of the moment when a credit transfer was completed could vary according to two different hypotheses. If the intention was to define completion with respect to the beneficiary's bank, then article 17 as currently drafted was correct. If, on the other hand, the intention was to define completion with respect to the beneficiary, then it should be made clear that the transfer was not completed until the latter actually received the funds.

16. Mr. FELSENFIELD (United States of America) said that article 17(1) was part of a larger structure, consisting of many articles. There was a superficial appeal in stipulating that a credit transfer was not over until the funds reached the beneficiary, but that did not accord with standard commercial practice. The originator would normally be instructed to make a payment by sending funds to the beneficiary's bank, and would have discharged his obligations once the funds had reached that bank. That was all that could be demanded of the originator, because the relationship between the beneficiary and the beneficiary's bank was beyond the control of the originator. Article 17(1) respected that basic principle. Some other transaction between originator and beneficiary might well be possible, but would be governed by the law of contract, and did not need to be covered by the Model Law.

17. Mr. GREGORY (United Kingdom) supported the position taken by the United States and Germany. The Commission should remember the actual purpose of the rule in article 17(1). It was not to define when the obligation between the originator and the beneficiary was discharged (which was covered in article 17(2)), but to define in a precise manner when a certain period came to an end. The Model Law as a whole set out the parties' responsibilities during a particular period, and article 17(1) defined the duration of the actions involved. The Commission had decided not to deal with the relationship between the beneficiary and the beneficiary's bank, and the current drafting of article 17(1) respected that decision. Many articles of the Model Law, such as articles 13 and 16, depended on article 17 as currently drafted, and would have to be changed if article 17 was changed. In addition, article 8 stated clear rules on when acceptance of a payment order took place, and to make a change in article 17 would call the certainty given by article 8 seriously into question.

18. He agreed, however, that within the context of article 17(2) consideration had to be given to the question of the underlying obligation, as raised by the delegations of France and the Banking Federation.

19. Mr. JONES (United Kingdom) explained that 15 to 20 years ago, it had been relatively easy to determine exactly when money had been credited to an account, but the present speed and volume of electronic funds transfers meant that account balances were altering from minute to minute or second to second. Modern banks kept track of those movements by real-time computer systems, but at the end of the day each account's statement was established on the basis of its position after trading had stopped, and the instantaneous results drawn from the real-time system were discarded. That raised the question of which accounting system would be used to determine the moment at which funds were actually credited to a beneficiary's account.

20. Banks using a real-time system had two different credit limits which they applied to each account, one for the balance drawn up at the end of the day, and a different one, much higher, relating to the balance as it changed from moment to moment during the day. The fluctuations in balances could cause major problems and losses if a customer failed during the day, such as had been the case when the Bank of Credit and Commerce International had been closed down. There were additional complications if a bank was operating in different currencies and with clients in different time zones.

21. Mr. CRAWFORD (Canada) said that he fully shared the views expressed by the Chairman concerning the importance of the rule contained in article 17(1) and the desirability of determining a clear point in time when a transfer was considered complete. He also agreed with most of the opinions expressed by the representatives of Germany and the United States of America on the matter. He had some difficulty, however, with the reasoning of the representative of Germany, which was based on the unexpressed assumption that the beneficiary would designate his bank for the purpose of receiving a transfer. The draft Model Law had established no such precondition. Indeed, as the text stood, the originator was free to designate any bank. The rule would work only if the bank was selected by the beneficiary and not by the originator of the transfer. One possible solution would be to include a definition of "beneficiary bank" modelled on the definition of "beneficiary", along the following lines: "Beneficiary bank" means the bank designated by the beneficiary to receive funds as a result of a credit transfer.

22. The CHAIRMAN wondered how, in such a case, the draft Model Law would be structured, since the designation of the beneficiary bank was provided for not in the payment order, but in the underlying relationship. He feared that the proposed solution might create another set of problems.

23. Mr. SANDOVAL (Chile) said that an international credit transfer was independent of the underlying relationship that led to such a transfer. In his view, article 17(1) should remain unchanged since it fulfilled the Commission's objective of indicating the moment when a transfer was completed.

24. Mr. LOJENDIO (Spain) said that article 17 sought to deal simultaneously with two difficult issues, namely, the completion of a credit transfer and the discharge of the principal obligation. It was important to distinguish between those two questions. He had difficulty with the way in which the concept of completion of a transfer was reflected in paragraph (1). While that paragraph should be retained in order to forestall a reopening of other questions on which agreement had already been reached, he did not believe that mere acceptance by a bank was sufficient to discharge the principal obligation of the originator of a transfer.

25. The CHAIRMAN said that the question currently before the Commission was that of the time of completion of the transfer. The matter of the discharge of an obligation was a separate issue which would be addressed in paragraph (2).

26. Mr. VASSEUR (Observer, Banking Federation of the European Community) pointed out that even the rapid electronic transfer of funds by coded message carried an indication of the beneficiary bank from the moment the payment order was given. He noted further that the Commission had earlier decided that the provisions of the draft Model Law would apply not only to electronic, but also to paper payments. The question of paper payments seemed to have been neglected since then.

27. The CHAIRMAN said that the rules contained in articles 6 and 8 concerning the time of transfer referred to all forms of transfer, including paper payments.

28. Mr. GREGORY (United Kingdom) said that the discussion on electronic payments had arisen because of the problems involved in determining the precise time of the completion of a transfer. No discrimination between different forms of transfer had been intended.

29. Referring to the suggestion of the representative of Canada to define "beneficiary bank" in order for the rule in paragraph (1) to be acceptable, he felt that the issue could not be dissociated from paragraph (2), which concerned the discharge of an obligation. The question, however, was not linked to the need for the Model Law to define the moment when a transfer was complete.

30. Mr. DUCHEK (Austria) agreed that paragraphs (1) and (2) should be considered together. The Commission should not interfere with the relationship between the originator and the beneficiary, and should concern itself only with the technical means of transferring the funds. In that regard, while the concept of time of completion might be feasible, it had legal consequences for the underlying transaction. He wondered whether paragraph (2) was at all necessary and whether its provisions were feasible. If the Commission felt, however, that rules were necessary to govern the underlying relationship between the originator and the beneficiary of a transfer, then he would support the proposal by the representative of France. It was unfortunate that, owing to the process of legislation followed by the Commission, such an important question had been raised at such a late stage.

31. The CHAIRMAN pointed out that the problem had not arisen at the last minute. The questions of the discharge of an obligation and the moment of completion of a credit transfer had been the subject of exhaustive discussion. The only new element was the contention that if paragraph (1) was changed, then the structure of the draft Model Law would need to be revised and new laws established to govern the relationship between a beneficiary and his bank. The Commission had addressed the difficult questions of acceptance and completion of a transfer before addressing other articles of the draft Model Law.

32. The practical difficulties encountered in the electronic and manual handling of accounts explained why articles 6 and 8 had contemplated all possibilities. The logic behind the structure of those articles was that the acceptance of an order by a beneficiary bank marked the moment of completion of the transfer.

33. Mr. LIM (Singapore) said that he shared the views just expressed by the Chairman. He wondered whether the representatives who advocated a change in the principle contained in article 17(1) did so because of the juxtaposition of the terms "completion" and "discharging an obligation". At the Commission's previous session, the view had been expressed (A/46/17, para. 284) that some of the difficulties might be alleviated if the rule on completion were returned to its original location in article 2(a) or, alternatively, if a reference to article 2(a) were added to paragraph (1).

34. Ms. KOSKELO (Observer for Finland), referring to the need for a precise determination of the completion of a transfer, said

that while it would be correct to rely on the time of acceptance by the beneficiary bank, she shared the view that, if the time of crediting was uncertain, then that uncertainty would affect the concept of acceptance. It had been pointed out that, under article 8, the earliest event that occurred would signify acceptance. Since crediting would be the first event, it was necessary to determine when the act of crediting was complete. While she did not object to the principle behind article 17(1), a problem would arise if a precise time was necessary to determine the completion of a transfer. There might thus be need to further refine article 8 in order to reach a conclusion on the precise time of completion of the transfer. In that connection, she would welcome clarification from the representative of the United Kingdom on how he interpreted article 8(1)(d).

35. While paragraphs (1) and (2) of article 17 dealt with separate problems, namely, the time of completion of a transfer and the time of discharge of an obligation, a lag between those two times could create problems for the originator, should difficulties arise for the beneficiary bank after it had accepted payment and before the discharge of the obligation. While the problems were separate, the solutions must be coordinated.

36. The suggestion that the scope of article 17(1) should be limited to cases in which the beneficiary designated the beneficiary bank was also relevant to article 17(2).

37. She was of the view that the first sentence of article 17(1) should be qualified by some formulation such as "that is consistent with the originator's payment order" in order to forestall any problems in the application of articles 13 and 16, concerning liability.

38. The CHAIRMAN said that the mixing of the issues in paragraphs (1) and (2) would make it difficult to reach a conclusion. Paragraph (1) concerned the question of when a credit transfer was complete while, in paragraph (2), the Commission must decide whether to have a rule that referred to the discharge of the obligation stemming from an underlying transaction. In other words, it would have to decide whether to retain or delete paragraph (2). If it was retained, the Commission would have to decide whether discharge of the obligation would occur at the same time as or at a different time from that stipulated in paragraph (1).

*The meeting was suspended at 11.35 a.m. and resumed at 12.05 p.m.*

39. Mr. LE GUEN (France) said he had the impression that some members of the Commission considered that the increasing practice of keeping accounts in real time complicated matters and made it difficult for banks to establish the exact time at which an account had been credited or debited. In his opinion, quite the opposite was true. French banks kept their clients' accounts in real time, and both the bank and the holder of the account had a much better knowledge of the transactions that had been made, and they received information about such transactions much more quickly than under previous systems. The problem referred to by the representative of the United Kingdom might therefore have its origin in the British accounting system.

40. His delegation was very interested in the pertinent comments made by the representative of Finland. It was his impression that what was understood by "acceptance" was to a large extent based on accounting practices. According to articles 6 and 8 of the draft Model Law, acceptance could take place when the bank credited or debited the account. He did not understand why the crediting or debiting of an account should be used to determine the precise time at which acceptance took place, while the same transactions could not be used to establish the precise point in time when a payment was completed.

41. Mr. BHALA (United States of America) said it was his understanding that the use of real-time systems had enabled the users of such systems to define more precisely the time at which certain transactions occurred, which included the crediting of accounts.

42. Mr. ROJANAPHAUR (Thailand) said that article 17(1) dealt with the completion of credit transfers and must therefore be read in conjunction with article 17(2), which dealt with the discharge of the originator's obligation. Article 17(2) was important because, even if it could be assumed that the credit transfer as defined in article 8 had been completed, the originator could not be considered to have discharged his obligation until the beneficiary received the full amount of the payment order in cash. His delegation could accept the text of articles 17(1) and 17(2) as they stood.

43. Mr. CHATURVEDI (India) said that the first sentence in article 17(1) did not correspond with the definition of "credit transfer" as contained in article 2. According to that definition, "credit transfer" meant "one or more payment orders, beginning with the originator's payment order, made for the purpose of placing funds at the disposal of a beneficiary", whereas in article 17(1) the funds were not placed at the beneficiary's disposal. In that regard, the representative of France seemed to be suggesting that, rather than referring to the acceptance of the payment order by the beneficiary's bank, the Model Law should refer to the crediting or debiting of the account that would complete the credit transfer. Moreover, the representative of Finland had correctly observed that it was not possible to separate the concepts of completion of credit transfer and discharge of obligation.

44. He proposed that, in the first sentence of article 17(1) the words "for the originator's bank" should be inserted after the words "a credit transfer". That would mean that the obligation of the originator's bank was discharged the moment the beneficiary's bank accepted the payment order.

45. Mr. KOMAROV (Russian Federation) said it was important to bear in mind that article 17(1) stressed the fact that the Model Law dealt only with the relationship between banks and the originator, and not the relationship between the beneficiary's bank and the beneficiary. If the first part of article 17(1) was deleted, the sphere of applicability of the Law would be unclear. His delegation therefore supported the proposal to leave article 17(1) as it stood, on the understanding that it should be interpreted in the light of the provisions of other articles of the Law, in particular article 8, which defined "acceptance".

46. Mr. EWORE (Observer for Gabon) said that the concept of "completion" should not be placed in a context that favoured the bank, the beneficiary or the originator, but should take account of the situation from the standpoint of all three participants in the credit transfer. His delegation supported the comments made by the representative of France and those made by the representative of the Banking Federation.

47. The CHAIRMAN said that a number of delegations shared the concerns expressed by the representative of France, while a larger number of delegations supported the text of article 17(1) as it stood. He suggested that those delegations that were not in favour of adopting article 17(1) should accept it on a provisional basis in order to enable the Commission to proceed to the consideration of article 17(2), at which time it would decide either to restrict the cases in which completion of a credit transfer meant the discharge of the underlying obligation, or would decide to delete the text dealing with completion of credit transfers.

48. Mr. LE GUEN (France) said that, before the Commission moved on to article 17(2), it should consider the proposal made by the representative of Canada concerning article 17(1).

49. Mr. CRAWFORD (Canada) said that his proposal had been intended to refer to draft article 17(2), as it addressed the problems of discharge rather than completion.

50. The CHAIRMAN noted that it would in any case be necessary for the Commission to return to article 17(1) when it had completed its consideration of article 17(2).

51. It was his understanding that article 17(2) did not presuppose discharge of the underlying obligation, but rather was intended to provide a rule concerning the time when the obligation was discharged. Many members of the Commission had expressed the view that the Model Law should not contain provisions regarding the discharge of the underlying obligation; if that view was accepted, it would be relatively easy to revise article 17(2) accordingly.

52. Mr. SONO (Observer, International Monetary Fund) supported the Chairman's proposal to set aside article 17(1) until the Commission had completed its consideration of article 17(2). It seemed to him that there had been some confusion with regard to the meaning of "credit transfer" during the earlier discussion of article 17, as some representatives had been speaking in terms of the availability of funds, while the Commission had in mind the crediting and debiting of accounts, which was a quite separate matter. That confusion might continue to arise so long as article 17(2) was retained. He was not sure, however, that the retention of article 17(2) in the Model Law was completely necessary. The Commission's main purpose was to fill the existing legal vacuum concerning the electronic transfer of funds; he did not think it was essential to that purpose for it to go into all the situations that could arise under article 17(2). The French representative might also feel more comfortable with the first sentence of article 17(1) if article 17(2) were deleted. It should be pointed out also that article 17(1) by itself was entirely compatible with article 9(1), while the addition of article 17(2) might lead to some confusion between the two articles.

53. Mr. GREGORY (United Kingdom) said that the Commission's purpose was to increase certainty concerning electronic and

other credit transfers. Article 17(2) was helpful in that respect, even though it did not cover all possible situations. It was important to remember that it did not deal with the question of whether an obligation could be discharged by a credit transfer. If article 17(2) did not exist, the originator would remain liable to pay the beneficiary even though the beneficiary had agreed to a credit transfer as an appropriate method of payment and all the steps set out in the Model Law had been taken.

54. The Canadian representative had raised the important question of the circumstances in which a beneficiary would be deemed to have agreed to accept payment by credit transfer. It seemed necessary to make it clear that the payment must be made to the last bank in the banking chain; he therefore suggested that the phrase "to the account indicated by the originator" in article 17(2) should be amended to read "to the relevant bank".

55. Mr. DE BOER (Observer for the Netherlands) said he agreed that if article 17(1) was adopted, article 17(2) would also be necessary, as otherwise the uncertainties pointed out, for example, by the Finnish representative would remain. Article 17(2) was also desirable for other reasons. Firstly, the interval between the time of receipt of the payment and the time of crediting was becoming smaller and smaller. Secondly, the system under which it was the moment of crediting that was decisive always seemed to require corrections; if article 17(2) was accepted, the need for such corrections would disappear. The adoption of article 17(2) would also be a contribution to international harmonization, as it would bring the rule into conformity with United States law; moreover, it should be relatively easy to make the change, as the rule was governed in most countries by case-law.

56. His delegation supported the suggestion that article 17(2) should be completed, and proposed that that should be done by adding the words "unless the beneficiary has excluded payment into that account" at the end of the sentence.

*The meeting rose at 1 p.m.*

## Summary record of the 472nd meeting

Wednesday, 6 May 1992, at 3 p.m.

[A/CN.9/SR.472]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.15 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (continued) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

### Article 17 (continued)

1. The CHAIRMAN said that there was an issue with regard to article 17 that had yet to be resolved, namely, that of payment orders executed by a receiving bank for amounts less than the amount of the payment order received. He drew attention to article 14, which provided that, in case of underpayment by a receiving bank, the bank was obligated to issue a payment order for the difference between the amounts. There appeared to be a discrepancy between article 14 and article 17(2), which provided that a credit transfer was completed when the beneficiary's bank ac-

cepted the payment order. He wondered whether it might be necessary to clarify article 14, and recalled that, at its previous session, the Commission had agreed to postpone a final decision on the matter until it took up article 17.

2. Mr. LOJENDIO (Spain) said that article 14 left several questions unanswered. For example, it was unclear what remedies were envisaged in the case of a receiving bank which failed to comply with its obligations to send a second payment order. It was also unclear which party was entitled to claim the unpaid amount: the beneficiary or the originator, under the money-back guarantee provided for in article 13.

3. The CHAIRMAN said that, strictly according to the provisions of the Model Law, only the originator would have a right to the funds.

4. Mr. BURMAN (United States of America) said that the options available to the originator were either to seek the enforcement of article 14 under his national procedural law or to claim a refund with interest under article 13.

5. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to leave article 14 unchanged, pending further review of article 17.

6. *It was so decided.*

7. The CHAIRMAN recalled that, at its twenty-fourth session, the Commission had deferred to the current session a discussion of the possible discrepancy between article 5(b)(ii) and article 17(2).

8. Ms. KOSKELO (Observer for Finland) said that it was she who had raised the possibility of a discrepancy. Article 5 defined the moment when payment took place between two banks in the credit-transfer chain; paragraph 5(b)(ii) envisaged a situation in which payment between the sending bank and the receiving bank took place at a third bank. The conflict with article 17(2) arose from the possibility that the reimbursement transaction was itself a credit transfer which would be governed by the Model Law. While article 17(2) defined the time of payment as the moment when the third bank accepted the payment order, article 5(b)(ii) defined it as the business day following the day on which the receiving bank learned that the funds were available. In her view, the conflict could not be resolved in the context of article 17; rather, it was necessary to redraft article 5 so that it defined the time of acceptance rather than the time of payment.

9. Mr. BHALA (United States of America) said that the issue raised by the Observer for Finland had already been dealt with under the Model Law. In the transfer chain, the originator issued a payment order to his bank, which issued a payment order to an intermediary bank. The intermediary bank issued a payment order to the beneficiary's bank, which then paid the beneficiary. Thereafter, under article 17(2), all the parties would have discharged their obligations. Article 5, however, dealt with a different issue, namely, payment among three banks, which was sometimes referred to as "settlement". If each settlement transfer was treated as a separate transaction, then the parties should be relabelled, so that the beneficiary's bank became the beneficiary of the previous transfer, and so on. In that case, article 17(2) would still be operative. If the Model Law definitions were applied consistently, no conflict would arise.

10. Mr. CRAWFORD (Canada) said he agreed with the Observer for Finland that a problem existed, and believed that the representative of the United States might have contributed part of the solution. A further contribution could be made by amending article 17(2) so that obligations could be discharged only where the beneficiary's bank was designated by the beneficiary.

11. In drafting article 5(b)(ii), the Commission had endeavoured to protect a bank from being required to accept an offer of settlement at a bank where it did not wish to have a credit. If a bank owing settlement transferred funds to another bank designated for that purpose by the bank receiving settlement, the safeguard of a day's delay would not be necessary. He believed that it would be preferable to narrow the scope of paragraph (2) rather than adopt the solution proposed by the Observer for Finland.

12. Mr. GREGORY (United Kingdom) said that a conflict might arise where, in the process described by the representative of the United States, the originator's bank issued a payment order to the intermediary bank and made payment by means of a credit transfer. That transfer would be a separate and subsidiary transaction, in which the originator's bank would become the originator and

the intermediary bank would become the beneficiary; if payment was made at another bank, that bank too would become an intermediary. Under article 17(2), the subsidiary transfer would be completed when the lesser intermediary bank, or the settlement bank, accepted the payment order. Yet under article 5(b)(ii), the originator's bank would be deemed to have paid the next bank in the chain when credit was made, or when the payee used the funds. The draft Model Law thus contained different rules, which could produce different results.

13. Since the primary purpose of article 5 was to enable articles 6 and 8 to operate properly, it might be advisable to insert the phrase "For the purposes of articles 6 and 8" at the beginning of article 5.

14. The CHAIRMAN said that the sole purpose of article 5 was to establish a specific time; it had nothing to do with discharging obligations.

15. Mr. FELSENFELD (United States of America) said that the Commission might not be faced with a problem of inconsistency after all. The opening words of article 5 referred only to the moment when payment of the sender's obligation under article 4(6) occurred. In that sense, what was involved was clearly a transfer subsidiary to the main credit transfer, with its own time structure; no conflict would arise between the rules of article 4(6) and those of article 17(2) because they dealt with two different situations. It might, however, be necessary to treat the subsidiary transfer as a separate transaction, in which case article 17(2) would apply.

16. Ms. KOSKELO (Observer for Finland) said that she fully supported the representative of the United Kingdom. There was an obscurity in the text which should be removed by amending the *chapeau* of article 5.

17. Mr. FUJISHITA (Japan) agreed that there was a conflict between article 5 and article 17(2) which could be resolved by amending the *chapeau* of article 5. However, that would reopen the debate on article 5, which had already been approved at the previous session. An alternative would be to delete the second paragraph of article 17.

18. Mr. DE BOER (Observer for the Netherlands) agreed with the representative of the United Kingdom that the scope of article 5 was too broad and should be limited to articles 6 and 8.

19. Mr. BURMAN (United States of America) asked whether the Commission could defer its consideration of paragraph (3), since any changes to that paragraph would have to be carefully checked against other articles of the Model Law for consistency.

20. Mr. CHATURVEDI (India) agreed with the representative of the United States that the Commission should not make changes which would materially affect the sender's obligations; it should not adopt paragraph (3) prematurely.

21. Mr. FUJISHITA (Japan) recalled that the representative of Finland had made the proposal to add a phrase at the end of the first sentence of article 17(1) to ensure that a payment order accepted by the beneficiary's bank was consistent with the payment order issued by the originator both in respect of the indication of the beneficiary and in respect of the amount of payment. He was in favour of that proposal.

22. The CHAIRMAN said that the Commission had addressed that question in connection with article 14.

23. Ms. KOSKELO (Observer for Finland) said that the situation addressed in article 14 was only part of the problem. There were

two ways a credit transfer could go wrong: the amount could change on the way—the situation covered in article 14—or the designation of the beneficiary could be mistakenly changed, so that the final beneficiary bank was not the beneficiary designated by the originator. In such a situation the credit transfer could not be considered to have been completed. There was no provision in the current text of the Model Law to deal with that problem.

24. Mr. CRAWFORD (Canada) said that that idea was embodied in article 7(2), concerning the obligation to issue a payment order consistent with the contents of the payment order received by the receiving bank and containing the instructions necessary to implement the credit transfer. That idea was also reflected in article 17(1). Unless every bank in the chain performed the duty laid down in article 7(2), the transfer was not complete. Nevertheless, the Finnish proposal posed no major problem.

25. Mr. BURMAN (United States of America) said that the matter seemed to be a drafting issue which could perhaps be referred to the Drafting Group.

26. The CHAIRMAN suggested that the Commission should adopt the Finnish proposal; no one could maintain that a payment order accepted by a beneficiary bank other than the bank designated by the sender was complete.

27. Mr. BURMAN (United States of America) asked what would happen in the event of a late payment order if the Finnish proposal was adopted.

28. Ms. KOSKELO (Observer for Finland) said that a credit transfer should be considered to be complete when a beneficiary bank accepted a payment order consistent with the payment order of the originator. The existence of a delay would be determined by the provisions governing the time of execution, not the contents of the payment order from the originator. It was important to make that clarification in article 17(1).

29. Mr. BHALA (United States of America) said he thought that the Finnish proposal might in itself create problems. For example, the beneficiary's bank would not necessarily know what had been said in the original payment order, giving rise, yet again, to a matching problem.

30. The CHAIRMAN said that the beneficiary's bank, when it received an accepted payment order, never knew whether it was consistent with the order issued by the originator's bank. The Finnish proposal should be dealt with by the Drafting Group, which should ensure that the Model Law clearly stipulated that no one could consider a credit transfer to have been completed if a payment order had been accepted by a bank other than the beneficiary bank designated by the originator.

31. Mr. CHATURVEDI (India) said that his delegation fully supported the suggestion made by the Observer for Finland. The problem was not merely a drafting problem; it was essential that a payment order that was accepted should be consistent with the payment order of the sender.

32. Ms. KOSKELO (Observer for Finland) said that she was not insisting on the actual wording of her proposal. The amendment could indicate that a payment order accepted by the beneficiary bank must be for the benefit of the beneficiary defined as the person designated by the originator.

33. Mr. DE BOER (Observer for the Netherlands) said that he could accept that wording.

34. Mr. GREGORY (United Kingdom) said that the original proposal by the Observer for Finland would have addressed both

the problem of a payment received by the wrong bank that was not completed because the amount was too small and the problem of a payment order accepted by the wrong beneficiary bank.

35. Mr. BURMAN (United States of America) said that his delegation would not object to the addition of the words "for the benefit of the beneficiary".

*The meeting was suspended at 4.35 p.m. and resumed at 5 p.m.*

36. Mr. SCHNEIDER (Germany) said that paragraph (3) of article 17 dealt with the underlying obligation between the originator and the beneficiary but that the Commission had yet to decide whether it wanted any rules on the underlying obligation in the Model Law.

37. The CHAIRMAN questioned whether paragraph (3) had anything to do with the underlying obligation.

38. Mr. PELICHET (Observer, The Hague Conference on Private International Law) explained that the reference to "the applicable law" was in fact a reference to the underlying obligation. He proposed that that reference should be made explicit by adding the words "governing the underlying obligation" after the phrase "the applicable law".

39. Mr. CHATURVEDI (India) wondered whether it might not be better to add the word "service" before the word "charges" in the second sentence.

40. The CHAIRMAN said that the Model Law did not deal with service charges. Customary practice in international banking allowed banks to deduct from transfers the amount of any charges. The deduction of such charges could not invalidate the transaction.

41. Mr. CHATURVEDI said that he had meant to stipulate that the bank should be entitled to deduct service charges only, and not other costs.

42. Mr. GREGORY (United Kingdom) said it was understood that the charges were for the transfer; consequently, there was no need to add "service". Indeed, that might only generate more debate. However, he welcomed the addition proposed by the Observer for The Hague Conference.

43. Mr. BURMAN (United States of America) said that his delegation supported that proposal. However, the completion of the credit transfer might have results pertinent to paragraphs (1) and (2). Care should be taken in drafting to preserve any rights or obligations that might flow from the completion of the credit transfer.

44. Mr. CRAWFORD (Canada) expressed his support for the changes proposed by the Observer for The Hague Conference.

45. Mr. DUCHEK (Austria) said that the second sentence of paragraph (3) might give the wrong impression. It obviously concerned to the relationship between the originator and the beneficiary, but in specifying certain rights that could not be prejudiced, it might preclude other rights. During the previous day's discussion on liability, it had been made clear that if, under the law applicable to the underlying obligation, a beneficiary was entitled to ask an originator for compensation for any damage resulting from a delay in payment, that right was not influenced by the Commission's rules. Likewise, the rights involved in the situation described in article 17(3) were not necessarily influenced by the Model Law.

46. Mr. VASSEUR (Observer, Banking Federation of the European Community) said that he was ill at ease with paragraph (3), as it dealt with two quite different matters. The first sentence was concerned with the completion of the credit transfer and the second with cost-sharing. He supported the suggestion put forward by the Observer for The Hague Conference, since the "applicable law" must certainly be the law applicable to the underlying obligation. The sharing of costs between the beneficiary and the originator, however, was not governed by any such law, but only by agreements between the two parties. That difficulty could be avoided by adding wording such as "and of the agreements concluded between the beneficiary and the originator" after the phrase "applicable law".

47. Given that paragraph (3) was an amalgam of two different subjects, the second sentence was in fact inappropriate and should be deleted. It would be appropriate only if the Model Law contained specific provisions regarding cost-sharing, which it did not.

48. Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) said that he supported the proposal made by the Observer for The Hague Conference, which would help clarify the text.

49. Mr. GREGORY (United Kingdom) said that paragraph (3) was a supplementary rule intended to clarify paragraph (1) by stipulating that a credit transfer was complete even though charges might have been deducted. It was not meant to address the question of whether such charges could be deducted.

50. He did not fully understand the remark by the representative of the United States that the rights and obligations specified in the Model Law needed to be preserved. The Model Law did not deal with the right of the beneficiary to recover charges from the originator, and he wondered which rights and obligations did need to be preserved.

51. The representative of Austria had expressed concern that the reference to the right of the beneficiary to recover charges from the originator might implicitly exclude other rights of the beneficiary *vis-à-vis* the originator in different situations. However, the Model Law was clear on that point. Perhaps the second sentence should be amended to ensure that it followed on clearly from the first. It was the rule contained in the first sentence which should not prejudice the right of the beneficiary to recover charges, rather than the completion of the transfer itself.

52. With regard to the proposal by the Observer for the Banking Federation of the European Community that reference should be made to any agreements under which charges might be payable, it was sufficient to refer to the applicable law governing the underlying transaction, since any agreement which failed to comply with that law would not be valid.

53. Mr. EFFROS (Observer, International Monetary Fund) was concerned that, under the provisions as they stood, a beneficiary receiving less than the full amount of a transfer would have an excuse for breaking his contract, while the originator would not know if the full amount required had been delivered until it was too late. The rule appeared to protect banks, while failing to take into account the greater interests of customers. It would be better to specify that the amount originally sent should always be delivered and that any unanticipated charges could be referred back through the chain of banks involved in the transaction and charged to the originator.

54. Mr. BHALA (United States of America) felt that the matter should be kept in perspective, given that the sums concerned were insignificant. There was a general consensus that, if charges were deducted, the beneficiary's right to recover those charges should

not be prejudiced. In the interests of clarity, the drafting amendment proposed by the Observer for The Hague Conference should be included, but there was no need for extensive redrafting of the provision at the present late stage.

55. Mr. AL-NASSER (Saudi Arabia) agreed with the Observer for the Banking Federation of the European Community that it was not appropriate to include paragraph (3) in article 17. It would be preferable to include it as the second paragraph of article 14.

56. Mr. LIM (Singapore) said that the point made by the representative of Austria was a valid one. The principle of consistency in the drafting of the Model Law was very important. The rights of the parties in the underlying transaction were not expressly preserved in other parts of the Law, and to do so in article 17 might lead to difficulties of interpretation.

57. Article 17 was confusing in that it dealt with both the completion of the credit transfer and the underlying transaction. He agreed with the representative of Germany that paragraph (3) might appear to refer to the underlying transaction rather than the completion of the transfer. While the problem was one of drafting, the need for consistency was paramount.

58. Mr. EL-SHARKAWY (Egypt) proposed that the words "under the applicable law" in paragraph (3) should be deleted, since there was some confusion as to what they actually meant. He felt that there was no need for the Model Law to provide for the beneficiary's right to recover charges from the originator at all, since it was covered by the general principles of law.

59. Mr. ZHAO Chengbi (China) said that, as article 17(3) would prejudice other articles, there was a need for greater consistency.

60. Mr. CHATURVEDI (India) said that he supported the proposal made by the Observer for the International Monetary Fund (IMF), since he felt that paragraph (3) might seriously jeopardize international contracts. The paragraph should therefore be revised.

61. The CHAIRMAN noted that there was a substantial divergence of views on the question. However, there did seem to be a general consensus in support of the proposal made by the Observer for The Hague Conference. He therefore suggested that the Drafting Group should be asked to insert the words "governing the underlying obligation" after the words "the applicable law" in paragraph (3).

62. *It was so decided.*

63. Mr. PELICHET (Observer, The Hague Conference on Private International Law) said that the observer for IMF had raised an important point which the Commission ought to discuss.

64. The CHAIRMAN said that he did not feel that the remarks made by the Observer for IMF were a source of concern to delegations. In his view, the sums concerned were so small that they could scarcely be considered valid justification for breaking a contract.

65. Mr. CRAWFORD (Canada) said that emphasis should be placed on the distinction between the completion of the credit transfer as an abstract exercise and the discharge of the underlying obligation. Paragraph (3) did not aim to extinguish that obligation, and there was no need to amend it in order to achieve the result desired by the Observers for IMF and The Hague Conference.

*The meeting rose at 5.55 p.m.*

## Summary record of the 473rd meeting

Thursday, 7 May 1992, at 10 a.m.

[A/CN.9/SR.473]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 10.15 a.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

1. Mr. BHALA (United States of America), speaking for his delegation and that of France, proposed that the following sentence should be added at the end of article 17(1) of the draft Model Law (A/46/17, annex I): "Completion does not otherwise affect the relationship between the beneficiary and the beneficiary's bank". The purpose of that addition was to ensure that completion did not interfere with the relationship between the beneficiary and the beneficiary's bank except as set forth in the second sentence of article 17(1).

2. Mr. LE GUEN (France) noted that no change was being proposed in article 17(2). The sponsors had not accepted the suggestion that the phrase "obligation of the originator to the beneficiary" in article 17(2) should be amended to read "obligation of the originator to pay the beneficiary", apparently in order to satisfy the needs of civil-law countries.

3. Mr. CHATURVEDI (India) said that he was not entirely satisfied with the new text, because it did not cover the case of partial acceptance by a beneficiary's bank of a transfer. Nevertheless, he could agree to the addition.

4. The CHAIRMAN pointed out that the Commission had decided at an earlier meeting, when considering the relationship between article 17(1) and article 14, which dealt with partial payment, to make no change in article 17(2) with respect to partial payment.

5. Mr. EL-SHARKAWY (Egypt) said that the additional sentence proposed for article 17(1) satisfied some of his objections, but still left some problems with respect to article 17(2). He suggested that the additional sentence should be made a separate paragraph in order to cover cases arising under either paragraph (1) or paragraph (2) of article 17.

6. Mr. CRAWFORD (Canada) said he regretted that article 17(2) had not been changed to give explicit expression to the implied condition that the beneficiary had selected the beneficiary's bank. If the addition to article 17(1) was intended to reflect that idea, he thought it should be discussed further; if it was not, he wondered why the idea had been dropped.

7. Mr. GREGORY (United Kingdom) said that he welcomed the addition proposed in article 17(1), but considered that the problem raised by the representative of Canada at an earlier meeting, concerning article 17(2), needed to be addressed. Although it had been decided that no change would be made in article 17(1) to take partial payment into account, something additional was needed in article 17(2) in order to take it into account there.

8. The CHAIRMAN said that he would ask the Drafting Group to take that point into consideration when it reviewed article 17.

9. Mr. FUJISHITA (Japan) asked the sponsors of the amendment for further clarification of the purpose of the new sentence.

10. Mr. LE GUEN (France) said that the purpose of the additional sentence was to bring article 17(1) into conformity with article 17(2), which defined the credit transfer in terms of the whole of the transaction.

11. Mr. DUCHEK (Austria) said that from the point of view of internal consistency, it would be equally logical to add that the internal relationship between the originator and the beneficiary also remained unaffected.

12. The CHAIRMAN said that that point would be dealt with when the Commission considered article 17(2). He noted that the reasons for regulating the relationship between the originator and the bank had to do with the central compromise underlying the Model Law: the compromise between giving the originator the right of refund without the involvement of foreign legal systems, and the need to give banks the benefit of limited liability as set forth in article 16. The beneficiary was not in the same position; if he had not received the transfer, he retained all the rights accruing to him under the Model Law.

13. Mr. AZZIMANE (Morocco) said that two concepts of credit transfer had been put forward in the Commission earlier in the session, one restrictive and the other broad. It had been his understanding that the purpose of amending article 17(1) was to strike a compromise between those two concepts. However, the addition proposed by the United States and France did not seem to be a compromise, as it simply adopted the restrictive concept. Although the change proposed did not seem to affect article 17(1) materially, it might have a greater effect on article 17(2).

14. Mr. LE GUEN (France) said that his delegation, like Morocco's, had originally been opposed to article 17(1), but had agreed to it because a majority of the Commission was in favour of it. In view of that situation, it was proposing the addition of the new sentence simply in order to preserve the internal logic of the article.

15. Mr. CHATURVEDI (India) said he supported the Austrian representative's suggestion to the effect that the new sentence should indicate that not only the relationship between the beneficiary and the beneficiary's bank, but the relationship between the beneficiary and the originator remained unaffected.

16. The CHAIRMAN said he took it that article 17(1), as amended, was adopted.

17. *It was so decided.*

18. The CHAIRMAN invited the Commission to take up article 17(2), and asked those who had voiced objections to that article at earlier meetings to restate them.

19. Mr. CRAWFORD (Canada) recalled that he had expressed the view that the rule of discharge stated in article 17(2) worked fairly only if the beneficiary had designated the account. Other delegations had apparently interpreted the phrase "that can be discharged by credit transfer ..." as preserving the rights of the beneficiary. He wondered whether that interpretation had been recorded in the Commission's records, but was concerned in any

case that the reference to "the account indicated by the originator" seemed to invite misinterpretation.

20. Mr. FUJISHITA (Japan) said that he had not been convinced by the arguments for retaining article 17(2). The article clearly interfered with the relationship between the originator and the beneficiary, which was something the Model Law should not do. Moreover, the paragraph introduced an element of uncertainty through its use of the words "can be". Further, as article 5 dealt with the credit risk or credit exposure of the receiving bank, he saw no reason for not dealing also with the credit risk or exposure of the beneficiary. Other arguments against the retention of article 17(2) had been put forward eloquently by a number of observers. For those reasons, he could not support article 17(2).

21. Mr. GREGORY (United Kingdom) said it was true that the words "can be discharged" could be understood as implying prior agreement by the originator. His delegation, however, continued to believe, for all of the reasons he had stated at an earlier meeting, that article 17(2) should be retained.

22. Mr. AZZIMANE (Morocco) said that he wished neither to approve nor disapprove of article 17(2), but simply to understand the reason for it. It had often been said that paragraph (2) only marginally affected the underlying obligation, but in fact it dealt fundamentally with the discharge of that very obligation. As the Commission had decided to formulate article 17(1) so abstractly, he did not understand why article 17(2) dealt with so concrete and specific an issue.

23. The CHAIRMAN stated that article 17(2) defined the moment when the underlying obligation was discharged. It was, indeed, the only instance in the Model Law dealing with the underlying obligation. It was necessary to have such a definition, precisely because electronic transfers were so fast and so voluminous. When agreement between the parties, or the Law, stipulated that an electronic transfer of funds amounted to a discharge of an obligation, then there was a need for the moment of discharge to be defined very precisely.

24. Mr. SCHNEIDER (Germany) said that the rule enshrined in article 17(2) was one of the most important in the entire Model Law, but like the representative of Japan he felt it had no place there. During the course of its work, the Commission had learned that the situation varied widely from country to country, both as to banking practice and as to legal framework. In some countries, electronic transfers were used for high volumes of funds, in others for much smaller volumes, and in addition banking rules differed from country to country. There was a need for harmonization, indeed there had been many attempts at harmonization, but with the proposed article 17(2) the Commission appeared to be adding to, not reducing, the confusion. Of the many international conventions in existence, not one had a provision comparable to article 17(2).

25. The question of the moment of discharge of the obligation had nothing to do with the transfer of funds itself. The Commission had decided to treat electronic transfers in a very abstract way, but with article 17(2) it was turning away from that decision and dealing with one very specific and very concrete issue.

26. The proposed article 17(2) enshrined a bad policy, one that would engender problems both for the system and for the consumer. The representative of Canada had said that article 17(2) allowed some flexibility, by the inclusion of the term "can" in the phrase "an obligation of the originator to the beneficiary that can be discharged by credit transfer". Increasingly, however, credit transfer was the only way for an obligation to be discharged. He cited the example of a person obliged to pay for an insurance policy by credit transfer. If the transfer were not correctly ac-

cepted by the insurance company's bank, then under article 17(2) the person would himself be liable for the loss of insurance coverage.

27. The Commission was seeking to establish consistency with other means of payment, such as cheques or cash, but was in the process of establishing, for electronic funds transfers, widely divergent rules as to when payment actually took place.

28. For all of the reasons he had given, he urged that article 17(2) should be deleted.

29. Mr. BHALA (United States of America) said that his delegation regarded article 17(2) as fundamental. Many assertions had been made against the article, but little argument. Whereas the representative of Japan felt that article 17(2) interfered with the underlying relationship between the originator and the beneficiary, it had to be pointed out that the article did not come into play unless two conditions were met: "if the transfer was for the purpose of discharging an obligation" and if it "can be discharged by credit transfer". "Certainty" and "predictability" were the words he would use for what the representative of Japan dubbed "interference". One of the benefits of a rule on discharge of obligation, as enshrined in article 17(2), was the avoidance of uncertainty. The representative of Japan felt that the phrase "can be discharged" injected a great deal of uncertainty, but, on the contrary, the stipulation in article 17(2) of the two conditions which had to be fulfilled before the rule would apply resulted in anything but uncertainty.

30. The representative of Germany had drawn analogies with other conventions, pointing out that they did not contain a rule on discharge of obligation, but it had to be remembered that the Commission had always taken the view that credit transfers were a fundamentally different way of making payment. Therefore, analogies were unhelpful.

31. The representative of Japan had stated that since article 5 spoke of the credit exposure of the receiving bank, the Commission should also consider the credit risk of the beneficiary to the beneficiary's bank. The United States took the view that the Model Law was not intended to have any effect on the relationship between the beneficiary and the beneficiary's bank, because that was private.

32. Reference had been made to the eloquent argument put forward by the observer for IMF. Equally eloquent arguments had been made from other points of view, and references to an argument's eloquence did not help the discussion to move forward.

33. The representative of Germany had claimed that the situation with regard to electronic funds transfers differed from country to country, but if the Commission was to be deflected every time it discovered a situation which varied from one country to another, then very little progress towards harmonization would ever have been made. The question of the differing volumes of transfers handled by different countries had no effect on the applicability of the rule on discharge of obligation in article 17(2), and in any event the Commission had decided not to make a distinction between situations which differed from country to country.

34. The representative of Germany had also claimed that the policy in article 17(2) would harm the consumer. That was simply not true. The rule in article 17(2) was a pro-consumer rule, in that it stated clearly to the ultimate users of the system when the obligation was discharged. As to loss of insurance coverage through lateness of acceptance, that problem had already been covered in article 16(1), which stipulated that in such a case, the receiving bank would have to pay interest. With regard to the assertion that

article 17(2) would lead to problems relative to other conventions, it was not true that the Commission was attempting to harmonize electronic funds transfers with paper transfers.

35. As for the assertion that the Model Law should be abstract, that was a sound principle, but it must not be forgotten that the objective of the Model Law was something very practical. The issue covered in article 17(2) was not one specific problem; it was the whole purpose of the credit transfer itself.

36. Mr. EL-SHARKAWY (Egypt) said that unlike some other representatives, he felt that the Model Law was the appropriate place to regulate the issue of discharge of obligation arising out of a credit transfer. It was important to determine not only when a credit transfer discharged the obligation of the originator with respect to the beneficiary, but also when it discharged the obligation of the beneficiary's bank to the beneficiary. He therefore suggested that the addition to article 17(1) put forward earlier by the representatives of France and the United States could also be adopted with respect to article 17(2), either in a newly-drafted paragraph which would combine both article 17(1) and 17(2), or in an additional sentence in article 17(2) stating that the discharge as described in the existing sentences of article 17(2) did not affect the relationship between the beneficiary and the beneficiary's bank.

37. Mr. SANDOVAL (Chile) said that it was precisely the notion of abstraction which had engendered a high degree of certainty with respect to other payment instruments, such as cheques, and had allowed them to be used for transfers of funds. He felt that that principle of abstraction should be retained in the Model Law by deleting article 17(2).

38. Mr. DUCHEK (Austria) said that while it had been stated that article 17(2) did not interfere with the underlying relationship between the originator and the beneficiary, such statements had been unconvincing.

39. The Chairman had said that not to accept the compromise embodied in article 17(2) would be to undo the drafting work of many years; that was an exaggeration. The formulation of article 17(2) was in the interests of the banks in the payment chain, but detrimental both to the originator and to the beneficiary.

40. Returning to the example of an individual who lost insurance coverage through late payment of a transfer, he said that the consequent obligation by the receiving bank to pay interest was not the point at all. The rule covered in article 17(2) should be removed from the Model Law, and left to the discretion of national legislatures. The more the provisions of a model law interfered with rights and obligations, the harder it became to transfer those provisions into national law. He supported the arguments of the representatives of Japan and Canada, found those of the representative of the United States to be unconvincing, and proposed that article 17(2) should be deleted.

41. The CHAIRMAN said that there had been a misunderstanding. In speaking of undoing the drafting work of many years, he had not been alluding to article 17(2).

*The meeting was suspended at 11.35 a.m. and resumed at 12.05 p.m.*

42. The CHAIRMAN announced that the delegation of the United States of America had prepared a draft text which might help to resolve the current impasse.

43. Mr. BURMAN (United States of America) proposed that the following text should be added to the current wording of article

17(2): "Payment under this paragraph is acceptance under article 17(1) unless applicable law provides for an earlier time of payment". He hoped that the addition would accommodate those national systems which provided for the obligation to be discharged at an earlier time.

44. Mr. LIM (Singapore) supported the deletion of paragraph (2) on the grounds that it interfered with the underlying obligations of the parties concerned. The scope of paragraph (2) was very restrictive and was subject to article 3, concerning variation by agreement between the parties.

45. He wished to know whether the United States proposal contemplated a situation in which an underlying contract between two parties contained provisions that were contrary to the provisions of article 17(2). Would such provisions be considered a variation of the provisions of article 17(2) and thereby override them?

46. He suggested that the words "the same amount in cash" in article 17(2) should be amended to make it clear that they referred to the same amount as stated in the payment order accepted by the beneficiary bank, and not the amount stated in the payment order issued by the originator.

47. Mr. BISCHOFF (Observer for Switzerland) supported the views expressed by the representatives of Austria, Chile, Germany and Japan. Many laws governing the contractual relationship between the originator and the beneficiary contained specific provisions that concerned the subject of article 17(2). In many legislations, financial obligations must be met by the payment of a sum of money. Modern judicial practice, however, offered many exceptions to that principle, such as where parties agreed to the discharge of an obligation by a credit transfer. Paragraph (2), if retained, would not only call into question the acceptance of the intervention of the Model Law in national legislation, but would also require the reopening of questions on which agreement had already been reached, including the issues of *force majeure* and revocation of a payment order. While the Model Law itself should not be abstract, it must provide for an abstract concept of transfer.

48. The CHAIRMAN pointed out that whether or not article 17(2) was retained, the provisions concerning *force majeure* and revocation of a payment order (article 11) would not be affected. Paragraph (2) was based on the assumption that the bank had already received the order of payment, and the questions of *force majeure* and revocation of the order could therefore no longer arise.

49. Mr. KOMAROV (Russian Federation) said that he supported the retention of paragraph (2), whose language provided a degree of certainty as to the time of discharge of an obligation. He did not share the view that the provision interfered with the relationship between the originator and the beneficiary. It merely sought to create a rational link or bridge between the two banks which they were free to use or not to use. The provision was worded in a practical way and would not prevent the parties from envisaging other possible times when an obligation would be considered as discharged.

50. Mr. VASSEUR (Observer, Banking Federation of the European Community) supported the position that paragraph (2) should be deleted. Acceptance by the beneficiary bank implied the discharge of the originator's obligation. The civil codes of most European countries contained provisions for the discharge of obligations and, if paragraph (2) were retained, an additional means of discharge of obligations would have to be introduced when a credit transfer was effected to the beneficiary bank. The draft Model Law was not the vehicle through which to introduce an additional means of discharge of an obligation. Moreover, a

transfer might be effected for other purposes, such as making a deposit or gift, and he failed to see why article 17(2) should provide for only one purpose, namely, the discharge of an obligation. For that reason, he could not support the amendment proposed by the delegation of the United States, which referred only to the case of the discharge of an obligation.

51. Mr. HOLEC (Czechoslovakia), in supporting the deletion of paragraph (2), said that the provision must take into account the varying situations in different countries, since the Model Law would apply notwithstanding the means used for effecting the payment order.

52. The completion of a credit transfer and the discharge of an obligation were separate issues. Discharge of an obligation was a matter best dealt with by the applicable national law and, in his view, the Commission should stress the abstract nature of the payment order.

53. Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) said that his delegation was in favour of deleting article 17(2).

54. Mr. GREGORY (United Kingdom) said that all the arguments that had been put forward for the deletion of article 17(2) seemed to be based on the concern that the Commission was interfering with the relationship between the originator and the beneficiary, as governed by national laws. That was, however, not the case. The Commission was not implying that a credit transfer could be used to discharge an obligation. Perhaps it might be advisable to indicate in article 17(2) that the Law did not address the question of whether or not an obligation could be discharged by a credit transfer.

55. The adoption of the compromise proposal made by the representative of the United States might clarify the matter. The addition of the words "unless applicable law provides for an earlier time of payment" would allow national legislation to provide for an earlier time of payment.

56. Mr. JANSSON (Observer for Sweden) said that, in the light of the amendment proposed by the representative of Canada, his delegation could support the retention of article 17(2).

57. Mr. MOORE (Nigeria) said that his delegation was also in favour of retaining article 17(2).

58. Mr. FELSENFELD (United States of America) said that his delegation supported article 17(2) because it was the only place in the Model Law that explained what the Law actually did. If article 17(2) was deleted, the Model Law would deal only with abstractions and would not specify what international electronic transfers of funds should accomplish.

59. Mr. CHATURVEDI (India) inquired whether the United States proposal to amend article 17(2) involved only the addition of the words "unless applicable law provides for an earlier time of payment" or whether the proposal also entailed other amendments.

60. Mr. BURMAN (United States of America) said that the proposal involved only an addition to the existing text of article 17(2). While his delegation believed that the Model Law would perform its task better without the addition, it was willing to accept a modification in order to allay the concerns of some delegations.

61. Mr. PELICHET (Observer, The Hague Conference on Private International Law) said that the United States proposal gave rise to some difficulty. It was quite probable that the law applicable to the underlying transaction was the same as the law applicable to payment. If a country that had adopted the Model Law had a national law that provided for an earlier time of payment than did the Model Law, he wished to know how a court would be able to determine the exact time discharge had occurred. It was necessary to specify what law was at issue and not refer simply to the "applicable law".

62. Mr. BHALA (United States of America) said that, in the situation described by the observer for the Hague Conference, the court would consider both the national law and the Model Law, and would apply the law that provided for the earlier time of discharge of payment.

*The meeting rose at 1 p.m.*

## Summary record of the 474th meeting

Thursday, 7 May 1992, at 3 p.m.

[A/CN.9/SR.474]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.15 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

### Article 17

1. The CHAIRMAN said that it had become clear at the previous meeting that there was no possibility of reaching consensus on eliminating or modifying article 17(2). He therefore suggested that the paragraph should be included in an annex as a provision related to completion of credit transfer and discharge of obligation.

2. Ms. KOSKELO (Observer for Finland) said that she felt it was important to keep article 17(2) in the Model Law; the amendment proposed by the representative of the United States of America would be acceptable.

3. Mr. SCHNEIDER (Germany) said that he had great difficulty with the idea of putting article 17(2) in an annex. In some of the directives of the European Community, important rules appeared in the form of an annex, and that arrangement had not been found helpful. If the paragraph was to be consigned to an annex, he would agree on condition that it was amended as suggested by the representative of the United Kingdom.

4. Mr. SANDOVAL (Chile) said it seemed that there was a majority in favour of deleting paragraph (2). His delegation would accept the paragraph only if it was placed in an annex to the Model Law.

5. Mr. DUCHEK (Austria) said it was clear that there was strong support for both schools of thought. He therefore wished to know what the implications of placing the paragraph in an annex would be. If an invitation to States to consider, in the context of the Model Law, questions relating to the influence of the credit transfer on the underlying transaction was included with paragraph (2), what relationship would the paragraph then have to the rules set out in the Model Law itself?

6. The CHAIRMAN said that the main objection to paragraph (2) had been that it was not relevant to the regulation of credit transfers; there had been no objection to the paragraph itself. By including the provision in an annex, the Commission would be recommending it to Governments for possible inclusion in the Model Law.

7. Mr. HERRMANN (Secretary of the Commission) said that the only model law adopted by the Commission so far had been the UNCITRAL Model Law on International Commercial Arbitration, and it did not have an annex. However, it did have a footnote drawing the attention of States to a certain point. In the Working Group on the New International Economic Order, which was drafting a model law on procurement, there had been a suggestion that certain provisions regarding the review of procurement proceedings should be included in an annex because they gave rise to questions of administrative and procedural law and because detailed rules of procedure might not be acceptable to many States. Those objections were similar to some of the objections that had been raised with regard to paragraph (2). The implications of including provisions in an annex would to some extent depend on what introductory wording, if any, was included with the provision; for example, a model clause might be included in a footnote as an additional clause on which parties might wish to agree. However, such a provision would be even more optional than the main text of the Model Law.

8. Mr. DE BOER (Observer for the Netherlands) said that he could support the United States proposal if it satisfied other delegations. However, probably no law provided for an earlier time in relation to credit transfers, apart from agreements between parties.

9. Mr. CHATURVEDI (India) said that his delegation, too, supported the deletion of the United States amendment; it referred to the time of payment, whereas paragraph (2) referred to the discharge of an obligation. If article 17(2) was included in an annex, then for all practical purposes it would be excluded from the Model Law.

10. Mr. FUJISHITA (Japan) said that his delegation was not entirely satisfied with either the United States or the United Kingdom amendments. While the United States amendment dealt with a situation where the applicable law provided for an earlier time of payment, it was not clear what would happen where the applicable law provided for a later time of payment. He saw no convincing reason why the time of completion should be assumed to be the time of discharge in that situation.

11. Mr. BURMAN (United States of America) said that the Commission's objective was to provide a new payment mechanism that would facilitate commerce, and not simply to develop inter-bank transfer rules. The concept of an annex was becoming less attractive to his delegation. In the past, the Chairman had taken the position that language in the Model Law could be

changed or removed only if there was a strong majority in favour of such a course. At some earlier meetings, even when there had been a slight majority in favour of an amendment, the Chairman had determined that there was not enough support for a change, and his delegation had conceded some points. The same standard must be applied to the current situation.

12. The CHAIRMAN observed that if the Commission could not reach agreement on paragraph (2), it would not be able to adopt the Model Law at the current session.

13. Mr. GREGORY (United Kingdom) said that including paragraph (2) in an annex would be better than retaining a paragraph in the Model Law on which there was substantial disagreement.

14. Mr. BHALA (United States of America) asked what the effect would be if paragraph (2) was left in the Model Law, either in its existing form or as amended by his delegation, and placed in square brackets.

15. Mr. HERRMANN (Secretary of the Commission) said that square brackets in a final text had no established meaning, but might suggest that the final text was still a draft. It would be better to indicate that there had been no consensus on the paragraph, or to include the paragraph in a footnote marked by an asterisk.

16. Mr. ALVAREZ (Uruguay) suggested that paragraph (2) should be left in square brackets. The Commission could then proceed with its other work while conducting informal consultations in order to find a solution to the problems posed by that paragraph.

17. Mr. BURMAN (United States of America) welcomed that suggestion, noting that, if the Commission opted for square brackets, the provision would have to be accompanied by a statement indicating that it had not been agreed upon by the Commission.

18. Mr. EWORE (Observer for Gabon) said that the second sentence of paragraph (1) meant that the beneficiary's bank was obliged to pay the beneficiary the amount of the payment order. The Model Law needed a provision that would deal with the discharge of that obligation, and paragraph (2) met the case. Including it in an annex would not be useful. However, revising the last words of the paragraph, following the word "extent", to read "that it pays the amount indicated in the payment order" would emphasize the discharge of the originator's obligation to the beneficiary.

19. Mr. GREGORY (United Kingdom) felt that square brackets were not the right solution and agreed with the Secretary of the Commission that placing the paragraph in an annex would have the undesirable effect of making it more optional than the other provisions. However, the annex might contain an indication of where the paragraph would have been placed in the body of the Model Law.

20. Mr. DUCHEK (Austria) shared the view of the representative of the United Kingdom. The use of square brackets with or without a footnote would constitute a precedent, and not necessarily a desirable one, for the Commission.

21. Mr. EL-SHARKAWY (Egypt) said that all members conceded that the text should be optional. The Commission should not be concerned with following precedents as the Model Law was only the second such instrument it had drafted. There were many ways to show that the text was optional: in addition to those already suggested, the paragraph might be inserted under the title "Optional text".

22. Mr. BHALA (United States of America) said that the idea of putting the paragraph in an annex to the Model Law and saying that it was optional would be of no practical help, as indeed the whole Model Law was optional. Footnotes had been used in other instruments, such as the one relating to the Bank for International Settlements, to show that no consensus had been reached. In any event, his delegation felt that square brackets, a footnote or both must be used.

23. The CHAIRMAN said that many delegations were opposed to the use of square brackets, which had the disadvantage of drawing attention to the lack of agreement.

24. Mr. OLSZOWKA (Poland) suggested that an ad hoc negotiating group should be established to find a compromise solution. Otherwise, his delegation would be in favour of retaining the paragraph in the text of the Model Law, perhaps in the manner outlined by the United States delegation.

25. The CHAIRMAN said that paragraph (2) as it stood was already the result of negotiations, and yet it continued to meet with strong opposition. There was resistance also to the footnote idea. As the only delegation opposed to the idea of placing the paragraph in an annex seemed to be the United States of America, he appealed to that delegation to display solidarity by accepting that idea.

26. Mr. BURMAN (United States of America) said that his delegation still thought that the worst option would be to place the paragraph in a separate document such as an annex. He therefore suggested that the entire paragraph should be included in a footnote to article 17. In that way, it would not be separated from the rest of the text.

27. Mr. KOMAROV (Russian Federation) said that the United States proposal appeared to meet his delegation's concern that the paragraph should be retained.

28. Mr. GREGORY (United Kingdom) said that his delegation, too, could accept the inclusion of the entire paragraph in a footnote. However, the Commission should indicate that there had been consensus on the placement of the paragraph, rather than that there had been no consensus on the text.

29. Mr. EL-SHARKAWY (Egypt) said that his delegation could also support the new proposal by the representative of the United States.

30. Mr. LIM (Singapore) said that his delegation also supported the proposal. Many countries had added provisions to the UNCITRAL Model Law on the International Commercial Arbitration, and there was no doubt that countries might do the same with the current text.

31. Mr. BISCHOFF (Observer for Switzerland) wondered whether the footnotes in the Model Law ought not to have the same function throughout the instrument. The footnote appended to article 1 served to define the scope of the law and reflected a consensus, while the footnote proposed for article 17 would point up a disagreement.

32. Mr. HERRMANN (Secretary of the Commission) said that the Model Law, once adopted, would be considered by legislators, who would then decide whether to model their own legislation after it. The distinction between the two kinds of footnote could be made clear by different wordings.

33. Mr. CHATURVEDI (India) said that the fact that there had been no consensus on the paragraph must be noted; otherwise, the footnote would not be distinct from the text.

#### Article 18

34. Mr. EL-SHARKAWY (Egypt) pointed out that, although the Model Law was intended to prevent any conflict of laws, article 18 was in fact entitled "Conflict of laws". The article should be deleted, as it was not appropriate in the Model Law.

35. The CHAIRMAN said that the Working Group had considered the fact that an international credit transfer by definition transited through various countries. Any one of those countries might not have adopted the Model Law, or might have adopted it only in part. Moreover, the Model Law itself might have lacunae that would lead to a conflict of national laws.

36. Mr. ABUL-ENEIN (Observer, Cairo Regional Centre for International Commercial Arbitration) said that the issues raised by the conflict of laws governing international credit transfers were very complex. One of the difficulties in relation to article 18 was its ambiguity. In his view, no single conflicts rule would be appropriate for both electronic and paper-based transfers; accordingly, he thought that article 18 should be deleted. He also believed, however, that the parties to a transfer should have the freedom to choose the legal regime applicable to their transactions.

37. Mr. RENGEL (Germany) said that the entire article should be deleted. For his country, as for other members of the European Economic Community, the article would raise more problems than it would solve, particularly with regard to the Rome Convention on the Law applicable to Contractual Obligations between the member States of the European Communities.

38. Mr. DE BOER (Observer for the Netherlands) said that, in principle, he had no objection to the adoption of rules on private international law. However, as the proposed text did not have a high degree of refinement, he wondered whether it might not constitute an obstacle to the further development of international law.

39. Mr. PELICHET (Observer, The Hague Conference on International Private Law) said that his organization had submitted written observations to the Commission at its previous session suggesting that article 18 should be deleted. The Hague Conference did not believe that a single conflicts rule could apply to both paper-based and electronic transfers. Moreover, the Model Law was based on a unitary concept—as evidenced in particular by the provisions on the revocation of payment orders and the duty to refund—while under article 18, a transfer carried out in different countries was viewed as having various segments. If any of those countries had not adopted the Model Law, the compromise on which it was based would collapse.

40. Article 18 was modelled on Section 4A-507 of the United States Uniform Commercial Code, which had been adopted in an inter-American context. While the conflicts rule reflected in that provision might function in an inter-American context, it would not be appropriate for European countries. Even in the United States the rule was not applied: where transfers were effected through electronic transfer networks, such as FedWire or the Clearing House Interbank Payments Systems (CHIPS), the conflicts rules laid down in Section 4A-507 were set aside in favour of unitary-rule systems.

41. Moreover, merely deleting article 18 would not solve the problem in its entirety. The Hague Conference had put the issue on its agenda for future discussion. If the Commission decided to delete the article, he recommended that efforts should be undertaken, in collaboration with banks, to develop a unitary rule which could function in the context of electronic transfers.

42. Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) said that, while his delegation had no difficulties with article 18 as a whole, it was unclear as to the meaning of the term "receiving banks" in paragraph (1), since each intermediary bank which took part in an international transfer was considered to be a receiving bank.

43. The CHAIRMAN said that paragraph (1) established a rule for each payment order, rather than for the entire transfer. All the operations required to carry out a payment order took place in the receiving bank, there being one receiving bank for each segment of the transfer.

44. Mr. EWORE (Observer for Gabon) said that the issue under discussion was highly sensitive. The arguments in favour of retaining paragraph (1) were legitimate, in view of the general lack of conflicts rules at the international level. The paragraph, however, raised some dangers. For example, if the parties to a transfer had the option of choosing the applicable law, it was to be expected that they would choose those national provisions with which they were most familiar. He therefore suggested that there should be an additional provision that would take into account both those States which had ratified the Model Law and those which had not, thereby ensuring that the Model Law would be applied at least by those countries which had ratified it.

45. Mr. FUJISHITA (Japan) said that he supported the deletion of the article.

46. Mr. OLSZOWKA (Poland) said that the article should be retained on the grounds that even an imperfect conflicts rule was better than none at all. While it was true that States which were already parties to conventions on conflict of laws would find it difficult to apply the provisions of the Model Law, ratification of such instruments was far from universal.

47. Despite its support for the article, his delegation felt that the expression "having different rules of law" in paragraph (3)(a) was ambiguous and might lead to conflicts.

48. Mrs. AUGIER (France) said that her delegation shared the views expressed by the observer for the Hague Conference and believed that, for a number of legal and practical reasons, the article should be deleted. She also supported the proposal to refer the question to a group of experts for review. It was unclear how a system based on article 18 could ensure certainty, which was the main purpose of the Model Law. For example, with regard to the application of article 13, the organization of a series of refund transfers could be disrupted if one party was able to invoke a law prohibiting such reimbursements.

49. Mr. BURMAN (United States of America) said that while article 18 was imperfect, its provisions, particularly paragraph (1), were supported by a number of United States commercial parties. The first sentence of that paragraph was probably acceptable to most delegations; it was intended to resolve situations in which commercial parties chose an applicable law which was not honoured by the courts owing to the lack of a statutory provision. The second sentence was more problematic. In the absence of a convention or some other means of binding countries to a common rule, the question raised by the representative of France could not be answered.

50. Mr. BHALA (United States of America), replying to the question raised by the observer for the Hague Conference, said that the FedWire rules had been enacted in United States law in what was known as Regulation J, which incorporated Article 4A of the Uniform Commercial Code. Consequently, the FedWire rules could not be cited as an argument against the retention of article 18, particularly as 37 American States had adopted Article 4A without amendment to date.

51. It was essential to consider the two parts of paragraph (1) separately. The first sentence was important because it allowed parties to agree that a single law should govern their transfer. The value of the second sentence was that it provided an element of certainty with regard to each aspect of a credit transfer. The provision stipulating that the law of the receiving bank would apply unless otherwise agreed was also useful because it dealt with the propensity of lawyers to seek out the most advantageous jurisdiction and prevented the unwarranted extraterritorial application of the law of a particular State.

52. The CHAIRMAN said that one of the major considerations borne in mind by the Working Group when adopting article 18 had been the existence of a complete lacuna in the area of conflict of laws. The article was thus intended as a first step in the drawing up of rules to remedy that situation.

53. Ms. KOSKELO (Observer for Finland) said that while there was general agreement on the need for provisions to govern conflict of laws, article 18 as currently drafted did not offer the best solution. The Working Group had not analysed the question in sufficient depth, and it was unlikely that States would be willing to adopt rules with which they did not feel comfortable. The provisions would not succeed in achieving harmonization in the field but might have the opposite effect by precluding the efforts of the Hague Conference to draw up its own rules on the subject. It would be preferable to allow the Hague Conference to take up the matter and give it thorough consideration. Article 18 should therefore be deleted.

54. The CHAIRMAN asked the observer for the Hague Conference if he could say when the Conference intended to start work on the question and how long its work might take.

55. Mr. PELICHET (Observer, The Hague Conference on Private International Law) said that a decision might be taken in June 1992 to start work immediately by submitting a questionnaire to banks, with a view to finding an appropriate basis for a solution. The results could then be submitted to the seventeenth session of the Conference in 1993 and, if the outlook was positive, the matter could be included on the agenda for the following session in 1996, when a convention could be drawn up and adopted.

56. Mr. JANSSON (Sweden) said that he fully endorsed the arguments put forward by the observer for the Hague Conference and therefore favoured the deletion of article 18.

57. Mr. DUCHEK (Austria) acknowledged that it was difficult to draft appropriate rules when several different jurisdictions were involved; nevertheless article 18(1) would not function properly in its current form. The aim of the article should be to identify a single law which would govern the whole operation.

58. There were also a number of technical deficiencies in paragraph (1). For example, it was not clear whether the reference to rights and obligations arising out of a payment order concerned the whole of a credit transfer; likewise it was unclear whether the obligation of the beneficiary's bank to the beneficiary after completion of the transfer was included. In addition, the terms "parties" and "agreement" were somewhat vague. In the light of all those considerations, he favoured the deletion of article 18.

59. Mr. VASSEUR (Observer, Banking Federation of the European Community) said that his organization had conducted a survey among its 17 member associations concerning rulings by the courts in their country during the last 30 years on the question of conflict of laws with regard to international credit transfers. None of the member associations had been able to cite a single court decision. He therefore felt that the matter was of no great urgency.

60. The Banking Federation was opposed to article 18 in its existing form but was anxious to cooperate with the Hague Conference in giving serious and wide-ranging consideration to the question. In addition, the Banking Federation did not accept the notion of a credit transfer as a series of separate operations. It therefore agreed with the Hague Conference that efforts should be

concentrated on devising a single law which considered credit transfers as a single operation. With that in view, the most appropriate provisions would be those of the law of the place where the beneficiary's bank was established.

*The meeting rose at 5.55 p.m.*

### Summary record of the 475th meeting

Friday, 8 May 1992, at 10 a.m.

[A/CN.9/SR.475]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 10.15 a.m.*

#### INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

1. Mr. CRAWFORD (Canada) said that his delegation was in favour of retaining article 18 of the draft Model Law on International Credit Transfers (A/46/17, annex I), because it was useful to have a rule on conflict of laws. The first sentence of article 18(1) confirmed the Parties' autonomy with respect to issues affecting payment, while the second sentence provided a good default rule in the absence of the exercise of such autonomy. The Commission should not decide to delete article 18 merely because the conflict-of-laws rule might not be the best possible rule for credit transfers.

2. Mr. BURMAN (United States of America) said that his delegation supported the statement of the representative of Canada. Article 18 provided the kind of guidance that made commercial transactions work better than did the absence of a rule on conflict of laws. The article would provide a workable solution for countries that adopted the Model Law, and would provide all parties that did not otherwise choose their applicable law under the first sentence of article 18(1) with a rule to fall back on.

3. Mr. GREGORY (United Kingdom) said that his delegation did not share the views expressed in the note prepared by the Hague Conference on Private International Law, which drew attention to a number of difficulties concerning article 18. The Hague Conference maintained that it was not possible to include a conflict-of-laws rule in a substantive law, particularly a rule that determined whether or not the Model Law itself applied. However, that was not what article 18 purported to do. A country that had adopted the Model Law with article 18 in it would apply the conflict-of-laws rule when a situation described in that rule arose. The Hague Conference maintained that it made no sense to consider only the separate segments of a credit transfer, and that it was necessary to consider the credit transfer as a whole. Nevertheless, that was not a reason for dismissing the rule entirely. A credit transfer was a series of separate operations involving individual parties—senders and recipients of payment orders—between whom a dispute might arise. In analysing a credit transfer, it was possible to consider the obligations of a party in respect of a payment order or a particular segment of the credit transfer, and to determine which law applied.

4. If all countries adopted the Model Law, there would be no need for a conflict-of-laws rule. The rule was necessary because

some countries might not adopt the Model Law, while others might adopt it with variations. Moreover, a credit transfer might pass through a number of countries whose laws were different. It was necessary to include in the Model Law some statement to the effect that rules should apply only where all parties were subject to them, either under their relevant law or by agreement. However, the Law would not work unless all participants in credit transfers were subject to it. Perhaps the Secretary of the Commission could provide some guidance in that respect.

5. Mr. HERRMANN (Secretary of the Commission) said that article 18 was a conflict-of-laws rule and was not designed to determine the territorial sphere of application of the Model Law in any other way. The rule applied only to a dispute in a State that had adopted article 18, and had no bearing on whether the States to which the rule referred had adopted the Model Law or not. If the rule referred to a State that had adopted the Model Law, it would then be necessary to determine whether the transaction involved an international credit transfer, in which case the Model Law would apply; otherwise, the existing national law, if any, would apply. In accordance with article 1(1), the question of sphere of application would arise only when reference was made to the State whose law would apply.

6. The conflict-of-laws rule provided a single law that was applicable to the entire international credit transfer. If it was realistic to expect States and their banks to agree to a single, uniform law, and to expect that the law of the State of the receiving bank would apply, that would mean that the Model Law would apply only in States that adopted it. A dispute taken to a court in one of the States parties could be settled easily. However, a problem might arise with a bank other than the beneficiary's bank. If a State had adopted the Model Law and that Law was applicable, there would be no need for a uniform system.

7. Consideration should be given to whether or not a State would be willing to accept the substantive unitary system provided by the Model Law and, in addition, a convention on the applicable law, which was currently being prepared by the Hague Conference. It might be preferable to have separate instruments in cases where a State had objections to adopting the unitary system but, in the area of conflicts, wished to become a party to a convention on the applicable law.

8. Mr. CHATURVEDI (India) said that his delegation supported the views expressed by the representatives of the United States and Canada regarding the desirability of retaining article 18.

9. Mrs. FERNANDEZ DE GURMENDI (Argentina) said that her delegation had considered the arguments adduced by the Hague Conference in its note, and wished to join those delegations that were in favour of deleting article 18. While a rule on conflict of laws was necessary, the Commission should endeavour to adopt a rule that would satisfy all parties concerned. It might therefore be better to wait three or four years until the Hague Conference had completed its convention on the applicable law.

10. Mr. SANDOVAL (Chile) said that his delegation was in favour of deleting article 18 in its entirety.

11. Mr. LOJENDIO (Spain) said that his delegation was in favour of retaining article 18. A decision to wait until another organization prepared a conflict-of-law rule would considerably delay the adoption of the Model Law. Moreover, while the Hague Conference made significant contributions to private international law, it lacked the universality of the United Nations.

12. The arguments for deleting article 18 were based on objections to the subsidiary rule, not to the main rule that provided that the parties were free to choose the law governing the rights and obligations arising out of a payment order. The subsidiary rule, which involved the application of the law of the State of the receiving bank, would apply only in the absence of agreement.

13. His delegation wished to know the precise reasons why some delegations considered the rule in article 18 to be invalid with respect to electronic transfers.

14. Some delegations favoured a single law that would apply to the entire credit transfer. However, it was quite possible that the parties involved in each segment of the transfer might choose a law that was different from the law chosen by the parties in the previous or subsequent segment. Those who defended the theory of the single law could not contend that the free choice of different laws would be restricted by the principle of the single law. If a problem were to arise in a single segment of the transfer, he did not understand why it would have to be resolved according to a law that was not directly applicable to the segment. More important than the single law itself was the proximity between a segment and the law that governed it; in that respect, article 18 satisfied that requirement.

15. Mr. KOMAROV (Russian Federation) said that his delegation supported the retention of article 18. In addition to the arguments already put forward in favour of retention, he would point out that the provisions of article 18 should be regarded not as an attempt to resolve questions of conflict of laws in credit transfers in general, but as a supplemental rule which could help to unify the substantive rules of the Model Law itself. From that point of view, the provision was the logical culmination of the effort of unification embodied in the draft Model Law. Moreover, even if the Model Law were to be adopted by all States, the provision would not automatically obviate all conflicts of laws, because the Model Law did not attempt to regulate all situations; that was true even in the case of parties in countries which had codified their rules concerning credit transfers. The provision should therefore be regarded as a general indication to countries of the need to take a more flexible approach to the question of conflicts of laws.

16. Mr. PELICHET (Observer, The Hague Conference on Private International Law) said that, in connection with the remarks made by the Secretary of the Commission, he wished to make it clear that there was no competition between his organization and the Commission, but only cooperation.

17. In clarification of his own view, he added that what he had said at an earlier meeting was that a Model Law without rules of autonomous application in particular cases could be implemented

only through the use of a conflict-of-laws system. With respect to how the Model Law could be made applicable to the entire transaction, he would reply that that could only be done either by the adoption of a convention containing rules governing the entire transaction, or by the inclusion in the Model Law of a rule governing conflict of laws. Of course, a convention would require enforcement in the sense of ratification and incorporation into national legal systems, but if the Hague Conference drew up such a convention and States approved of it, they would then of course proceed to ratify and adopt it.

18. With respect to the comment that article 18 established a degree of certainty on the question, he would reply that, on the contrary, article 18 provided no certainty. For example, in the hypothetical case of a credit transfer from Salzburg to Cleveland, Ohio, via Vienna and New York on which litigation subsequently arose in London, a judge would find no certainty in the provision, because he would be unable to establish in which intermediate segment of the transaction any particular event had taken place.

19. With respect to the comment that the rule of autonomy was a good one and should be retained, he would add that it also created great problems. For example, if, in the hypothetical case he had referred to, the New York segment of the transaction involved an electronic transfer under the CHIPS system, all segments of the transaction would automatically be subject to New York law under the legislation of that State. His point was that if the rule on conflict of laws was retained as it stood in article 18, it would create many more problems than it would resolve.

20. The CHAIRMAN asked the observer for the Hague Conference how the hypothetical problem he had given as an example would be resolved under the Rome Convention.

21. Mr. PELICHET (Observer, The Hague Conference on Private International Law) said that the Rome Convention would not, in his opinion, offer a good solution to the problem, as it consisted of a set of general contractual rules. In dealing with international credit-transfer questions, a more detailed set of rules than those provided by that Convention would be required.

22. Mr. BISCHOFF (Observer for Switzerland) said that he favoured the deletion of article 18 in its entirety, for the reasons given by the observer for the Hague Conference.

23. Mr. BHALA (United States of America) said that the work of both the Hague Conference and the Commission was valuable. There seemed no need to try to decide which was the more appropriate body to deal with questions of conflict of laws.

24. It seemed to him that the observer for the Hague Conference had demonstrated the potential usefulness of article 18, as he had given an example of a hypothetical conflict of laws arising out of a credit transfer and then proceeded to solve the problems involved through the application of the Model Law. His delegation did not maintain that segmentation in itself was a good thing; its preference would be, rather, for an end-to-end system. But the only way to achieve such a system was either by universal adoption of the Model Law, which was unlikely, or for the parties to a credit transfer to agree that the Model Law applied, which was possible as a practical matter. A similar approach had been adopted in United States federal jurisprudence to deal with a similar situation, and had provided some certainty. The point was that a beginning had to be made somewhere.

25. Mr. ROJANAPHAIK (Thailand) said that if a convention on conflict of laws was adopted, its provisions would govern such questions—but no such convention was as yet in existence. In any case, the Model Law could include provisions with respect to conflict of laws which might be useful. It was indeed necessary

to have some applicable rule providing certainty on the question. Moreover, the first sentence of article 18(1), which left choice of the applicable law to the parties, should alleviate the concerns of those not in favour of the second sentence.

*The meeting was suspended at 11.30 a.m. and resumed at noon.*

26. Mr. LIM (Singapore) said that he felt sympathetic towards those who considered that article 18 provided a degree of certainty, but he was afraid that it was more ambiguous than the existing rules on conflict of laws, which the Commission should not attempt to modify without sufficient consideration.

27. For article 18 to apply, all relevant States would have to have adopted the Model Law. If that were not the case, article 18 would apply only if the Model Law were the applicable law, which would have to be determined by the rules on conflict of laws. The problem was circular, and article 18 seemed of limited usefulness.

28. Mr. MONTES DE OCA (Mexico) said that having heard the arguments for and against article 18, he was in favour of its retention.

29. Mr. EL-SHARKAWY (Egypt) said that for the reasons which he and others had already stated, he was convinced that article 18 should be deleted. He did not propose to repeat all the reasons he had already given, but wished to add one further consideration. The Model Law would be applied by national courts. If a national court found the Model Law not to be applicable, then its provision on conflict of laws, article 18, would not be applicable either. If the Model Law's applicability or inapplicability was to be decided by the national courts, then there was no need for a rule on conflicts of laws.

30. Mrs. AUGIER (France) recalled that France had been in favour of deleting article 18. Having heard the arguments of the various representatives, in particular those who were in favour of retaining it, her delegation had concluded that the discussion had a dual nature. On the one hand, there was a question of private international law, and of the rule on conflict of laws. On the other hand, there was the issue of the underlying conception of the Model Law, which came down to the question of whether credit transfers were seen as a single operation running from the originator to the beneficiary, or as a series of separate segments. If consideration of article 18 did indeed make it necessary to re-examine the underlying conception of the Model Law, she proposed that article 18 should be removed from the Model Law and referred to a group of experts.

31. Mr. MOORE (Nigeria) said that particularly after listening to the views of the observer for the Hague Conference, he saw no reason to retain article 18.

32. Mr. DASTIS (Spain) said that he was in favour of retaining article 18. It might well be that the Hague Conference would deal with the issue in more detail at some time in the future, but it had to be asked when that future might be. Some of the Hague Conference's Conventions, although completed, were not yet in force.

33. Article 18 seemed fundamentally acceptable, and he urged that the Commission should retain it rather than put off to some uncertain future the resolution of the question of conflict of laws.

34. Mr. DE BOER (Observer for the Netherlands) said that he had found most convincing the argument of the observer for Finland that because of article 18, which was relatively minor, some countries might not accept the rest of the Model Law.

35. Mr. DRAGOS (Observer for Romania) stated that it was very important for a country such as Romania, which was currently undergoing the transition to a free-market economy, to be able to rely on a precise framework regulating international relationships. He supported retention of article 18, with one minor modification, namely that article 18(1) should state that the article would apply as a subsidiary or complement to the national law of the receiving bank.

36. Mr. SONO (Observer, International Monetary Fund) said that if article 18 was to be retained, then there were still many points of disagreement to be resolved. If, on the other hand, the issues covered in article 18 were to be left to the Hague Conference, then any work which that body undertook on the question of conflict of laws would be of more general applicability than was necessary for the Commission's purposes. For those two reasons, he supported the proposal of the representative of France that a group of experts should resolve the question of article 18; representatives of the Hague Conference should be invited to participate in such a group.

37. The CHAIRMAN said that if the French proposal were to be accepted, the Model Law would end after article 17. The Commission would adopt an incomplete Model Law, the question of conflict of laws would be studied by a group of experts, and a provision on the issue might or might not be added to the Model Law at a later date.

38. Instead, he suggested that the provisions of article 18 shall be incorporated in a footnote to the Model Law. The footnote could specify that as the question of conflict of laws did not directly affect credit transfers, States might wish, but were not obliged, to adopt a rule such as that in article 18. That solution would allow States which felt a need for the provisions of article 18, to adopt the article, however imperfect. At the same time, it would satisfy those that did not wish its provisions to be included in the Model Law, and lastly, it would allow the Commission to continue its work and move on to other issues.

39. Mr. GREGORY (United Kingdom) agreed with the Chairman and with his reasons for not wishing to submit article 18 to a special group. He also agreed with the observer for IMF that the Hague Conference would take a wider view of the rules on conflict of laws than was necessary for the Commission's purpose of resolving disputes in the one very specific area of international credit transfers. Within that limited context, he felt that article 18 was highly effective.

40. He supported the Chairman's suggestion that article 18 should be incorporated in a footnote, for adoption or rejection by individual States as they saw fit.

41. Mr. DASTIS (Spain) also agreed with the Chairman's suggestion, but expressed a preference for an annex over a footnote. A footnote had to be at the foot of something, and there would be nothing in the text to which article 18 as a footnote, could be attached.

42. The CHAIRMAN said that, while he would prefer an annex, he had suggested a footnote for the sake of consistency in the draft Model Law.

43. Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) suggested that the second sentence of article 18(1) should be deleted and the first sentence, on which there was consensus, retained. In that way, the draft Model Law would both respect the principle of contractual freedom and contain a provision concerning conflict of laws.

44. The CHAIRMAN pointed out that many delegations were opposed to the deletion of the second sentence of article 18(1). Moreover, it was not possible to split up a single provision in the manner suggested by the representative of the Islamic Republic of Iran.

45. Mr. GRIFFITH (Observer for Australia) agreed with the representative of Spain.

46. Paragraph (1) should not be split up, since a rule providing for situations in which there was no agreement between the parties was necessary in order to complete the structure of the proposed norm.

47. Mr. FUJISHITA (Japan) supported the idea of a footnote. The footnote should, however, state that the Commission had failed to achieve a consensus on the text of article 18 and that its application was optional.

48. The CHAIRMAN said that he had suggested a footnote precisely because it was desirable to avoid any reference in the Model Law to a lack of consensus.

49. Mr. BURMAN (United States of America) said that, while he had no objection to the use of a footnote, there was indeed consensus on the first sentence of article 18(1). The two sentences of article 18(1) dealt with different questions which might usefully have been separated in the Commission's discussions. The first sentence related to the choice of law and not to conflict of laws; it should be appended to article 3, concerning variation by agreement, while the provision of the second sentence might be included in a footnote to either article 1 or article 3.

50. He was not in favour of an annex, because it would create doubt in the minds of users concerning the relative importance of the provisions contained in the annex and in the footnotes respectively.

51. The CHAIRMAN urged members not to be sidetracked into a discussion of whether or not to retain the first sentence of article 18(1), on which, moreover, the Commission had not reached a consensus. He hoped that the representative of Spain would not insist on the use of an annex.

52. Mr. ALVAREZ (Uruguay) supported the arguments of the representative of Spain in favour of an annex, which would also give more prominence to the provision it contained.

53. The CHAIRMAN said the fact that article 18 was unattached to any other provision in the draft Model Law was a minor detail. The Drafting Group would have enough resourcefulness to place the footnote at a logical point in the text.

54. Mr. RINGER (Germany) said that he would support either solution. He agreed with the representative of Japan that the footnote should include a statement that explained why the provision had been placed in a footnote.

55. The CHAIRMAN said that the footnote should contain a statement along the following lines: "The Commission felt that the provision on conflict of laws was directly related to the question of credit transfers. Countries may, however, decide whether they wish to accept the provisions of this article."

56. Mr. DASTIS (Spain) said that he would support the use of a footnote to article 1, as suggested by the representative of the United States.

57. The CHAIRMAN said he took it that the Commission wished to accept his suggestion for a footnote.

58. *It was so decided.*

59. Mr. BHALA (United States of America) said that the purpose of paragraph (2) was to serve as an exception to paragraph (1) in the case of interloper fraud, for example, where the sender sent a payment order in the name of an innocent customer. His delegation was opposed to paragraph (2) because it offered no guidance on the applicable law in cases of interloper fraud in which the actual and purported senders came under different jurisdictions. In contrast, paragraph (1) provided clear guidance, and the predictability which it offered would be lessened if paragraph (2) were retained.

60. The CHAIRMAN pointed out that the objective of article 18(2) was limited to article 4(1) and did not extend to article 4 in its entirety. Article 4 provided for situations in which a payment order was either authenticated or authorized. Where the payment order was authenticated according to the procedures provided in paragraph (2) of article 4, the same conflict-of-laws rule would apply as in the draft Model Law as a whole. Paragraph (1) referred to an exceptional situation in which there was authorization but not authentication. In such a case, the law of the State of the receiving bank would apply.

61. Mr. DE BOER (Observer for the Netherlands) observed that it might be possible for a country to accept only the conflict-of-laws rule and not the remainder of the Model Law.

62. Mr. HERRMANN (Secretary of the Commission) said that the provision on conflict of laws was important even if a country did not accept the Model Law. It should therefore be considered separately from the remainder of the text. Article 18(1) sought to determine the domain of the applicable law, while article 18(2) envisaged an exception. The issue which was the subject of the exception must be described, and not for the purposes of article 4(1). In fact, one solution might be to delete the words "for the purposes of article 4(1)" from paragraph (2) of article 18.

63. Mr. CHATURVEDI (India) said that paragraph (2) was related to paragraph (1) and should therefore be either deleted or similarly placed in a footnote.

64. The CHAIRMAN said that his suggestion was for the entire article to be placed in a footnote.

65. Mr. FUJISHITA (Japan) said that paragraph (2) should be retained as a footnote since it would be useful to provide conflict-of-laws rules for questions of agency.

66. Mr. GREGORY (United Kingdom), supported by Ms. KOSKELO (Observer for Finland), said that he shared the opinion of the Secretary of the Commission that the words "for the purposes of article 4(1)" should be deleted from paragraph (2).

67. The CHAIRMAN said he took it that the Commission wished to delete those words and adopt article 18(2), as amended.

68. *It was so decided.*

*The meeting rose at 1 p.m.*

## Summary record of the 476th meeting

Friday, 8 May 1992, at 3 p.m.

[A/CN.9/SR.476]

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.15 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367)

### Article 18 (*continued*)

1. The CHAIRMAN said that paragraph (3) of article 18 was a provision that was commonly included in the general clauses of conventions that were applicable to States with various territorial jurisdictions. The Commission had already taken the position that branches and separate offices of a bank in different States were separate banks.

2. Mr. DASTIS (Spain) said that paragraph (3)(a) was too general; instead of referring to territorial units having "different rules of law", it should refer to different regulations in respect of credit transfers. In Spain there were territorial units which had different regulations in many areas of law but the same commercial law.

3. The CHAIRMAN pointed out that if the Commission amended paragraph (3)(a), it would be departing from the language normally used in conventions.

4. Mr. GREGORY (United Kingdom) said that since paragraph (3) began with the words "For the purposes of this article", the provision was relevant only where there was a conflict of laws. If the law relating to credit transfers was the same in two territorial units of a State, the provision did not apply. If the Spanish amendment was adopted, it would not be clear what the rules of law governing credit transfers were, since they would include both the provisions of the Model Law and also other rules of law that were relevant to credit transfers.

5. The CHAIRMAN suggested that the Drafting Group should consider the suggestion made by the representative of Spain.

### Outstanding issues

6. The CHAIRMAN said that at its twenty-fourth session, the Commission had left three issues pending. The first issue, referred to in paragraph 84 of the report of that session (A/46/17), concerned the definition of the term "beneficiary's bank". It was his view that the Commission's discussions had shown that a definition was unnecessary. If he heard no objection, therefore, he would take it that that was the view of the Commission.

7. *It was so decided.*

8. Mr. CHATURVEDI (India) said his delegation felt that the absence of a definition of the term "beneficiary's bank" could create some problems, especially in relation to article 7 and other articles concerning the discharge of the obligation of the sender or the originator. The Commission should put it on record that problems could arise in respect of implementation.

9. The CHAIRMAN said that the second issue, referred to in paragraph 222 of the report, was the possible insertion of a general provision along the lines of article 7(2) of the United Nations

Convention on Contracts for the International Sale of Goods. The wording of the general provision would be:

"Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."

The wording would be adjusted, as required.

10. Mr. BURMAN (United States of America) said his delegation felt that the general provision would work just as well in a model law as in a convention and would provide useful guidance for courts in producing decisions that would support the overall purpose of the Model Law.

11. Mr. DE BOER (Observer for the Netherlands) said that it was appropriate to include the general provision in the Model Law, since the Model Law could be applied by courts in the absence of statutory law.

12. Mr. PELICHET (Observer, The Hague Convention on Private International Law) disagreed that the proposed general provision had a place in the Model Law. The Model Law would always be applied as the law of any State that incorporated it into its system; if there were lacunae in the Model Law, they would be filled by national law.

13. Mr. HERRMANN (Secretary of the Commission) said that since the general provision was taken from a convention, it would have to be adjusted for the purposes of the Model Law. There was no need for a court to invoke a conflict-of-laws rule when considering matters governed by the Model Law but not expressly regulated by it. If a question was not expressly addressed in the Model Law, an attempt should be made to find an answer in the principles of the Model Law before referring to other parts of the national legal system.

14. Mr. CHATURVEDI (India) said that it was unnecessary to include the general provision in the Model Law: where there was a point of dispute, courts should look at the laws and judicial decisions of other countries, as was the general practice.

15. Mr. EL-SHARKAWY (Egypt) said that he supported the inclusion of the general provision in article 18.

16. Mr. LIM (Singapore) said that at the previous session he had opposed the inclusion of the general provision. However, since then he had studied the application of UNCITRAL arbitration law in various parts of the world and had concluded that a provision regarding interpretation would be very useful.

17. Mr. CRAWFORD (Canada) said that it was very difficult to make a last-minute change in article 18; the new provision could be interpreted in ways that were completely foreign to his own legal system and would give the Model Law a much broader scope of application.

18. The CHAIRMAN observed that the proposal had been made at the previous session.

19. Mr. GRIFFITH (Observer for Australia) said that, as the Commission had a satisfactory text, there was a danger in introducing a general provision at the last minute.

20. Mr. GREGORY (United Kingdom) suggested that the Commission should consider deleting the words after the phrase "on which it is based".

21. Mr. DE BOER (Observer for the Netherlands) suggested that the question should be referred to the Drafting Group.

*Suggestions by the Secretariat for the final review of the draft Model Law (A/CN.9/367)*

22. Mr. BERGSTEN (Consultant to the Secretariat) briefly introduced document A/CN.9/SR.367, containing the Secretariat's suggestions for the final review. In general, the points raised in the document were either drafting matters or relatively minor policy questions, such as the definition of "banking day" in paragraph 22.

23. The CHAIRMAN suggested that such minor questions should be sent to the Drafting Group. The Commission might then proceed to consider substantive questions.

24. Mr. HARRIS-BURLAND (Observer, Commission of the European Communities) said that the value date, which had not yet been discussed as a general point, could not be considered a drafting point. The Chairman should seek the permission of the Commission before referring the matter to the Drafting Group.

25. Mr. BERGSTEN (Consultant to the Secretariat) suggested that the Commission might consider the problem of the applicability of article 10 to the beneficiary's bank. The definition of the term "execution", which was still enclosed in square brackets, also referred to the beneficiary's bank, but the latter term was not defined. The most significant aspect of paragraph (1) of article 10 was the deemed-acceptance rule, and a clear decision was needed on whether that rule did or did not apply to the beneficiary's bank.

26. Mr. GREGORY (United Kingdom) said that the rule applied to the beneficiary's bank. There was no need to define execution in the context of the beneficiary's bank; the text was correct as it stood. The definition of execution referred only to banks other than the beneficiary's bank, so "execution" had its ordinary meaning in paragraph (1) with respect to the beneficiary's bank.

27. It was legitimate to include the beneficiary's bank under paragraph (1), which meant that the beneficiary's bank was required to execute the payment order on the same day or the following day. Precise stipulations, however, should be left to the local law to determine. With regard to paragraphs (1 *bis*) and (1 *ter*), the Commission ought to consider when value was to be given by the beneficiary's bank.

28. Mr. BHALA (United States of America) said that the definition of "execution" in article 2(1) should be retained without square brackets. With regard to the execution of a payment order by the beneficiary's bank, his delegation thought that such an order could be accepted, but not executed, by that bank. Accordingly, the word "executed" in article 9(2) and (5), which dealt with the obligations of the beneficiary's bank, might better be changed to "accepted". It might also be advisable to delete the phrase "within the time required for execution under article 10" from article 9(5), in which case the time required would be governed by local law.

29. Ms. KOSKELO (Observer for Finland) agreed that article 10(1) was applicable to the beneficiary's bank. If the beneficiary's bank did not accept the payment order in accordance with

the other rules of article 8 by crediting the beneficiary's account, it ought to be possible to determine when the beneficiary's bank should have acted. It was also necessary to know when the transaction had been completed for the purposes of article 16.

30. Mr. CHATURVEDI (India) said that his delegation supported the position of the United Kingdom with regard to article 10(1), on the understanding that the text as revised by the Drafting Group would be circulated to the members of the Commission.

31. Mr. LE GUEN (France) pointed out that article 10(1) as currently drafted stipulated that a receiving bank was required to execute a payment order. The definition of a receiving bank given in article 2(g) did not exclude the beneficiary's bank, a fact which was clear from the wording of other provisions such as article 11(5), which referred to "a receiving bank other than the beneficiary's bank". Since article 10(1) did not specifically exclude the beneficiary's bank, it was clear that the provision must apply to that bank. He therefore fully agreed with the remarks made by the representative of the United Kingdom.

32. To adopt the text proposed by the Secretariat and delete the words in square brackets would radically change the paragraph in question. Consequently, the square brackets should be deleted and the words inside retained.

33. Mr. FELSENFELD (United States of America) said that the application of article 10 to the beneficiary's bank created an unwarranted inconsistency in the Model Law. Articles 8 and 9 already specified clearly what the beneficiary's bank was required to do, and it was neither necessary nor appropriate to apply article 10, which referred to "execution", a term totally inapposite with regard to the beneficiary's bank.

34. Mr. CRAWFORD (Canada) said that he would agree with the remarks made by the representative of the United States of America if he could be fully satisfied that there was a duty on the beneficiary's bank to accept or reject the payment order within a specified period of time. One of the main objectives of the Commission's work was to improve the response of the international banking system, and it was essential that there should be a clear duty on banks to react upon receipt of a payment order. However, the Secretariat's proposal to delete the concept of deemed acceptance would create a disturbing situation where, although the funds were in the beneficiary's bank, the bank had no duty to act. If article 10 was not applied to the beneficiary's bank, the efforts to ensure a timely response by all banks participating in the transfer would be in jeopardy.

35. Mr. JONES (United Kingdom) agreed that it was essential that the beneficiary's bank should have a duty to act. With regard to the term "execution", the definition contained in article 2 of the Model Law referred specifically to receiving banks other than the beneficiary's bank. The question of execution in relation to the beneficiary's bank should be dealt with in accordance with local law, particularly as the Commission had already agreed that the relationship between the beneficiary's bank and the beneficiary fell outside the terms of the Model Law.

36. Mr. SONO (Observer, International Monetary Fund) said that the Working Group had left the term "execution" in square brackets throughout the text because it had not been sure whether the term should apply to the beneficiary's bank. It had been agreed that article 2(1) could be deleted if, after discussion of articles 8 and 10, it was found that there was no problem in using the term "execution" in relation to the beneficiary's bank. However, some uncertainty had remained in the Drafting Group, and it had been decided to retain the square brackets. Nevertheless, in using the term "execution" in the discussion of articles 8 and 10,

the Drafting Group had been aware that the term applied also to the beneficiary's bank, in that the latter was also a receiving bank. To attempt to discuss at the present stage whether or not article 10(1) was applicable to the beneficiary's bank was therefore tantamount to reopening an issue which had already been decided.

37. The CHAIRMAN said that the most appropriate solution would be to remove the square brackets, since they did not correspond to any decision taken by the Commission.

38. Mr. BERGSTEN (Consultant to the Secretariat) drew attention to paragraphs (1 *bis*) and (1 *ter*) and said that they should be considered together, as they dealt with the same problem—namely the question of the day as of which a bank must give value to its credit party. Paragraph (1 *ter*) was quite clearly a deemed-acceptance situation and provided a specific rule governing the value date for a credit party other than the beneficiary's bank. It had not been extended to apply to the beneficiary's bank because it had not been thought appropriate to specify a value date to the beneficiary. Paragraph (1 *bis*) did apply to the beneficiary's bank, because it was dependent on paragraph (1).

39. However, if paragraph (1 *ter*) was not to apply to the beneficiary's bank, then neither should paragraph (1 *bis*). He did not understand why one value-date rule should apply to the beneficiary's bank and the other should not.

40. Mrs. FLINT (United Kingdom), supported by Mr. FELSENFELD (United States of America), said that neither paragraph (1 *bis*) nor paragraph (1 *ter*) should apply to the beneficiary's bank.

41. Mr. CHATURVEDI (India) said that paragraphs (1 *bis*) and (1 *ter*) should apply to the beneficiary's bank.

42. The CHAIRMAN said that to apply the paragraphs in question to the beneficiary's bank would clearly run counter to the policy adopted by the Working Group and the Commission throughout the drafting of the Model Law.

43. Mr. SCHNEIDER (Germany) said that for his delegation it was clear that paragraphs (1) and (1 *bis*) did apply to the beneficiary's bank. He was surprised that the Commission should be reopening policy discussions at the current stage.

44. Mr. BERGSTEN (Consultant to the Secretariat) said that, according to the decisions taken, paragraphs (1) and (1 *bis*) applied to the beneficiary's bank but paragraph (1 *ter*) did not. The scope of paragraph (2) was clear, since it referred to articles 7 and 9, and paragraphs (4), (5) and (6) should fall into place without any need for discussion.

45. Mr. GREGORY (United Kingdom) questioned the advisability of allowing the inconsistency between paragraphs (1 *bis*) and (1 *ter*) to remain. He was not convinced that a policy decision had been taken at the previous session.

46. Mr. DE BOER (Observer for the Netherlands) said that paragraphs (1 *bis*) and (1 *ter*) could either both apply to the beneficiary's bank or both exclude it, but to leave the discrepancy between them was very peculiar.

47. Mr. BERGSTEN (Consultant to the Secretariat) said that the problem of time-limits within the context of deemed acceptance was a difficult one, and the Secretariat had not attempted to put forward a solution. Nevertheless, a simple drafting change might resolve the problem, and that was to delete the deemed-acceptance rule and rely on the definition of payment contained in article 5. However, he recognized that a policy change was implied which might not be acceptable to some delegations.

48. Mr. GREGORY (United Kingdom) said that the proposal raised substantive questions of policy which could not be discussed at the current stage. In any case, such a radical solution was not really necessary: the current provisions were unsatisfactory only in terms of their drafting and not in the way in which the substantive rules operated. He felt that the Commission could recognize that a problem existed but agree not to address it.

49. Mr. BHALA (United States of America) said that he agreed with the remarks made by the Consultant to the Secretariat. However, although he understood the reasons for wanting to delete the deemed-acceptance rule, it was rather late for such a radical amendment of the text. In order to achieve the same goal, it might be possible to delete articles 6(2)(e) and 8(1)(h), and either amend article 8(1)(c) or insert a new article 8(1)(h) reading "when the beneficiary's bank has been paid by its sender". While some delegations might then wonder whether article 6(3) and article 8(2) should not also be deleted, those provisions should be retained because they obliged the receiving bank to give notice of rejection.

50. Mr. CHATURVEDI (India) agreed with the Consultant to the Secretariat that the concept of deemed acceptance should be deleted. However, the questions concerned were substantive ones and should not be left to the Drafting Group.

51. Mr. LE GUEN (France) said that, if his understanding was correct, the United States was proposing to replace deemed acceptance with payment, since payment was deemed to have been accepted by a receiving bank when it was received. Under article 5, however, payment did not depend on action by the receiving bank, but took place on the initiative of the sending bank. While acceptance usually required an action by the party receiving payment, the concept of deemed acceptance implied that acceptance resulted from non-action by the receiving bank. That would seriously undermine the concept of acceptance, which was crucial to the Model Law.

52. Mr. BERGSTEN (Consultant to the Secretariat) said that, under the United States proposal, there was only one situation in which a receiving bank would not have an opportunity to reject a payment prior to receiving it and thus accepting it: namely, when it received credit with a central bank. Under article 5(b)(iv), if a bank received a payment order during the day and wished to reject it, it could do so until such time as there was settlement of the net amount, usually at the close of the business day.

53. Mr. SCHNEIDER (Germany) said that, as his delegation attached importance to the principle that a bank should have the opportunity to reject a payment order, it opposed the United States proposal and supported the statement made by the representative of France.

54. The CHAIRMAN said that it was improper to reopen debate on an issue on which the Commission had already taken a decision; accordingly, he suggested that the text should remain as it stood.

55. Mr. LE GUEN (France), referring to the question of the automatic conversions of currencies by receiving banks in implementing credit transfers, said his delegation had supported a proposal at the twenty-fourth session to add to article 7(2) a provision requiring the receiving bank to execute the transfer in the currency stipulated by the sender. That proposal had been rejected on the grounds that protection against the practice of automatically converting currencies was already implicit in the wording of that paragraph. The issue, however, was of great importance in Europe, where there were plans to adopt a single European currency. In the future, banks might be required to convert payment orders into, for example, both French francs and European Currency Units (ECUs). In such cases, banks should be given the option of rejecting a payment order.

56. Mr. HARRIS-BURLAND (Observer, Commission of the European Communities) said that the current discussion was similar to the one which had arisen in the context of article 17(2), where there was a possibility that a beneficiary might receive an amount less than the amount indicated in the payment order. UNCITRAL had dealt with that issue by deciding that the payment order would none the less be deemed to be complete. Banks did, in fact, make currency conversions, and it was important to avoid laying down a rigid rule on the subject. Originators sometimes specified in their payment orders that the conversion was to be made by their bank or by an intermediary bank farther down the chain; on the other hand, banks were sometimes required to make that decision. In any case, the Commission of the European Communities preferred for the matter to be dealt with as part of a rule governing the manner in which the payment order issued was made consistent with the payment order received.

57. Mr. CHATURVEDI (India) said his delegation felt that the payment order should be accepted and executed in the currency specified by the originator.

58. Mr. LE GUEN (France) proposed that the following phrase should be inserted in article 7(2) after the words "in an appropriate manner": "and in the currency stipulated in the payment order received by the receiving bank".

59. Mr. OPAQOS (Observer for Romania) proposed that the following clause should be inserted after the second sentence of article 18(1): "However, the law of the State of the receiving bank shall be of secondary or lesser application, and shall apply only in order to supplement the Model Law where and to the extent that the law of the State of the receiving bank shall be the most favourable to the beneficiary of the transfer".

60. The CHAIRMAN recalled that the Commission had decided to include article 18 in a footnote.

61. Mr. BURMAN (United States of America) said that, as the Commission had decided at its previous session that the rules governing the revocation of a payment order would apply also to the amendment of a payment order (article 11 (8 bis)), the Commission should add similar wording to articles 2(j) and 4(1) and (2) for the sake of consistency.

62. Mr. CRAWFORD (Canada) said that the proposal should be referred to the Drafting Group.

63. Mr. GREGORY (United Kingdom) said that in principle, he agreed with the Canadian representative.

64. Mr. CHATURVEDI (India) sought assurance that the proposal did not involve any substantive changes in the text.

65. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to refer the United States proposal to the Drafting Group.

66. *It was so decided.*

67. Mr. FUJISHITA (Japan) said that he wished to place on record his delegation's concern at the provision in article 4(2) which excluded an authentication procedure commonly applied in his country, namely, the comparison of a signature and a seal. His delegation believed that the national law of each State should apply with regard to authentication procedures.

*The meeting rose at 6 p.m.*

## Summary record of the 481st meeting

Wednesday, 13 May 1992, at 10 a.m.

[A/CN.9/SR.481]\*

Chairman: Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 10.30 a.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367; A/CN.9/XXV/CRP.2/Add.2)

1. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, referred the Commission to the report of the Drafting Group on the Model Law (A/CN.9/XXV/CRP.2/Add.2). The Drafting Group had decided that former article 18 should be inserted in the text as a footnote marked with an asterisk appearing after the title of chapter I. The text should be headed "Article X. *Conflict of laws*", and the phrase "for the purposes of article 4(1)" in paragraph (2) should be deleted. It had also been decided to include article 17 as a footnote.

2. Mr. FUJISHITA (Japan) said that he did not oppose the text of article X, but felt that the wording of the footnote conveyed an implication that the Commission had been in favour of the adoption of

the provision, whereas in fact a majority had opposed it. He therefore proposed that the wording at the beginning of the footnote should be changed to read: "The Commission suggests the following additional text for States that might wish to adopt it."

3. Mr. DUCHEK (Austria) agreed that the wording might leave room for misinterpretation. He therefore supported the Japanese proposal, but felt that the Commission might go a little further by replacing the words "decided to provide" with the word "offers".

4. Mr. SCHNEIDER (Germany) and Mrs. FERNÁNDEZ DE GURMENDI (Argentina) supported the Japanese proposal.

5. *The proposal was adopted.*

6. The CHAIRMAN invited the Commission to consider the text article by article.

*Article 1*

7. *Article 1 was adopted.*

\*Summary records for the 477th, 478th and 479th meetings are not reproduced. No summary record was issued for the 480th meeting.

*Article 2, paragraph (a)*

8. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, noted that the Drafting Group had restored the wording of the beginning of paragraph (a) ("Credit transfer means ..."), which had previously appeared in the text.

9. *Paragraph (a) was adopted.*

*Article 2, paragraph (b)*

10. *Paragraph (b) was adopted with minor drafting changes.*

*Article 2, paragraphs (c), (d) and (e)*

11. *Paragraphs (c), (d) and (e) were adopted.*

*Article 2, paragraphs (f) to (n)*

12. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, pointed out that the Commission had deleted the text of paragraph (f) at its previous session; the Drafting Group had therefore added "[missing]" to indicate that fact. In paragraph (j), the words "an amendment or" had been added, and immediately after paragraph (j), a paragraph defining "banking day" had been added. In paragraph (k), the Drafting Group had deleted a phrase which had appeared in the earlier text.

13. Mr. LE GUEN (France) pointed out that in the French version of subparagraph (n), "*valeur dans le temps*" had been incorrectly changed to "*valeur de rendement*".

14. *Paragraphs (f) to (n) were adopted.*

*Article 2 bis*

15. *Article 2 bis was adopted.*

*Article 3*

16. *Article 3 was adopted.*

*Article 4*

17. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, pointed out that "amendment or" had been added in paragraphs (1), (2) and (5), and that paragraph (3) had been redrafted in line with the suggestions of the secretariat as contained in paragraph 47 of document A/CN.9/367. He explained that the purpose of the procedure referred to in paragraph (5) was to detect discrepancies, such as might arise, for example, from a mistake made by the sender or from some problem in transmission. The Drafting Group had felt that the word "error" alone might have narrowed the concept, and therefore "or discrepancy" had been added in several places.

18. *Article 4 was adopted.*

*Article 5*

19. *Article 5 was adopted.*

*Article 6*

20. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the only change in article 6 was the addition of the word "or" for stylistic reasons at the end of paragraph (2)(d).

21. *Article 6 was adopted.*

*Article 7*

22. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the Drafting Group had seen no way to shorten paragraph (3), but had made some changes in the interests of clarity. The beginning had been changed to read: "A receiving bank that determines ...", and various small alterations had been made to reflect that changed syntax. The phrase "before the end of the execution period" had been placed after "paragraph (2) if", and "in the light of the circumstances" had been deleted as redundant. In paragraph (5), "of this article" had been added to the end of the last sentence, in the interests of greater clarity.

23. *Article 7 was adopted.*

*Article 8*

24. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the only change made in article 8 was the addition of "or" at the end of paragraph (1)(g).

25. *Article 8 was adopted.*

*Article 9*

26. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the wording "that identifies the beneficiary" in paragraph (4) had been changed to "intended to identify the beneficiary", because the point of the paragraph was that the information did not, in fact, identify the beneficiary. In paragraph (5), "his" had been changed to "its".

27. Mr. SANDOVAL (Chile) said that in paragraph (3) "*la cantidad de dinero*" should be replaced by "*la suma de dinero*".

28. *Article 9 was adopted.*

*Article 10*

29. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the changes made in paragraph (1) were based on the suggestions of the secretariat contained in document A/CN.9/367, but were not identical to them. The phrase "that is obligated to execute a payment order" had been added, as article 10 covered only the time period within which an obligation had to be discharged, not the imposition of the obligation itself. The second sentence had been modified and split into two sentences. In subparagraphs (a) and (b), "order" had been changed to "payment order" several times; in subparagraph (b), "in which case" had been deleted and "the order shall be executed on that date" had been added.

30. Mr. SANDOVAL (Chile) pointed out a minor typographical error in the Spanish version of paragraph (1).

31. Mr. DE BOER (Observer for the Netherlands) asked whether article 10, as it stood, covered the situation in which the obligation of the bank arose later than the date of receipt.

32. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, explained that a receiving bank became obligated to execute a payment order because of its acceptance thereof, and from the moment of acceptance. But the point in time at which it was obligated to execute was determined by article 10. The time period ran not from acceptance, but from receipt. A situation in which acceptance occurred after receipt was covered by the first two sentences of article 10(1). If acceptance occurred later, there was indeed a problem, which had been discussed at length in document A/CN.9/367.

33. Mr. DE BOER (Observer for the Netherlands) suggested that a wording might be found to cover the problem.

34. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, recalled that the problem raised by the observer for the Netherlands was one of the issues which the Commission had decided not to attempt to resolve. It was, in any event, likely to be a relatively rare situation.

35. Mr. LE GUEN (France) recalled that the delegation of France was firmly opposed to the substance of paragraph (1 *bis*), considering that the issue of execution for value was a purely contractual matter with which UNCITRAL should not have concerned itself. He wished to ensure that the views of his delegation were placed on record.

36. The CHAIRMAN said that those views would be placed on record.

37. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that paragraph (1 *ter*) had been modified in the light of the suggestions made by the secretariat in paragraph 36 of document A/CN.9/367.

38. Mr. LIM (Singapore) asked whether "banking day" should not be used in paragraphs (4) and (5) in place of "day the bank executes that type of payment" and "day it performs that type of action".

39. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that that was a suggestion which had been made, but the Drafting Group had not made the change.

40. Mr. DE BOER (Observer for the Netherlands) asked, relative to paragraph (4), whether the Drafting Group had considered the relationship between the banking day and the cut-off time, and whether there could also be a cut-off time within a banking day.

41. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, referred to the definition of "banking day" in article 2. The question raised by the observer for the Netherlands had been discussed in the Drafting Group, which had recognized that in some banking systems, each new banking day began at a given time in the morning, while in others it began as soon as the preceding one ended at a given time in the evening. The problem was covered, at least partially, by the use of the phrase "that part of the day" in the definition.

42. *Article 10 was adopted.*

*The meeting was suspended at 11.30 a.m. and resumed at noon.*

*Article 11, paragraph (1)*

43. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that paragraph (1) incorporated the drafting changes which the Commission had agreed upon the previous week.

44. *Paragraph (1) was adopted.*

*Article 11, paragraph (2)*

45. *Paragraph (2) was adopted.*

*Article 11, paragraph (3)*

46. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the text had been

amended in accordance with the wishes of the Commission. The words "paragraphs (1) and (2)" should read instead "paragraph (1) or (2)".

47. *Paragraph (3), as amended, was adopted.*

*Article 11, paragraph (4)*

48. *Paragraph (4) was adopted.*

*Article 11, paragraph (5)*

49. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the references to "beneficiary's bank" should be amended to read "beneficiary bank".

50. *Paragraph (5), as amended, was adopted.*

*Article 11, paragraph (6)*

51. *Paragraph (6) was adopted.*

*Article 11, paragraphs (6 bis) and (6 ter)*

52. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that a sentence had been added in square brackets at the end of paragraph (6 *ter*) to state explicitly the implicit provision that the paragraph did not apply to a bank if it would affect the bank's rights or obligations under any agreement or any rule of a funds transfer system.

53. Mr. BURMAN (United States of America) said that the bracketed text did not represent a substantive change, and merely served to clarify the position of the Drafting Group so as to prevent any possible misunderstanding at a later time.

54. The CHAIRMAN suggested that the square brackets should be deleted.

55. *It was so decided.*

56. Mr. BONELL (Italy) suggested that the sentence which concluded both paragraphs (6 *bis*) and (6 *ter*) should be moved to a separate paragraph in the article.

57. *It was so decided.*

58. *Paragraphs (6 bis) and (6 ter), as amended, were adopted.*

*Article 11, paragraphs (7) to (9)*

59. *Paragraphs (7) to (9) were adopted.*

*Article 12*

60. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the word "procedure" in the first sentence should be in the plural. The addition of the second sentence reflected the decision of the Drafting Group to state explicitly that a receiving bank's failure to fulfil its obligations under article 12 would not give rise to any liability.

61. Mr. DE BOER (Observer for the Netherlands) said that he could not recall a decision being taken by the Drafting Group to state that explicitly.

62. The CHAIRMAN said that during its consideration of the article the previous week, the Drafting Group had indeed taken a decision that the article would not give rise to any liability.

63. Mr. SCHNEIDER (Germany) said that he shared the reservations of the observer for the Netherlands with respect to article 12. The second sentence constituted a substantive provision on

which there had been no conclusive discussion. It should therefore be omitted from the article.

64. Mr. J.E. GUEN (France) said that a distinction should be drawn between a decision not to provide sanctions and an explicit provision that no liability would arise if a receiving bank failed to comply with its obligations. He therefore shared the concerns of the representative of Germany and the observer for the Netherlands.

65. Mr. GREGORY (United Kingdom) said that the Commission had not reached any conclusion on the second sentence of article 12.

66. Mr. BONELL (Italy) said that the sentence made no sense whatsoever; he strongly urged the Commission to delete it.

67. Mr. EL-SHARKAWY (Egypt) proposed that, in the first sentence of article 12, the words "under a duty" should be replaced by "requested", and the second sentence should be deleted.

68. Mr. EWORE (Observer for Gabon), Mr. SAFARIAN NEMAT-ABAD (Islamic Republic of Iran) and Mr. BURMAN (United States of America) supported the proposal made by the representative of Egypt.

69. Ms. BUURE-HAGGLUND (Observer for Finland) said that the Egyptian proposal to amend the first sentence of article 12 would weaken the content of that article. In her opinion, the only correct way to proceed would be to delete the second sentence.

70. Mr. GREGORY (United Kingdom) said that his delegation agreed with the observer for Finland. Moreover, it was odd for a law to contain a request. He proposed that the Commission either should decide to delete the second sentence of article 12 or should reword the article to indicate that there was no liability.

71. Mr. CHATURVEDI (India) proposed that the Commission should delete the second sentence, leaving the first sentence intact.

72. Mr. GRIFFITH (Observer for Australia) suggested that the first sentence of article 12 should be amended to read: "Without

giving rise to any liability, until the credit transfer is completed, each receiving bank should assist the originator ...". The second sentence should be deleted.

73. Mr. DUCHEK (Austria) said that the second sentence of article 12 was indeed very odd. A law that only requested something to be done was also quite unusual. The inclusion of such a provision in the Model Law would enable States that had always been sceptical about the Model Law to belittle its importance. The best solution would be to abide by the decision taken by the Commission at its previous session. Another solution would be to delete the second sentence.

74. Mr. DE BOER (Observer for the Netherlands), Mr. GREGORY (United Kingdom) and Mr. HOLEC (Czechoslovakia) supported the Australian suggestion.

75. Mr. LOJENDIO (Spain) said that the Spanish text of the first sentence of article 12 presented fewer problems than did the English text. He was in favour of retaining the first sentence as it stood, at least in the Spanish version, and deleting the second sentence.

76. Mr. FUJISHITA (Japan) said that his delegation could support either the Egyptian or the Australian formula.

*Article 13, paragraphs (1) to (3)*

*77. Paragraphs (1) to (3) were adopted.*

*Article 13, paragraphs (4) and (5)*

78. Mr. BONELL (Italy) suggested that the sentence which concluded both paragraphs (4) and (5) should be moved to a separate paragraph in the article.

*79. It was so decided.*

*80. Paragraphs (4) and (5), as amended, were adopted.*

*The meeting rose at 1 p.m.*

## Summary record (partial)\* of the 482nd meeting

Wednesday, 13 May 1992, at 3 p.m.

[A/CN.9/SR.482]

*Chairman:* Mr. ABASCAL ZAMORA (Mexico)

*The meeting was called to order at 3.20 p.m.*

INTERNATIONAL PAYMENTS: DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS (*continued*) (A/46/17; A/CN.9/346, A/CN.9/347 and Add.1 and A/CN.9/367; A/CN.9/XXV/CRP.2/Add.2)

### *Article 12*

1. The CHAIRMAN recalled that at the previous meeting, the representative of Egypt had proposed, as a compromise solution,

that the words "under a duty" should be changed to "requested" and that the last sentence should be deleted. He appealed to members of the Commission to adopt that proposal in a spirit of compromise.

*2. Article 12, as amended, was adopted.*

### *Article 14*

3. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that the Drafting Group had added the words "other than as a result of the deduction of its

\*No summary record was prepared for the rest of the meeting.

charges" to article 14, since the original text seemed to imply that a bank which deducted charges would still be obligated to issue a payment order for correction of underpayment.

4. *Article 14 was adopted.*

*Article 15*

5. *Article 15 was adopted.*

*Article 16*

6. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that paragraphs (1) and (2) had been redrafted on the basis of the proposal made by the representatives of the United Kingdom and Finland, which the Commission had accepted. In addition, the Drafting Group had deleted the phrase "other than the beneficiary's bank" following the words "a receiving bank" in paragraph (1) because of the possibility the text might be misread; the meaning was clear from the context. The words "fails to comply" had been changed to "does not comply" because the word "fails" could imply that a subjective criterion was involved. The reference to article 17(1) had been deleted, the word "failure" had been changed to "non-compliance" and the original third sentence had been deleted.

7. In paragraph (2), the words "of the transfer" had been deleted, since they were thought to be redundant. There had been some doubt in the Drafting Group as to whether the Commission had approved paragraph (2 *ter*); consequently that paragraph had been included, without changes, in square brackets.

8. In paragraph (3), the reference to article 7(3), and the phrase "other than the beneficiary's bank" had been deleted. Finally, a new sentence had been added at the end of paragraph (7).

9. Ms. BURRE-HAGGUND (Observer for Finland) said that, under the basic liability scheme set out in paragraphs (1) and (2), interest deriving from a delay in the completion of a credit transfer should go to the beneficiary. Paragraph (2 *ter*) provided a subsidiary rule for situations in which the beneficiary did not automatically receive the interest to which he was entitled. In such a situation, the beneficiary could try to determine which bank in the chain had caused the delay or failed to pass on interest, or could claim interest from the originator on the basis of the rules governing the underlying contract. If the beneficiary decided to follow the latter course, the originator needed to recover the interest to which the beneficiary would have been entitled. The purpose of the paragraph then, was to ensure that the interest loss was not borne by the originator, when the delay was caused by one of the banks in the transfer chain.

10. Mr. BHALA (United States of America) said that he opposed the inclusion of paragraph (2 *ter*) in article 16 because it put the burden of recovering lost interest on the originator, who would have to look upstream in the credit-transfer chain to determine which bank had caused the delay. That was an unwarranted interference in the originator-beneficiary relationship, which many delegations seemed to feel was a matter best left to local law. There would only be a small number of cases in which the originator decided to pay interest to the beneficiary instead of referring to article 16(1).

11. The paragraph also posed a problem of moral hazard by encouraging banks to delay a credit transfer in the hope that the originator would pay interest to the beneficiary. While paragraph (1) put pressure on banks to keep the credit transfer moving quickly, paragraph (2 *ter*) weakened that pressure. Paragraph (2 *ter*) might have other undesirable effects: on the basis of the underlying contract, the originator might claim, not just interest, but also fees or penalties from banks in the chain.

12. Mr. GREGORY (United Kingdom) said that most members of the Drafting Group had believed that the Commission had already approved paragraph (2 *ter*). It was indicated in paragraph 6 of the Commission's draft report to the General Assembly (A/CN.9/XXV/CRP.1/Add.1) that after discussion, the Commission adopted the substance of the proposed paragraphs (1) and (2 *ter*) and had referred them to the Drafting Group.

13. Paragraph (2 *ter*) was needed because the beneficiary would always find it easier to recover interest from the originator, if the contract gave that right, than to invoke article 16(1). The objective of the paragraph was to relieve the originator of liability and make it clear that liability lay with the bank that had caused the delay. The paragraph did not interfere with the originator-beneficiary relationship since it did not indicate whether the beneficiary had the right to claim interest from the originator, but dealt only with the situation in which the beneficiary exercised that right, and related strictly to the bank that had caused the delay.

14. The problem of moral hazard was more likely to arise if paragraph (2 *ter*) was omitted. If the beneficiary exercised his rights under the underlying contract, the originator might have rights of subrogation under ordinary law, and the situation would be much less clear. Instead of paying interest to the beneficiary and the originator, a bank might withhold the interest and allow the beneficiary to sue the originator, because rights of subrogation were difficult to enforce. A clear rule was needed requiring a bank to give up interest to the beneficiary, or to the originator if the beneficiary first applied to the originator. As to the question of excessive claims, paragraph (2 *ter*) clearly referred only to the interest the beneficiary would have been entitled to.

15. Mr. DE BOER (Observer for the Netherlands) said that he also supported the inclusion of paragraph (2 *ter*). If it was not included, problems might arise in respect of subrogation, which was not always an automatic right. There could also be difficulties in countries having systems of statutory interest, which was generally higher than bank interest.

16. Mr. GRIFFITH (Observer for Australia) said that the provision was useful, particularly as there was no clear right of subrogation in civil-law countries.

17. Mr. CHATURVEDI (India) and Mr. SCHNEIDER (Germany) said that they also supported the inclusion of paragraph (2 *ter*).

18. The CHAIRMAN urged the United States delegation to accept paragraph (2 *ter*), on the understanding that its view would be fully reflected in the Commission's report to the General Assembly.

19. *Article 16 was adopted.*

*Article 16 bis*

20. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that article 16 *bis* comprised former paragraph (8) of article 16. Its topic, the exclusivity of remedies, had been judged important enough to warrant a separate article. The first sentence of the former paragraph (8) had been eliminated, as the Drafting Group, after considerable discussion, had concluded it no longer served any purpose, the relevant rights and obligation being set out in the Model Law.

21. The words "in respect of non-compliance with articles 7 or 9" had been inserted after the words "shall be available" in the new article simply in order to make the scope of the remedies provided explicit. Otherwise, only minor drafting changes had been made.

22. Mr. BURMAN (United States of America) proposed a further drafting change that had already been discussed by the members of the Drafting Group: instead of "articles 7 or 9", the article might read "the obligations dealt with in article 16".

23. Mr. SCHNEIDER (Germany) said that the wording suggested did not have quite the same meaning as the wording it would replace—article 16 dealt with other articles than just 7 and 9.

24. Mr. DUCHEK (Austria) said that he found the proposed drafting technically deficient, since it did not specify the nature of the obligations referred to, which were essentially to pay interest under certain circumstances.

25. Mr. CHATURVEDI (India) noted that India had opposed the concept of exclusivity of remedies as contrary to the common-law system of judicial review of remedies. His delegation therefore did not favour the creation of a separate article 16 *bis*. Those considerations apart, the change proposed by the representative of the United States was acceptable.

26. Mr. LIM (Singapore) said that he opposed the United States proposal reluctantly. Like the representative of Austria, he found the drafting deficient in that it did not make clear what obligations were referred to.

27. Moreover, article 16(6) referred to the liability of the beneficiary's bank towards the beneficiary, which was also an obligation dealt with in article 16. Therefore, the proposed wording represented a substantive change.

28. The CHAIRMAN suggested that the representative of the United States should withdraw his proposal.

29. Mr. BURMAN (United States of America) withdrew his proposal, which his delegation had put forward to facilitate statutory drafting in systems such as its own. The intent had not been to alter the substance of the article.

30. *Article 16 bis was adopted.*

#### *Article 17*

31. Mr. BERGSTEN (Consultant to the Secretariat), speaking as Chairman of the Drafting Group, said that former paragraph (2) of article 17 had been deleted and placed in a footnote to article 17, in accordance with the Commission's wishes. Accordingly, the title of the article had been changed to "Completion of credit transfer", eliminating the reference to discharge of obligation. In paragraph (3) the words "shall be considered complete" had been replaced by "is completed".

32. Mr. ALVAREZ (Uruguay) noted that the introductory formula for the footnote to chapter 1 was the same as that for the footnote to article 17 except that it included the word "additional" between the words "following" and "text". He proposed its removal so that the two introductions would be identical.

33. The CHAIRMAN said he would take it that the Commission agreed to the proposal of the representative of Uruguay.

34. Mr. SCHNEIDER (Germany) said that the report should duly reflect the strong opposition among members of the Commission to the provisions that had been placed in footnotes.

35. *Article 17 was adopted.*

36. The CHAIRMAN invited the Commission to adopt the draft Model Law on International Credit Transfers as a whole.

37. *The Model Law, as a whole, was adopted.*

38. Mr. CHATURVEDI (India) said he wished to put on record that the documents prepared by the secretariat, although issued too late to stimulate broad discussion, had raised some very good points and should receive further consideration.

*The discussion covered in the summary record ended at 4.40 p.m.*

# **IV. CONVENTION ON THE LIMITATION PERIOD IN THE INTERNATIONAL SALE OF GOODS AS AMENDED BY THE PROTOCOL AMENDING THE CONVENTION ON THE LIMITATION PERIOD IN THE INTERNATIONAL SALE OF GOODS**

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## I. Convention on the Limitation Period in the International Sale of Goods as amended by the Protocol amending the Convention on the Limitation Period in the International Sale of Goods

### *Introductory note*

1. The Convention on the Limitation Period in the International Sale of Goods (hereinafter called the 1974 Limitation Convention) was concluded in New York on 14 June 1974. A Protocol to the 1974 Limitation Convention (hereinafter called the 1980 Protocol) was concluded at Vienna on 11 April 1980.

2. The 1974 Limitation Convention and the 1980 Protocol both entered into force on 1 August 1988, in accordance with articles 44 (1) of the 1974 Limitation Convention and IX (1) of the 1980 Protocol.

3. In accordance with paragraph 2 of article XIV of the 1980 Protocol, the text of the 1974 Limitation Convention as amended by the 1980 Protocol has been prepared by the Secretary-General and will be found hereinafter.

4. The present text includes the relevant amendments to the articles of the 1974 Limitation Convention, as provided for by the 1980 Protocol. For ease of reference, the text of the original provisions of the 1974 Limitation Convention which have been amended by the 1980 Protocol are reproduced in footnotes. The present text also incorporates substantive provisions (final clauses) of the 1980 Protocol as required, including editorial

additions. The relevant articles of the 1980 Protocol which have been incorporated in the present text of the 1974 Limitation Convention as amended have, for clarity, been assigned "bis" numbers with the indication in parentheses of the corresponding number of the 1980 Protocol.

**CONVENTION ON THE LIMITATION PERIOD IN THE  
INTERNATIONAL SALE OF GOODS  
AS AMENDED BY THE PROTOCOL  
AMENDING THE CONVENTION ON THE LIMITATION  
PERIOD IN THE INTERNATIONAL SALE OF GOODS**

*Preamble*

*The States Parties to the present Convention,*

*Considering that international trade is an important factor in the promotion of friendly relations amongst States,*

*Believing that the adoption of uniform rules governing the limitation period in the international sale of goods would facilitate the development of world trade,*

*Have agreed as follows:*

**Part I. Substantive provisions**

*Sphere of application*

*Article 1*

(1) This Convention shall determine when claims of a buyer and a seller against each other arising from a contract of international sale of goods or relating to its breach, termination or invalidity can no longer be exercised by reason of the expiration of a period of time. Such a period of time is hereinafter referred to as "the limitation period".

(2) This Convention shall not affect a particular time-limit within which one party is required, as a condition for the acquisition or exercise of his claim, to give notice to the other party or perform any act other than the institution of legal proceedings.

(3) In this Convention:

(a) "buyer", "seller" and "party" mean persons who buy or sell, or agree to buy or sell, goods, and the successors to and assigns of their rights or obligations under the contract of sale;

(b) "creditor" means a party who asserts a claim, whether or not such a claim is for a sum of money;

(c) "debtor" means a party against whom a creditor asserts a claim;

(d) "breach of contract" means the failure of a party to perform the contract or any performance not in conformity with the contract;

(e) "legal proceedings" includes judicial, arbitral and administrative proceedings;

(f) "person" includes corporation, company, partnership, association or entity, whether private or public, which can sue or be sued;

(g) "writing" includes telegram and telex;

(h) "year" means a year according to the Gregorian calendar.

*Article 2*

For the purposes of this Convention:

(a) a contract of sale of goods shall be considered international if, at the time of the conclusion of the contract, the buyer and the seller have their places of business in different States;

(b) the fact that the parties have their places of business in different States shall 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;

(c) where a party to a contract of sale of goods has places of business in more than one State, the place of business shall be that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at the time of the conclusion of the contract;

(d) where a party does not have a place of business, reference shall be made to his habitual residence;

(e) neither the nationality of the parties nor the civil or commercial character of the parties or of the contract shall be taken into consideration.

*Article 3\**

(1) This Convention shall apply only

(a) if, at the time of the conclusion of the contract, the places of business of the parties to a contract of international sale of goods are in Contracting States; or

(b) if the rules of private international law make the law of a Contracting State applicable to the contract of sale.

(2) This Convention shall not apply when the parties have expressly excluded its application.

*Article 4\*\**

This Convention shall not apply to sales:

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

(b) by auction;

(c) on execution or otherwise by authority of law;

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

(e) of ships, vessels, hovercraft or aircraft;

(f) of electricity.

*Article 5*

This Convention shall not apply to claims based upon:

(a) death of, or personal injury to, any person;

\*Text as amended in accordance with article I of the 1980 Protocol. States that make a declaration under article 36 bis (article XII of the 1980 Protocol) will be bound by article 3 as originally adopted in the Limitation Convention, 1974. Article 3 as originally adopted reads as follows:

*"Article 3*

(1) This Convention shall apply only if, at the time of the conclusion of the contract, the places of business of the parties to a contract of international sale of goods are in Contracting States.

(2) Unless this Convention provides otherwise, it shall apply irrespective of the law which would otherwise be applicable by virtue of the rules of private international law.

(3) This Convention shall not apply when the parties have expressly excluded its application."

\*\*Text of paragraphs (a) and (e) as amended in accordance with article II of the 1980 Protocol. Paragraphs (a) and (e) of article 4 as originally adopted in the Limitation Convention, 1974, prior to its amendment under the 1980 Protocol, read as follows:

"(a) of goods bought for personal, family or household use;

(e) of ships, vessels, or aircraft;"

- (b) nuclear damage caused by the goods sold;
- (c) a lien, mortgage or other security interest in property;
- (d) a judgement or award made in legal proceedings;
- (e) a document on which direct enforcement or execution can be obtained in accordance with the law of the place where such enforcement or execution is sought;
- (f) a bill of exchange, cheque or promissory note.

#### Article 6

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

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

#### Article 7

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

#### *The duration and commencement of the limitation period*

#### Article 8

The limitation period shall be four years.

#### Article 9

(1) Subject to the provisions of articles 10, 11 and 12 the limitation period shall commence on the date of which the claim accrues.

(2) The commencement of the limitation period shall not be postponed by:

- (a) a requirement that the party be given a notice as described in paragraph (2) of article 1, or
- (b) a provision in an arbitration agreement that no right shall arise until an arbitration award has been made.

#### Article 10

(1) A claim arising from a breach of contract shall accrue on the date on which such breach occurs.

(2) A claim arising from a defect or other lack of conformity shall accrue on the date on which the goods are actually handed over to, or their tender is refused by, the buyer.

(3) A claim based on fraud committed before or at the time of the conclusion of the contract or during its performance shall accrue on the date on which the fraud was or reasonably could have been discovered.

#### Article 11

If the seller has given an express undertaking relating to the goods which is stated to have effect for a certain period of time, whether expressed in terms of a specific period of time or otherwise, the limitation period in respect of any claim arising from the undertaking shall commence on the date on which the buyer notifies the seller of the fact on which the claim is based, but not

later than on the date of the expiration of the period of the undertaking.

#### Article 12

(1) If, in circumstances provided for by the law applicable to the contract, one party is entitled to declare the contract terminated before the time for performance is due, and exercises this right, the limitation period in respect of a claim based on any such circumstances shall commence on the date on which the declaration is made to the other party. If the contract is not declared to be terminated before performance becomes due, the limitation period shall commence on the date on which performance is due.

(2) The limitation period in respect of a claim arising out of a breach by one party of a contract for the delivery of or payment for goods by instalments shall, in relation to each separate instalment, commence on the date on which the particular breach occurs. If, under the law applicable to the contract, one party is entitled to declare the contract terminated by reason of such breach, and exercises this right, the limitation period in respect of all relevant instalments shall commence on the date on which the declaration is made to the other party.

#### *Cessation and extension of the limitation period*

#### Article 13

The limitation period shall cease to run when the creditor performs any act which, under the law of the court where the proceedings are instituted, is recognized as commencing judicial proceedings against the debtor or as asserting his claim in such proceedings already instituted against the debtor, for the purpose of obtaining satisfaction or recognition of his claim.

#### Article 14

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

(2) In the absence of any such provision, arbitral proceedings shall be deemed to commence on the date on which a request that the claim in dispute be referred to arbitration is delivered at the habitual residence or place of business of the other party or, if he has no such residence or place of business, then at his last known residence or place of business.

#### Article 15

In any legal proceedings other than those mentioned in articles 13 and 14, including legal proceedings commenced upon the occurrence of:

- (a) the death or incapacity of the debtor,
- (b) the bankruptcy or any state of insolvency affecting the whole of the property of the debtor, or
- (c) the dissolution or liquidation of a corporation, company, partnership, association or entity when it is the debtor, the limitation period shall cease to run when the creditor asserts his claim in such proceedings for the purpose of obtaining satisfaction or recognition of the claim, subject to the law governing the proceedings.

#### Article 16

For the purposes of articles 13, 14 and 15, any act performed by way of counterclaim shall be deemed to have been performed on the same date as the act performed in relation to the claim

against which the counterclaim is raised, provided that both the claim and the counterclaim relate to the same contract or to several contracts concluded in the course of the same transaction.

#### Article 17

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

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

#### Article 18

(1) Where legal proceedings have been commenced against one debtor, the limitation period prescribed in this Convention shall cease to run against any other party jointly and severally liable with the debtor, provided that the creditor informs such party in writing within that period that the proceedings have been commenced.

(2) Where legal proceedings have been commenced by a subpurchaser against the buyer, the limitation period prescribed in this Convention shall cease to run in relation to the buyer's claim over against the seller, if the buyer informs the seller in writing within that period that the proceedings have been commenced.

(3) Where the legal proceedings referred to in paragraphs (1) and (2) of this article have ended, the limitation period in respect of the claim of the creditor or the buyer against the party jointly and severally liable or against the seller shall be deemed not to have ceased running by virtue of paragraphs (1) and (2) of this article, but the creditor or the buyer shall be entitled to an additional year from the date on which the legal proceedings ended, if at that time the limitation period had expired or had less than one year to run.

#### Article 19

Where the creditor performs, in the State in which the debtor has his place of business and before the expiration of the limitation period, any act, other than the acts described in articles 13, 14, 15 and 16, which under the law of that State has the effect of recommencing a limitation period, a new limitation period of four years shall commence on the date prescribed by that law.

#### Article 20

(1) Where the debtor, before the expiration of the limitation period, acknowledges in writing his obligation to the creditor, a new limitation period of four years shall commence to run from the date of such acknowledgement.

(2) Payment of interest or partial performance of an obligation by the debtor shall have the same effect as an acknowledgement under paragraph (1) of this article if it can reasonably be inferred from such payment or performance that the debtor acknowledges that obligation.

#### Article 21

Where, as a result of a circumstance which is beyond the control of the creditor and which he could neither avoid nor over-

come, the creditor has been prevented from causing the limitation period to cease to run, the limitation period shall be extended so as not to expire before the expiration of one year from the date on which the relevant circumstance ceased to exist.

#### Modification of the limitation period by the parties

##### Article 22

(1) The limitation period cannot be modified or affected by any declaration or agreement between the parties, except in the cases provided for in paragraph (2) of this article.

(2) The debtor may at any time during the running of the limitation period extend the period by a declaration in writing to the creditor. This declaration may be renewed.

(3) The provisions of this article shall not affect the validity of a clause in the contract of sale which stipulates that arbitral proceedings shall be commenced within a shorter period of limitation than that prescribed by this Convention, provided that such clause is valid under the law applicable to the contract of sale.

#### General limit of the limitation period

##### Article 23

Notwithstanding the provisions of this Convention, a limitation period shall in any event expire not later than ten years from the date on which it commenced to run under articles 9, 10, 11 and 12 of this Convention.

#### Consequences of the expiration of the limitation period

##### Article 24

Expiration of the limitation period shall be taken into consideration in any legal proceedings only if invoked by a party to such proceedings.

##### Article 25

(1) Subject to the provisions of paragraph (2) of this article and of article 24, no claim shall be recognized or enforced in any legal proceedings commenced after the expiration of the limitation period.

(2) Notwithstanding the expiration of the limitation period, one party may rely on his claim as a defence or for the purpose of set-off against a claim asserted by the other party, provided that in the latter case this may only be done:

(a) if both claims relate to the same contract or to several contracts concluded in the course of the same transaction; or

(b) if the claims could have been set-off at any time before the expiration of the limitation period.

##### Article 26

Where the debtor performs his obligation after the expiration of the limitation period, he shall not on that ground be entitled in any way to claim restitution even if he did not know at the time when he performed his obligation that the limitation period had expired.

## Article 27

The expiration of the limitation period with respect to a principal debt shall have the same effect with respect to an obligation to pay interest on that debt.

## Calculation of the period

## Article 28

(1) The limitation period shall be calculated in such a way that it shall expire at the end of the day which corresponds to the date on which the period commenced to run. If there is no such corresponding date, the period shall expire at the end of the last day of the last month of the limitation period.

(2) The limitation period shall be calculated by reference to the date of the place where the legal proceedings are instituted.

## Article 29

Where the last day of the limitation period falls on an official holiday or other *dies non juridicus* precluding the appropriate legal action in the jurisdiction where the creditor institutes legal proceedings or asserts a claim as envisaged in article 13, 14 or 15, the limitation period shall be extended so as not to expire until the end of the first day following that official holiday or *dies non juridicus* on which such proceedings could be instituted or on which such a claim could be asserted in that jurisdiction.

## International effect

## Article 30

The acts and circumstances referred to in articles 13 through 19 which have taken place in one Contracting State shall have effect for the purposes of this Convention in another Contracting State, provided that the creditor has taken all reasonable steps to ensure that the debtor is informed of the relevant act or circumstances as soon as possible.

## Part II. Implementation

## Article 31

(1) If a Contracting State has two or more territorial units in which, according to its constitution, different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification or accession, declare that this Convention shall extend to all its territorial units or only to one or more of them, and may amend its declaration by submitting another declaration at any time.

(2) These declarations shall be notified to the Secretary-General of the United Nations and shall state expressly the territorial units to which the Convention applies.

(3) If a Contracting State described in paragraph (1) of this article makes no declaration at the time of signature, ratification or accession, the Convention shall have effect within all territorial units of that State.

(4)\* If, by virtue of a declaration under this article, this Convention extends to one or more but not all of the territorial units of a Contracting State, and if the place of business of a party to a contract is located in that State, this place of business shall, for the purposes of this Convention, be considered not to be in a Contracting State, unless it is in a territorial unit to which the Convention extends.

\*New paragraph 4, added in accordance with article III of the 1980 Protocol.

## Article 32

Where in this Convention reference is made to the law of a State in which different systems of law apply, such reference shall be construed to mean the law of the particular legal system concerned.

## Article 33

Each Contracting State shall apply the provisions of this Convention to contracts concluded on or after the date of the entry into force of this Convention.

## Part III. Declarations and reservations

## Article 34\*

(1) Two or more Contracting States which have the same or closely related legal rules on matters governed by this Convention may at any time declare that the Convention shall not apply to contracts of international sale of goods where the parties have their places of business in those States. Such declarations may be made jointly or by reciprocal unilateral declarations.

(2) A Contracting State which has the same or closely related legal rules on matters governed by this Convention as one or more non-Contracting States may at any time declare that the Convention shall not apply to contracts of international sale of goods where the parties have their places of business in those States.

(3) If a State which is the object of a declaration under paragraph (2) of this article subsequently becomes a Contracting State, the declaration made shall, as from the date on which this Convention enters into force in respect of the new Contracting State, have the effect of a declaration made under paragraph (1), provided that the new Contracting State joins in such declaration or makes a reciprocal unilateral declaration.

## Article 35

A Contracting State may declare, at the time of the deposit of its instrument of ratification or accession, that it will not apply the provisions of this Convention to actions for annulment of the contract.

## Article 36

Any State may declare, at the time of the deposit of its instrument of ratification or accession, that it shall not be compelled to apply the provisions of article 24 of this Convention.

## Article 36 bis (Article XII of the Protocol)

Any State may declare at the time of the deposit of its instrument of accession or its notification under article 43 *bis* that it will not be bound by the amendments to article 3 made by article I of the 1980 Protocol.\*\* A declaration made under this article shall be in writing and be formally notified to the depositary.

\*Text as amended in accordance with article IV of the 1980 Protocol. Article 34 as originally adopted in the Limitation Convention, 1974, prior to its amendment under the 1980 Protocol, read as follows:

## Article 34

Two or more Contracting States may at any time declare that contracts of sale between a seller having a place of business in one of those States and a buyer having a place of business in another of those States shall not be governed by this Convention, because they apply to the matters governed by this Convention the same or closely related legal rules."

\*\*Such a State will then be bound by article 3 of the unamended Convention. For its text, see footnote under article 3.

*Article 37\**

This Convention shall not prevail over any international agreement which has already been or may be entered into and which contains provisions concerning the matters governed by this Convention, provided that the seller and buyer have their places of business in States parties to such agreement.

*Article 38*

(1) A Contracting State which is a party to an existing convention relating to the international sale of goods may declare, at the time of the deposit of its instrument of ratification or accession, that it will apply this Convention exclusively to contracts of international sale of goods as defined in such existing convention.

(2) Such declaration shall cease to be effective on the first day of the month following the expiration of twelve months after a new convention on the international sale of goods, concluded under the auspices of the United Nations, shall have entered into force.

*Article 39*

No reservation other than those made in accordance with articles 34, 35, 36, 36 *bis* and 38 shall be permitted.

*Article 40*

(1) Declarations made under this Convention shall be addressed to the Secretary-General of the United Nations and shall take effect simultaneously with the entry of this Convention into force in respect of the State concerned, except declarations made thereafter. The latter declarations shall take effect on the first day of the month following the expiration of six months after the date of their receipt by the Secretary-General of the United Nations. [Reciprocal unilateral declarations under article 34 shall take effect on the first day of the month following the expiration of six months after the receipt of the latest declaration by the Secretary-General of the United Nations.]\*\*

(2) Any State which has made a declaration under this Convention may withdraw it at any time by a notification addressed to the Secretary-General of the United Nations. Such withdrawal shall take effect on the first day of the month following the expiration of six months after the date of the receipt of the notification by the Secretary-General of the United Nations. In the case of a declaration made under article 34 of this Convention, such withdrawal shall also render inoperative, as from the date on which the withdrawal takes effect, any reciprocal declaration made by another State under that article.

**Part IV. Final clauses***Article 41*

This Convention\*\*\* shall be open until 31 December 1975 for signature by all States at the Headquarters of the United Nations.

\*Text as amended in accordance with article V of the Protocol. Article 37 as originally adopted in the Limitation Convention, 1974, prior to its amendment under the 1980 Protocol, read as follows:

*Article 37*

This Convention shall not prevail over conventions already entered into or which may be entered into, and which contain provisions concerning the matters covered by this Convention, provided that the seller and buyer have their places of business in States parties to such a convention."

\*\*Last sentence of paragraph (1) of article 40 (between brackets) added in accordance with article VI of the 1980 Protocol.

\*\*\*Refers to the 1974 Limitation Convention.

*Article 42*

This Convention\* is subject to ratification. The instruments of ratification shall be deposited with the Secretary-General of the United Nations.

*Article 43*

This Convention\* shall remain open for accession by any State. The instruments of accession shall be deposited with the Secretary-General of the United Nations.

*Article 43 bis (Article X of the Protocol)*

If a State ratifies or accedes to the 1974 Limitation Convention after the entry into force of the 1980 Protocol, the ratification or accession shall also constitute a ratification of or an accession to the Convention as amended by the 1980 Protocol if the State notifies the depositary accordingly.

*Article 43 ter (Article VIII (2) of the Protocol)*

Accession to the 1980 Protocol by any State which is not a Contracting Party to the 1974 Limitation Convention shall have the effect of accession to that Convention as amended by the Protocol, subject to the provisions of article 44 *bis*.

*Article 44*

(1) This Convention shall enter into force on the first day of the month following the expiration of six months after the date of the deposit of the tenth instrument of ratification or accession.

(2) For each State ratifying or acceding to this Convention after the deposit of the tenth instrument of ratification or accession, this Convention shall enter into force on the first day of the month following the expiration of six months after the date of the deposit of its instrument of ratification or accession.

*Article 44 bis (Article XI of the Protocol)*

Any State which becomes a Contracting Party to the 1974 Limitation Convention, as amended by the 1980 Protocol, shall, unless it notifies the depositary to the contrary, be considered to be also a Contracting Party to the Convention, unamended, in relation to any Contracting Party to the Convention not yet a Contracting Party to the 1980 Protocol.

*Article 45*

(1) Any Contracting State may denounce this Convention by notifying the Secretary-General of the United Nations to that effect.

(2) The denunciation shall take effect on the first day of the month following the expiration of twelve months after receipt of the notification by the Secretary-General of the United Nations.

\*Refers to the 1974 Limitation Convention.

*Article 45 bis (Article XIII (3) of the Protocol)*

Any Contracting State in respect of which the 1980 Protocol ceases to have effect by the application of paragraphs (1) and (2)\*

\*Paragraphs (1) and (2) of article XIII of the Protocol read as follows:

"(1) A Contracting State may denounce this Protocol by notifying the depositary to that effect.

(2) The denunciation shall take effect on the first day of the month following the expiration of twelve months after receipt of the notification by the depositary."

of article XIII of the 1980 Protocol shall remain a Contracting Party to the 1974 Limitation Convention, unamended, unless it denounces the unamended Convention in accordance with article 45 of that Convention.

*Article 46*

The original of this Convention, of which the Chinese, English, French, Russian and Spanish texts are equally authentic, shall be deposited with the Secretary-General of the United Nations.

## II. Explanatory note by the UNCITRAL secretariat on the Convention on the Limitation Period in the International Sale of Goods and the Protocol amending the Convention on the Limitation Period in the International Sale of Goods\*

### INTRODUCTION

1. The Convention on the Limitation Period in the International Sale of Goods (New York, 1974) provides uniform international legal rules governing the period of time within which a party under a contract for the international sale of goods must commence legal proceedings against the other party to assert a claim arising from the contract or relating to its breach, termination or invalidity. This period is referred to in the Convention as the "limitation period". The basic aims of the limitation period are to prevent the institution of legal proceedings at such a late date that the evidence relating to the claim is likely to be unreliable or lost and to protect against the uncertainty and injustice that would result if a party were to remain exposed to unasserted claims for an extensive period of time.

2. The Limitation Convention grew out of the work of the United Nations Commission on International Trade Law (UNCITRAL) towards the harmonization and unification of international sales law, which also resulted in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (hereinafter referred to as the "United Nations Sales Convention"). During that work it was observed that, while most legal systems limited or prescribed a claim from being asserted after the lapse of a specified period of time, numerous disparities existed among legal systems with respect to the conceptual basis for doing so. As a result there were disparities in the length of the period and in the rules governing the limitation or prescription of claims after that period. Those disparities created difficulties in the enforcement of claims arising from international sales transactions, and thus burdened international trade.

3. In view of those problems UNCITRAL decided to prepare uniform international legal rules on the limitation period in the international sale of goods. On the basis of a draft Convention prepared by UNCITRAL, a diplomatic conference convened in New York by the General Assembly adopted the Limitation Convention on 14 June 1974. The Limitation Convention was amended by a Protocol adopted in 1980 by the diplomatic conference that

adopted the United Nations Sales Convention, in order to harmonize the Limitation Convention with the latter Convention.

4. The Limitation Convention entered into force on 1 August 1988. As of 31 January 1990, 11 States had ratified or acceded to the Convention. Czechoslovakia, Dominican Republic, Ghana, Norway and Yugoslavia are parties to the unamended Convention. Argentina, Egypt, German Democratic Republic, Hungary, Mexico and Zambia are parties to the Convention as amended by the 1980 Protocol.

### A. SCOPE OF APPLICATION

5. The Convention applies to contracts for the sale of goods between parties whose places of business are in different States if both of those States are Contracting States. Under the 1980 Protocol the Convention also applies if the rules of private international law make the law of a Contracting State applicable to the contract. However, in becoming a party to the Protocol a State may declare that it will not be bound by that provision. Each Contracting State must apply the Convention to contracts concluded on or after the date of the entry into force of the Convention.

6. The application of the Convention is excluded in certain situations. Firstly, the Convention will not apply if the parties to a sales contract expressly exclude its application. This provision gives effect to the basic principle of freedom of contract in the international sale of goods. Secondly, the Convention will not apply in certain cases where matters covered by the Convention are governed by other Conventions. Thirdly, Contracting States are permitted to deposit declarations or reservations excluding the application of the Convention in the following situations: two or more Contracting States may exclude the application of the Convention to contracts between parties having their places of business in those States when the States apply to those contracts the same or closely related legal rules. So far, one State has availed itself of that declaration. In addition, a State may exclude the application of the Convention to actions for annulment of the contract. No State has thus far availed itself of such a declaration.

7. Since the Convention applies only in respect of international sales contracts, it clarifies whether contracts involving certain services are covered. A contract for the supply of goods to be manufactured or produced is considered to be a sales contract unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for their manufacture or production. Furthermore, when the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services, the Convention does not apply.

\*This note has been prepared by the secretariat of the United Nations Commission on International Trade Law for informational purposes; it is not an official commentary on the Convention. A commentary on the unamended Convention prepared at the request of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods appears in A/CONF.63/17 (reprinted in *Yearbook of the United Nations Commission on International Trade Law*, 1979, vol. X, part three, chap. I (United Nations publication, Sales No. E.81.V.2) and in *UNCITRAL: The United Nations Commission on International Trade Law* (United Nations publication, Sales No. E.86.V.8), annex II.B).

8. The Convention contains a list of types of sales that are excluded from the Convention, either because of the purpose of the sale (goods bought for personal, family or household use (under the 1980 Protocol sales of those goods are covered by the Convention if the seller could not have known that they were bought for such use)), the nature of the sale (sales by auction, on execution or otherwise by law) or the nature of the goods (stocks, shares, investment securities, negotiable instruments, money, ships, vessels, aircraft or electricity (the 1980 Protocol adds hovercraft)).

9. The Convention makes it clear that it applies only to the usual type of commercial claims based on contract. It specifically excludes claims based on death or personal injury; nuclear damage; a lien, mortgage or other security interest; a judicial judgement or award; a document on which direct enforcement or execution can be obtained; and a bill of exchange, cheque or promissory note. The limitation periods for those claims are generally subject to particular rules and it would not necessarily be appropriate to apply in respect of those claims the rules applicable to ordinary commercial contractual claims.

#### B. DURATION AND COMMENCEMENT OF LIMITATION PERIOD

10. The duration of the limitation period under the Convention is four years. The period cannot be modified by agreement of the parties, but it can be extended by a written declaration of the debtor during the running of the period. Also, the contract of sale may stipulate a shorter period for the commencement of arbitral proceedings, if the stipulation is valid under the law applicable to the contract. Rules are provided as to how the period should be calculated.

11. A limitation period of four years' duration was thought to accomplish the aims of the limitation period and yet to provide an adequate period of time to enable a party to an international sales contract to assert his claim against the other party. Circumstances where an extension or recommencement of the limitation period would be justified are dealt with in particular provisions of the Convention.

12. With respect to the time when the limitation period commences to run, the basic rule is that it commences on the date on which the claim accrues. The Convention establishes when claims for breach of contract, for defects in the goods or other lack of conformity and for fraud are deemed to accrue. Special rules are provided for the commencement of the limitation period in two particular cases: where the seller has given the buyer an express undertaking (such as a warranty or guarantee) relating to the goods which is stated to have effect for a certain period of time, and where a party terminates the contract before the time for performance is due. Rules are also provided in respect of claims arising from the breach of an instalment contract and claims based on circumstances giving rise to a termination of such a contract.

#### C. CESSATION AND EXTENSION OF LIMITATION PERIOD

13. Having established the time of commencement and the length of the limitation period, the Convention sets forth rules concerning the cessation of the period. The period ceases to run when the claimant commences judicial or arbitral proceedings against the debtor, or when he asserts his claim in existing proceedings. A counterclaim is deemed to have been asserted on the same date as the date when the proceedings in which the counterclaim is asserted were commenced, if the counterclaim and the claim against which it is raised relate to the same contract or to several contracts concluded in the course of the same transaction.

14. Judicial or arbitral proceedings commenced by a claimant within the limitation period might terminate without a binding decision on the merits of the claim, for example, because the court or arbitral tribunal lacks jurisdiction or because of a procedural defect. The creditor would normally be able to pursue his claim by commencing new proceedings. Thus, the Convention provides that if the original proceedings end without a binding decision on the merits the limitation period will be deemed to have continued to run. However, by the time the original proceedings have ended, the limitation period might have expired, or there might remain insufficient time for the claimant to commence new proceedings. To protect the claimant in those cases the Convention grants him an additional period of one year to commence new proceedings.

15. The Convention contains rules to resolve in a uniform manner questions concerning the running of the limitation period in two particular cases. Firstly, it provides that where legal proceedings have been commenced against one party to the sales contract, the limitation period ceases to run against a person jointly and severally liable with him if the claimant informs that person in writing within the limitation period that the proceedings have been commenced. Secondly, it provides that where proceedings have been commenced against a buyer by a party who purchased the goods from him, the limitation period ceases to run in respect of the buyer's recourse claim against the seller if the buyer informs the seller in writing within the limitation period that the proceedings against the buyer have been commenced. Where the proceedings in either of those two cases have ended, the limitation period in respect of the claim against the jointly and severally liable person or against the seller will be deemed to have continued to run without interruption, but there will be an additional year to commence new proceedings if at that time the limitation period has expired or has less than a year to run.

16. One effect of the provision mentioned above relating to the buyer is to enable him to await the outcome of the claim against him before commencing an action against his seller. This enables the buyer to avoid the trouble and expense of instituting proceedings against the seller and the disruption of their good business relationship if it turns out that the claim against the buyer was not successful.

17. Under the Convention the limitation period recommences in two cases: if the creditor performs in the debtor's State an act that, under the law of that State, has the effect of recommencing a limitation period, or if the debtor acknowledges in writing his obligation to the creditor or pays interest or partially performs the obligation from which his acknowledgement can be inferred.

18. The Convention protects a creditor who was prevented from taking the necessary acts to stop the running of the limitation period in extreme cases. It provides that when the creditor could not take those acts as a result of a circumstance beyond his control and which he could neither avoid nor overcome, the limitation period will be extended so as to expire one year after the date when the circumstance ceased to exist.

#### D. OVERALL LIMIT OF LIMITATION PERIOD

19. Since the limitation period may, under the circumstances noted above, be extended or recommence, the Convention establishes an overall time period of 10 years, from the date on which the limitation period originally commenced to run, beyond which no legal proceedings to assert the claim may be commenced under any circumstances. The theory behind that provision is that enabling proceedings to be brought after that time would be inconsistent with the aims of the Convention in providing a definite limitation period.

#### E. CONSEQUENCES OF EXPIRATION OF LIMITATION PERIOD

20. The principal consequence of the expiration of the limitation period is that no claim will be recognized or enforced in legal proceedings commenced thereafter. The expiration of the limitation period will not be taken into consideration in legal proceedings unless it is invoked by a party to the proceedings. However, in light of views expressed at the diplomatic conference that adopted the Convention that the limitation or prescription of actions was a matter of public policy and that a court should be able to take the expiration of the limitation period into account on its own initiative, a Contracting State is permitted to declare that it will not apply that provision. No State has thus far made such a declaration.

21. Even after the limitation period has expired a party can in certain situations raise his claim as a defence to or set-off against a claim asserted by the other party.

#### F. OTHER PROVISIONS AND FINAL CLAUSES

22. Other provisions of the Convention deal with implementation of the Convention in States having two or more territorial units where different legal systems exist. A series of provisions deals with declarations and reservations permitted under the Convention and with procedures for making and withdrawing them. The permitted declarations and reservations have been mentioned above; no others may be made under the Convention.

23. The final clauses contain the usual provisions relating to the Secretary-General of the United Nations as depositary of the Con-

vention. The Convention is subject to ratification by States that signed the Convention by 31 December 1975 and for accession by States that did not do so. The Chinese, English, French, Russian and Spanish texts of the Convention are equally authentic.

24. The Secretary-General of the United Nations is also the depositary of the 1980 Protocol amending the Convention, which is open for accession by all States. The Protocol having received the necessary number of accessions, the Convention as amended by the Protocol entered into force on the same date as the unamended Convention, i.e. on 1 August 1988.

25. A State that ratifies or accedes to the Convention after the Convention and Protocol come into force will become a party to the Convention as amended by the Protocol if it notifies the depositary accordingly. The Convention as amended will enter into force for that State on the first day of the month following the expiration of 6 months after the date of deposit of its instrument of ratification or accession. Accession to the Protocol by a State that is not a Contracting Party to the Convention constitutes accession to the Convention as amended by the Protocol.

Further information can be obtained from:

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(A/CN.9/382) [Original: English]

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Contents: Presentation on the section devoted to the work of the National Center of Inter-American Free Trade / B. Kozolchyk, p. 361-365 — Standby letter of credit rules: an exercise in drafting a commercial statute / J. E. Byrne, p. 366-371 — Select Advisory Group proposed draft standby letter of credit rules, p. 372-378 — Select Advisory Group commentary, p. 379-485. This commentary refers to several UNCITRAL Working Group papers: A/CN.9/WG.II/WP.73 of 17 September 1991, and Add.1 of 14 October 1991; A/CN.9/358 of 12 February 1992; A/CN.9/361 of 27 April 1992.  
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## VI. CHECK-LIST OF UNCITRAL DOCUMENTS

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| A/CN.9/366  | Not issued   |                                   |
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| A/CN.9/XXV/CRP.2 and Add.1  | Report of the Drafting Group   | Not reproduced                    |
| A/CN.9/XXV/CRP.3  | International countertrade: draft legal guide on international countertrade transactions   | Not reproduced                    |

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| A/CN.9/362<br>and Add.1-17        | International countertrade: draft chapters of legal guide on international countertrade transactions | Part Two, II, C |

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## VII. LIST OF UNCITRAL DOCUMENTS REPRODUCED IN THE PREVIOUS VOLUMES OF THE YEARBOOK

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  - (c) Working Group III: International Legislation on Shipping
  - (d) Working Group IV: International Negotiable Instruments (1974 to 1987: 7th session-20th session); International Payments (1988 to 1989: 21st session-22nd session)
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## 6. Documents submitted to Working Groups

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| A/CN.9/WG.2/WP.27                             | Volume IX: 1978     | Part Two, I, B    | 85  |
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(d) *Working Group IV*(i) *International Negotiable Instruments*

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| A/CN.9/WG.IV/WP.21              | Volume XIII: 1982  | Part Two, II, A, 2(a)   | 72  |
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(e) *Working Group V: New International Economic Order*

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#### 9. Bibliographies of writings relating to the work of the Commission

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