

YEARBOOK

Volume XXXIII: 2002



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UNITED NATIONS COMMISSION ON
INTERNATIONAL TRADE LAW

YEARBOOK

Volume XXXIII: 2002



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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.

Changes of and additions to wording that appeared in earlier drafts of conventions, model laws and other legal texts are in italics, except in the case of headings to articles, which are in italics as a matter of style.

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INTRODUCTION

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

The present volume consists of three parts. Part one contains the Commission's report on the work of its thirty-fifth session, which was held in New York, from 17-28 June 2002, 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 thirty-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 prepared for the Working Groups.

Part three contains the UNCITRAL Model Law on International Commercial Conciliation, the corresponding Summary Records, Guide to Enactment to Model Law on International Commercial Conciliation, bibliography of recent writings related to the Commission's work, a list of documents before the thirty-fifth session and a list of documents relating to the work of the Commission reproduced in the previous volumes of the *Yearbook*.

UNCITRAL secretariat
Vienna International Centre
P.O. Box 500, 1400 Vienna, Austria
Telephone: (+43-1) 26060-4060 Telex: 135612 Telefax: (+43-1) 26060-5813
E-Mail: uncitral@uncitral.org Internet: <http://www.un.or.at/uncitral>

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

<i>Volume</i>	<i>Years covered</i>	<i>United Nations publication 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
XXIII	1992	E.94.V.7
XXIV	1993	E.94.V.16
XXV	1994	E.95.V.20
XXVI	1995	E.96.V.8
XXVII	1996	E.98.V.7
XXVIII	1997	E.99.V.6
XXIX	1998	E.99.V.12
XXX	1999	E.00.V.9
XXXI	2000	E.02.V.3
XXXII	2001	E.04.V.4

Part One

**REPORT OF THE COMMISSION
ON ITS ANNUAL SESSION
AND COMMENTS AND ACTION THEREON**

THE THIRTY-FIFTH SESSION (2002)

A. Report of the United Nations Commission on International Trade Law on its thirty-fifth session (New York, 17-28 June 2002) (A/57/17) [Original: English]

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I. INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law (UNCITRAL) covers the thirty-fifth session of the Commission, held in New York from 17 to 28 June 2002.

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

II. ORGANIZATION OF THE SESSION

A. Opening of the session

3. UNCITRAL commenced its thirty-fifth session on 17 June 2002. The session was opened by the Under-Secretary-General for Legal Affairs and the Legal Counsel of the United Nations, Hans Corell.

B. Membership and attendance

4. The General Assembly, in its resolution 2205 (XXI), established the Commission with a membership of 29 States, elected by the Assembly. By its resolution 3108 (XXVIII) of 12 December 1973, the Assembly increased the membership of the Commission from 29 to 36 States. The current members of the Commission, elected on

24 November 1997 and on 16 October 2000, 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:¹ Argentina (2004), alternating annually with Uruguay), Austria (2004), Benin (2007), Brazil (2007), Burkina Faso (2004), Cameroon (2007), Canada (2007), China (2007), Colombia (2004), Fiji (2004), France (2007), Germany (2007), Honduras (2004), Hungary (2004), India (2004), Islamic Republic of Iran (2004), Italy (2004), Japan (2007), Kenya (2004), Lithuania (2004), Mexico (2007), Morocco (2007), Paraguay (2004), Romania (2004), Russian Federation (2007), Rwanda (2007), Sierra Leone (2007), Singapore (2007), Spain (2004), Sudan (2004), Sweden (2007), Thailand (2004), the former Yugoslav Republic of Macedonia (2007), Uganda (2004), United Kingdom of Great Britain and Northern Ireland (2007) and United States of America (2004).

5. With the exception of Benin and Rwanda, all the members of the Commission were represented at the session.

¹Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 19 were elected by the General Assembly at its fifty-second session, on 24 November 1997 (decision 52/314) and 17 were elected by the General Assembly at its fifty-fifth session, on 16 October 2000 (decision 55/308). By General Assembly resolution 31/99 of 15 December 1976, the Assembly altered the dates of commencement and termination of membership by deciding that members would take office at the beginning of the first day of the regular annual session of the Commission immediately following their election, and that their terms of office would expire on the last day prior to the opening of the seventh regular annual session following their election.

6. The session was attended by observers from the following States: Australia, Belarus, Bulgaria, Chile, Congo, Cyprus, Czech Republic, Denmark, Dominican Republic, Ecuador, Finland, Gabon, Greece, Guatemala, Indonesia, Iraq, Kuwait, Lesotho, Libyan Arab Jamahiriya, Luxembourg, Malta, Oman, Peru, Philippines, Portugal, Qatar, Republic of Korea, Saudi Arabia, Slovakia, Slovenia, South Africa, Switzerland, Turkey, Ukraine, Uruguay and Venezuela.

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

(a) *United Nations system*: United Nations Development Programme;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Organization, Asian Clearing Union, East African Development Bank, International Development Law Institute and Permanent Court of Arbitration;

(c) *Non-governmental organizations invited by the Commission*: American Arbitration Association, American Bar Association, Cairo Regional Centre for International Commercial Arbitration, Centre d'Arbitrage du Rwanda, Chartered Institute of Arbitrators, Global Center for Dispute Resolution Research, Institute of International Banking Law Practice, Inter-American Bar Association, International Chamber of Commerce, International Cotton Advisory Committee, International Council for Commercial Arbitration, International Maritime Committee, International Union of Marine Insurance, North American Free Trade Agreement Advisory Committee on Private Commercial Disputes, Queen Mary (University of London) School of International Arbitration, University of the West Indies and U.S.-Mexico Conflict Resolution Center.

8. The Commission was appreciative of the fact that international non-governmental organizations that had expertise regarding the major items on the agenda of the current session had accepted the invitation to take part in the meetings. Being aware that it was crucial for the quality of texts formulated by the Commission that relevant non-governmental organizations should participate in the sessions of the Commission and its working groups, the Commission requested the Secretariat to continue to invite such organizations to its sessions based on their particular qualifications.

C. Election of officers

9. The Commission elected the following officers:

Chairman: Henry M. Smart (Sierra Leone)

Vice-Chairmen: Guillermo Francisco Reyes (Colombia)
László Milassin (Hungary)
Vilawan Manglatanakul (Thailand)

Rapporteur: David Morán Bovio (Spain)

D. Agenda

10. The agenda of the session, as adopted by the Commission at its 739th meeting, on 17 June, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Finalization and adoption of the draft UNCITRAL Model Law on International Commercial Conciliation.
5. Insolvency law: progress report of Working Group V.
6. Security interests: progress report of Working Group VI.
7. Electronic commerce: progress report of Working Group IV.
8. Transport law: progress report of Working Group III.
9. Privately financed infrastructure projects: progress report of Working Group I.
10. Monitoring implementation of the 1958 New York Convention.
11. Enlargement of membership of the Commission.
12. Case law on UNCITRAL texts (CLOUT).
13. Digest of case law on the United Nations Sales Convention.
14. Training and technical assistance.
15. Status and promotion of UNCITRAL legal texts.
16. General Assembly resolutions on the work of the Commission.
17. Coordination and cooperation.
18. Other business.
19. Date and place of future meetings.
20. Adoption of the report of the Commission.

E. Establishment of a Committee of the Whole

11. The Commission established itself as a Committee of the Whole for the consideration of agenda item 4. The Commission elected José María Abascal Zamora (Mexico) Chairman of the Committee of the Whole. The Committee of the Whole met from 17 to 25 June.

F. Adoption of the report

12. At its 752nd meeting, on 25 June, and at its 756th and 757th meetings, on 28 June, the Commission adopted the present report by consensus.

III. DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

A. General remarks

13. The Commission exchanged views on the usefulness of the draft UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/506, annex) (the “Model Law”) and its potential to promote the use of conciliation both internationally and domestically and to strengthen the enforcement of settlement agreements. It was observed with approval that the draft Model Law avoided over-regulation of conciliation proceedings and gave a high priority to party autonomy.

B. Title

14. The Commission adopted the draft title without comment.

C. Consideration of draft articles

Article 1. Scope of application and definitions

15. Draft article 1 as considered by the Commission was as follows:

“1. This Law applies to international¹ commercial² conciliation.

“2. For the purposes of this Law, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator or the panel of conciliators does not have the authority to impose upon the parties a solution to the dispute.

“3. A conciliation is international if:

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

“(b) The State in which the parties have their places of business is different from either:

“(i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or

“(ii) The State with which the subject matter of the dispute is most closely connected.

“4. For the purposes of this article:

“(a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

“(b) If a party does not have a place of business, reference is to be made to the party’s habitual residence.

“5. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.

“6. The parties are free to agree to exclude the applicability of this Law.

“7. Subject to the provisions of paragraph 8 of this article, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.

“8. This Law does not apply to:

“(a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and

“(b) [. . .].

¹States wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text: [. . .]

²The term ‘commercial’ should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.”

Paragraph 1

16. A drafting suggestion was that the title of article 1 should be “Definitions and scope of application”.

17. Some concern was expressed as to the application of the Model Law in the context of the rules of private international law, and it was suggested that that issue needed to be carefully addressed in the Guide to Enactment and Use of the Model Law (hereinafter referred to as “the Guide” or “the draft Guide” (A/CN.9/514)), to avoid the Model Law being misinterpreted as interfering with existing conflict-of-laws rules. A related concern was the need to encourage States to adopt the Model Law with as few changes as possible to ensure uniformity of adoption, a result which would overcome the potential for conflict-of-laws issues to arise.

18. A further concern related to the application of the Model Law to both national and international commercial conciliation and the desirability of having different regimes apply was questioned. It was recalled that different views were discussed in the Working Group and footnote 1 reflected the agreement on how that issue should be approached to take account of the different views. The

Commission agreed to postpone its discussion of the content of footnote 1 until it had had the opportunity to consider a proposal on the amendments that would be required.

19. The Commission adopted paragraph 1 as drafted, pending discussion of the content of the footnote.

Paragraph 2

20. It was suggested that the Guide should indicate that when interpreting article 1, paragraph 2, it would be relevant to take into consideration conduct of the parties that demonstrated their understanding that they were engaged in conciliation.

21. Paragraph 2 was adopted as drafted.

Paragraph 3

22. A suggestion was made that the order of paragraphs 3(b)(i) and (ii) should be reversed on the basis that paragraph 3(b)(ii) stated the general principle and paragraph 3(b)(i) was a specific example of that general principle. A contrary view was that since paragraph 3(b)(i) indicated the most direct means of determining internationality, and paragraph 3(b)(ii) raised more complex issues of conflicts of laws, the existing order should be maintained. In support of that view, it was observed that the current text reflected the discussion in the Working Group and was consistent with the approach taken in the UNCITRAL Model Law on International Commercial Arbitration. The Commission adopted paragraph 3 as drafted.

Paragraphs 4 and 5

23. Paragraphs 4 and 5 were adopted by the Commission without comment.

Paragraph 6

24. One suggestion expressed was that the parties should be able to agree to apply the Model Law in whole or in part and that paragraph 6 should be amended to that end. In reply, it was pointed out that paragraph 6 was concerned with the question of whether or not the Model Law would apply and that article 3 then dealt with the issue, where the Model Law was to apply, of whether it would apply in whole or in part. After discussion, the Commission adopted paragraph 6 as drafted.

Paragraph 7

25. Paragraph 7 was adopted by the Commission without comment.

Paragraph 8

26. In support of adopting paragraph 8 as drafted, it was observed that the paragraph would neither encourage nor

discourage the practice of a judge or arbitrator facilitating a settlement in the course of court or arbitration proceedings; the practices in that regard differed in the various legal systems and it was considered prudent not to interfere with the rules of procedure governing the conduct of the judge or arbitrator and provide that the Model Law would not apply in those situations. It was observed that, in some cases of so-called “court-annexed conciliation”, it might not be clear whether such conciliation was carried out “in the course of a court [. . .] proceeding”. For such cases, it was suggested that the Guide should draw the attention of enacting States to the need to clarify in the piece of legislation enacting the Model Law whether such conciliation should be governed by that piece of legislation or not. It was pointed out, however, that the Model Law could apply to the situations referred to in paragraph 8 if the parties agreed under paragraph 5 that it should apply and that that issue should be addressed in the Guide. It was noted that paragraph 8(b) was provided to enable countries to indicate other situations where the Model Law might not apply and that examples would be given in the Guide. After discussion, paragraph 8 was adopted by the Commission without change.

27. The Commission referred draft article 1 to the drafting group.

Article 2. Interpretation

28. Draft article 2 as considered by the Commission was as follows:

“1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

“2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.”

29. Draft article 2 was adopted as drafted.

Article 3. Variation by agreement

30. Draft article 3 as considered by the Commission was as follows:

“Except for the provisions of article 2 and article 7, paragraph 3, the parties may agree to exclude or vary any of the provisions of this Law.”

31. A proposal was made that article 15 should also be referred to in article 3. A contrary view was that article 3 should be left as it was in order to preserve maximum party autonomy. A separate but related observation was that, while parties could not agree to a higher standard of enforceability than that reflected in article 15, they should be free to agree to a lesser standard. While the Commission approved that view, it was agreed that those issues should

be further considered in the context of the discussion of article 15. It was also suggested that article 3 might need further consideration when the discussion of all articles of the Model Law had been completed. The Commission adopted draft article 3, subject to further consideration when the discussion of other articles had been completed.

Article 4. Commencement of conciliation proceedings

32. Draft article 4 as considered by the Commission was as follows:

“Article 4. Commencement of conciliation proceedings³

“1. Unless otherwise agreed by the parties, the conciliation proceedings in respect of a particular dispute that has arisen commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.

“2. If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

³The following text is suggested for States that might wish to adopt a provision on the suspension of the limitation period:

‘Article X. Suspension of limitation period

‘(1) When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

‘(2) Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.’”

Footnote

33. Various views were expressed as to the substance and placement of draft article X contained in the footnote to draft article 4. In favour of maintaining a provision along the lines of draft article 4 in the text of the Model Law, it was stated that, in the absence of such a provision, some legal systems would treat the commencement of conciliation proceedings as interrupting the limitation period, which, at the end of an unsuccessful attempt at conciliation, would have to start running again from day one. To avoid that result, a specific provision was needed to establish that the commencement of conciliation proceedings would result only in a suspension of the limitation period. The contrary view was that, before adopting a provision along the lines of draft article X, States should be warned against the risks inherent in such a provision. It was stated that establishing as a rule that the commencement of conciliation proceedings should result in suspension of the limitation period would require a high degree of precision as to what constituted such commencement. Requiring such a degree of precision might disregard the fundamentally informal and flexible nature of conciliation. It was pointed out that

the acceptability of the Model Law might be jeopardized if it were to interfere with existing procedural rules regarding the suspension or interruption of limitation periods. Furthermore, the good reputation of conciliation as a dispute settlement technique might suffer if expectations regarding its procedural implications were created and could not easily be fulfilled, due to the circumstances under which conciliation generally took place. It was also stated that States considering adoption of article X should be informed of the possibilities for parties to preserve their rights when article X had not been adopted, namely that a party could commence a national court proceeding or arbitration to protect its interests. It was suggested that the text of draft article X should not appear as a footnote to article 4 but should be dealt with exclusively in the Guide, with appropriate explanations being given as to the various arguments that had been exchanged regarding that provision during the preparation of the Model Law.

34. After discussion, the Commission adopted the footnote to draft article 4 without change. It was agreed that the Guide should reflect the opposing views that had been expressed regarding the suitability of enacting article X.

Paragraph 1

35. The view was expressed that paragraph 1 did not distinguish clearly enough between the time when the parties agreed to conciliate (which might occur long before any dispute arose) and the time when the parties decided to engage in conciliation in the context of a specific dispute. In response, it was generally agreed that a provision dealing with the commencement of conciliation proceedings was clearly not geared to the stage where an agreement was made in principle to resort to conciliation but to the time when parties engaged in conciliation in respect of a particular dispute. However, it was also agreed that the text might be improved to avoid any misunderstanding, for example by adding the words “in respect of that dispute” at the end of paragraph 1. The matter was referred to the drafting group.

Paragraph 2

36. A concern was expressed that paragraph 2 might not provide a satisfactory solution where, prior to any dispute having arisen, parties had concluded a general agreement to conciliate in respect of future disputes. It was stated that, in such a case, where a dispute arose and a party no longer wished to conciliate, paragraph 2 offered that party an opportunity to disregard its contractual obligation simply by not responding to the invitation to conciliate within thirty days. It was stated in response that the Model Law was based on the policy that no attempt should be made to force any party to conciliate. It was observed that, consistent with that policy, draft article 12 allowed any party to conciliation proceedings to terminate those proceedings unilaterally. The purpose of paragraph 2 was not to allow disregard of any contractual commitment to conciliate but rather to provide certainty in a situation where it was unclear whether the party was willing to conciliate (by determining the time when an attempt at conciliation was deemed to have failed), irrespective of whether that failure

was or was not a violation of an agreement to conciliate. It was thus agreed that the Model Law should not deal with the consequences of failure by a party to comply with an agreement to conciliate. That matter was to be dealt with under the general law of obligations applicable in the circumstances.

37. While the Commission adopted the substance of paragraph 2 without change, the drafting group was invited to consider the possibility of expressing more clearly the above-mentioned policy in the context of paragraph 2 and it was agreed that further clarification would be included in the Guide.

Article 5. Number of conciliators

38. Draft article 5 as considered by the Commission was as follows:

“There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators.”

39. The Commission adopted the substance of draft article 5 without change and referred it to the drafting group.

Article 6. Appointment of conciliators

40. Draft article 6 as considered by the Commission was as follows:

“1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

“2. In conciliation proceedings with two conciliators, each party appoints one conciliator.

“3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

“4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

“(a) A party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

“(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

“5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

“6. When a person is approached in connection with his or her possible appointment as a conciliator, he

or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.”

Paragraphs 1 to 3

41. A concern was expressed as to how paragraphs 1 to 3 on appointment of conciliators would apply in the case of multiparty conciliations. It was observed that, while paragraph 2 expressed a general principle that, where there were two parties, each party could appoint a conciliator, that principle might not be appropriate for extension to cases where there were a large number of parties. In response, it was suggested that article 6 should adopt a more neutral formulation that focused on the autonomy of the parties to appoint conciliators; a choice of conciliators could not be imposed upon the parties and, if they could not agree as to who should be appointed, it would not be possible for the conciliation to take place. That neutral solution could be achieved by addressing the need for parties to reach agreement on the identity and number of conciliators to be appointed, or on a procedure by which those appointments could be made. To reflect those considerations, two possible variants were proposed as follows:

Variant 1

“1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

“2. In conciliation proceedings with two or more conciliators, the parties shall endeavour to reach agreement on either a joint appointment of the conciliators or on [the procedure for the appointment of the conciliators] [the way in which the parties will appoint the conciliators].”

Variant 2

“The parties shall endeavour to reach agreement on either a joint appointment of the conciliator or conciliators or on [the procedure for the appointment of the conciliator or conciliators] [the way in which the parties will appoint the conciliator or conciliators].”

42. It was noted that variant 1 retained paragraph 1 of the draft text where a sole conciliator was to be appointed and reformulated paragraph 2 to indicate the need, in a situation where two or more conciliators were to be appointed, for the parties to agree on either a joint appointment of conciliators or on a procedure for appointment. It was noted that variant 2 stated, as a general principle applicable to all proceedings without reference to the number of conciliators to be appointed, the need for the parties to agree on either a joint appointment of conciliators or on a procedure for appointment.

43. Wide support was expressed in favour of variant 1 on the basis that it offered a more structured approach to the

issue of appointment and retained the reference to the possibility of appointing two conciliators, an important distinction between conciliation and arbitration; in arbitration the need for an odd number of arbitrators was generally emphasized. At the same time, variant 1 was felt to be sufficiently flexible to address situations where more than two conciliators were to be appointed, including in multi-party conciliations. The observation was made, however, that both variants removed the concept of each party appointing a conciliator, previously reflected in paragraph 2 of draft article 6 and that that notion should be reflected in the Guide as one of the possibilities to be covered by paragraph 2 of variant 2. A different suggestion was that that idea should somehow be incorporated in the text of variant 2. A further suggestion was that the concept reflected in paragraph 3 of draft article 6, that of the appointment of three conciliators, should also be included in the Guide. A related proposal was that paragraph 2 of variant 1 could be divided into two sentences. The first sentence would address the need for parties to agree on the appointment of conciliators. The second sentence would address the possibility of parties also reaching agreement on a procedure for appointment of conciliators; that approach was intended to cover the possibility included in paragraph 3 of draft article 6 of parties each appointing one conciliator and then agreeing upon the means of appointing a third conciliator. That proposal also received some support.

44. It was proposed that the reference to a “joint” appointment should be deleted on the basis that a joint appointment was only one possible means of parties making an appointment and that the emphasis should be placed more broadly upon the need for agreement as to the appointment. That proposal was widely supported.

45. General support was expressed in favour of retaining the first alternative text in square brackets, that is “the procedure for the appointment of the conciliators”.

46. As a matter of drafting, it was suggested that the language of paragraph 1 of variant 1, which referred to the “agreement on the name of the sole conciliator” should be aligned with paragraph 2 of variant 1, which referred to agreement on appointment of conciliators or the procedure for appointment.

47. After discussion, the Commission agreed to adopt variant 1, with the deletion of the word “joint”, the retention of the first alternative text in square brackets, and the alignment of the language of paragraphs 1 and 2. (For continuation of the discussion, see para. 53 below.)

Paragraph 4

48. The Commission adopted the substance of paragraph 4 without change.

Paragraph 5

49. It was observed that, in view of the adoption of variant 1 as proposed, the words in paragraph 5 “with respect to a sole or third conciliator” might need to be amended. The Commission adopted the substance of paragraph 5.

Paragraph 6

50. It was proposed and the Commission agreed that the Guide should make it clear that a failure to disclose facts which might give rise to justifiable doubts within the meaning of paragraph 6 should not create a ground for setting aside a settlement agreement that would be additional to the grounds already available under applicable contract law. It was noted that those grounds were not unified and that that was a matter for each jurisdiction to address under its own law. It was noted that the issue of nullification of the settlement agreement was not related to the question of whether a conciliator who failed to disclose such facts, whether intentionally or inadvertently, would be subject to sanctions for that failure.

51. As a matter of drafting, it was suggested that the words “of which he or she is aware” should be added to qualify the circumstances to be disclosed. In response, it was observed that a conciliator could not be required to disclose circumstances of which he or she was not aware and the additional words were not required. The Commission did not adopt the suggested text.

52. The Commission referred the substance of article 6 as adopted to the drafting group.

53. Following the discussion of draft articles 5 and 6, the Commission agreed to a suggestion to combine those draft articles in a draft article to be numbered article 5. The Commission referred to the drafting group the task of preparing that combined draft article and in so doing to reflect the discussion set forth above under articles 5 and 6.

Article 7. Conduct of conciliation

54. Draft article 7 as considered by the Commission was as follows:

“1. The parties are free to agree, by reference to a set of rules or otherwise, on the manner in which the conciliation is to be conducted.

“2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any wishes that the parties may express and the need for a speedy settlement of the dispute.

“3. In any case, in conducting the proceedings, the conciliator or the panel of conciliators shall seek to maintain fair treatment of the parties and, in so doing, shall take into account the circumstances of the case.

“4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.”

Paragraphs 1 and 2

55. The Commission adopted the substance of paragraphs 1 and 2 without change.

Paragraph 3

56. A concern was expressed that, as currently drafted, paragraph 3 might easily be misinterpreted as creating new grounds for setting aside a conciliation settlement. Such misunderstanding might arise if paragraph 3 was construed as applying not only to the conduct of the conciliation proceedings but also to the result of such proceedings, i.e., the settlement agreement. It was suggested that paragraph 3 should be deleted or, as an alternative to the deletion of the entire paragraph, that it should be made non-mandatory under article 3, redrafted through a deletion of the words “in any case”, and complemented by appropriate explanations in the Guide to clarify that paragraph 3 was not intended to create a cause of action to challenge the settlement agreement.

57. The widely prevailing view, however, was that paragraph 3 should be regarded as a basic obligation and a minimum standard to be observed mandatorily by any conciliator.

58. After discussion, the Commission adopted the substance of paragraph 3 without change. It was agreed that the Guide should make it clear that paragraph 3 was intended to govern the conduct of the conciliation proceedings and that it did not address the contents of the settlement agreement.

Paragraph 4

59. The Commission adopted the substance of paragraph 4. As a matter of drafting, it was observed that the text of paragraph 4 should be brought in line with paragraphs 2 and 3 by referring not only to “the conciliator” but also to “the panel of conciliators”.

60. The Commission referred the substance of article 7 as adopted to the drafting group.

Article 8. Communication between conciliator and parties

61. Draft article 8 as considered by the Commission was as follows:

“Unless otherwise agreed by the parties, the conciliator, the panel of conciliators or a member of the panel may meet or communicate with the parties together or with each of them separately.”

62. The discussion focused on the opening words of the draft article (“Unless otherwise agreed by the parties”). The view was expressed that, in view of the general reference to party autonomy contained in article 3, the opening words were superfluous and should be deleted from both draft article 8 and other provisions where they appeared in the draft Model Law. The prevailing view was that, while the general terms of article 3 made it unnecessary to refer to party autonomy in every provision that could be varied through contract, references to contractual derogations in the draft Model Law would need to be reviewed on a

case-by-case basis. With respect to draft article 8, it was decided that the opening words should be omitted as superfluous.

63. The Commission referred the substance of article 8 as adopted to the drafting group.

Article 9. Disclosure of information between the parties

64. Draft article 9 as considered by the Commission was as follows:

“When the conciliator, the panel of conciliators or a member of the panel receives information concerning the dispute from a party, the conciliator, the panel of conciliators or a member of the panel may disclose the substance of that information to the other party. However, when a party gives any information to the conciliator, the panel of conciliators or a member of the panel subject to a specific condition that it be kept confidential, that information shall not be disclosed to the other party.”

Title

65. It was observed that the title of the draft article inadequately reflected the scope of the provision, which did not cover direct exchanges of information between the parties but rather information disclosed to the conciliator by a party (and possibly by the conciliator to another party). It was agreed that, in line with article 10 of the UNCITRAL Conciliation Rules, the title should read “Disclosure of information”.

Reference to “information concerning the dispute”

66. The view was expressed that the reference to “information concerning the dispute” was too restrictive. It was stated that the conciliator, in the conduct of the conciliation proceedings, might find it useful to communicate to the other party information received from another party that might be conducive to a settlement, although it did not directly concern the dispute. Information regarding the practices of a party as to pricing was given as an example. It was thus suggested that the words “concerning the dispute” should be deleted. The Commission did not follow that suggestion.

Reference to “may disclose”

67. A question was raised as to whether it was appropriate to provide that the conciliator “may disclose” to a party the substance of the information received from another party. In particular, doubts were expressed as to whether such a discretionary power granted to the conciliator might disregard the duty to treat the parties with equality. In response, it was explained that the purpose of draft article 9 was to establish a discretionary power allowing the conciliator to proceed in the manner that was most likely to conduce to a solution of the dispute.

68. Certain countries expressed concern with respect to the policy on which draft article 9 was based, which was described as a long outdated approach. It was stated that, in the absence of agreement to the contrary, requiring the conciliator to maintain strict confidentiality of the information communicated by a party was the only way of ensuring frankness and openness of communications in the conciliation process. Such confidentiality was reported to be consistent with conciliation practice in certain countries (A/CN.9/487, para. 131). It was proposed that draft article 9 should be amended to read as follows: "When the conciliator, the panel of conciliators or a member of the panel of conciliators receives information concerning the dispute from a party, the conciliator or the panel of conciliators shall not disclose that information to any other party unless the party giving the information expressly consents to such disclosure" (see A/CN.9/506, para. 78).

69. In response, the Commission reiterated the preference expressed by the Working Group for the view that had prevailed widely at its thirty-fourth and thirty-fifth sessions, that draft article 9 should ensure circulation of information between the various participants in the conciliation process. It was pointed out that requiring consent by the party who gave the information before any communication of that information to the other party by the conciliator was not the practice in some countries and that such was reflected in article 10 of the UNCITRAL Conciliation Rules (A/CN.9/487, para. 132 and A/CN.9/506, para. 79), but that it was the practice in some other countries.

70. However, in order to take into account what might be regarded as a natural and legitimate expectation by the parties that information communicated to conciliators would be treated as confidential, it was widely agreed that the Guide should contain a recommendation to conciliators that they should inform the parties that information communicated to a conciliator might be revealed unless the conciliator was instructed otherwise (see para. 161, below).

Reference to "the substance of that information"

71. As a matter of drafting, it was suggested that the words "the substance of that information" should be replaced with the words "that information". It was pointed out in response that the current text, along the lines of article 10 of the UNCITRAL Conciliation Rules, was preferable to avoid burdening the conciliator with an obligation to communicate the literal content of any information received from the parties (A/CN.9/506, para. 81). The suggestion was not followed by the Commission.

Reference to "the other party"

72. As a matter of drafting, it was pointed out that the words "to the other party" in both the first and the second sentence of draft article 9 did not accommodate the needs of multiparty conciliation. In order to cover unambiguously the case where the proceedings involved more than one party, it was suggested that the words "to the other party" should be replaced with the words "to any other party". The Commission took note of the suggestion with approval.

73. After discussion, the Commission referred the substance of article 9 as adopted to the drafting group.

Article 10. Duty of confidentiality

74. Draft article 10 as considered by the Commission was as follows:

"Unless otherwise agreed by the parties, all information relating to the conciliation proceedings shall be kept confidential, except where disclosure is required under the law or for the purposes of implementation or enforcement of a settlement agreement."

75. Concern was expressed that, because of the broad definition of conciliation in article 1 of the draft Model Law, article 10 as drafted might apply to establish liability where a person other than a professional conciliator was asked to facilitate the settlement of a dispute in informal circumstances where neither the parties involved nor the person asked to facilitate would have any knowledge of the application of the Model Law or expectations as to their involvement in an international commercial conciliation. Although part of the solution to that issue might lie in the sanctions applicable under national law for breach of a duty of confidentiality, the concern was to protect inadvertent parties and third persons, rather than professional conciliators who were well aware of issues relating to confidentiality. It was observed that that problem had been identified in some countries and addressed by way of a narrower definition of conciliation that would restrict the instances in which such a duty could arise. However, given the Commission's adoption of a broad definition in the draft Model Law, it was proposed that draft article 10 should apply only "whenever agreed by the parties". A contrary view was that what was required in the draft Model Law was a rule on confidentiality that would reflect the general expectation of parties participating in conciliation that the proceedings would be confidential, without the need for them to explicitly address that issue in their conciliation agreement; the result of such a proposal for amendment would be that if the parties did not address the issue there would be no obligation to observe confidentiality. A related view was that the duty of confidentiality should apply broadly and be subject only to the limitations included in the draft article.

76. Another proposal to address the concerns raised was that the words "duty of" should be deleted from the title, and that an explanation along the following lines should be included in the Guide:

"It is the intent of the drafters that, in the event a court or other tribunal is considering an allegation that a person did not comply with article 10, it should include in its consideration any evidence of conduct of the parties that shows whether they had, or did not have, an understanding that a conciliation existed and consequently an expectation of confidentiality. A State that enacts the Model Law may wish to clarify article 10 to reflect this interpretation."

77. General support was expressed in favour of that approach. It was suggested, however, that the second sentence of the explanation implied that the draft article did

not in fact achieve its stated purpose and it was proposed that that sentence should be deleted. Support was expressed in favour of retaining the idea expressed in the sentence because of the need for such a clarification in some States, but, acknowledging that that implication could be made, it was suggested that the sentence should be amended to read: "When enacting the Model Law, certain States may wish to clarify article 10 to reflect that interpretation". That proposal was supported. As a further amendment to the title of article 10, it was proposed that the words "of conciliation" should be added.

78. The view was expressed that the explanation to be included in the Guide for draft article 10 might also be relevant to other articles, such as draft article 11, to assist in determining the general question of whether or not a conciliation was being conducted. In support of that view, it was observed that further explanation was required in the Guide in respect of article 1 to clarify the circumstances in which a conciliation could be deemed to exist.

79. Some concern was expressed as to who would be required to observe the obligation of confidentiality and whether the article as drafted would cover the parties, the conciliator and third persons, including those charged with administering a conciliation. In response, it was observed that draft article 10 was broader than draft article 9 and applied broadly to "all information relating to the conciliation proceedings", regardless of who might be in possession of that information.

80. Some support was expressed in favour of deleting the words "unless otherwise agreed", since they were superfluous given the presence of article 3. After discussion, however, the prevailing view was that they should remain in order to reinforce in that context the principle of party autonomy.

81. The Commission adopted the substance of article 10 and referred it to the drafting group.

Article 11. Admissibility of evidence in other proceedings

82. Draft article 11 as considered by the Commission was as follows:

"1. Unless otherwise agreed by the parties, a party that participated in the conciliation proceedings or a third person, including a conciliator, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding, any of the following:

"(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;

"(b) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;

"(c) Statements or admissions made by a party in the course of the conciliation proceedings;

"(d) Proposals made by the conciliator;

"(e) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator;

"(f) A document prepared solely for purposes of the conciliation proceedings.

"2. Paragraph 1 of this article applies irrespective of the form of the information or evidence referred to therein.

"3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement.

"4. The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.

"5. Subject to the limitations of paragraph 1 of this article, evidence that is otherwise admissible in arbitral or court proceedings does not become inadmissible as a consequence of having been used in a conciliation."

Paragraph 1

83. It was noted in respect of the phrase "or a third person" that paragraph 61 of the draft Guide indicated that those words were used to clarify that persons other than the party (for example, witnesses or experts) who participated in the conciliation proceedings were to be covered by paragraph 1. To reflect that coverage better, it was proposed that the words "or a third person" should be moved and amended so that the paragraph would read: "Unless otherwise agreed by the parties, a party or third person that participated . . .". A further proposal was that the words "including a conciliator" should also be moved to the same position. In response to those suggestions, a concern was raised that that drafting would not cover third persons, including personnel who worked in a conciliation institution, who might obtain information of the type referred to in article 11, but who did not themselves participate directly in the proceedings. Support was expressed in favour of including such persons within the scope of paragraph 1, even though it was acknowledged that in some cases the information provided by such a third person might not, under applicable law, be admissible in arbitral, judicial or similar proceedings.

84. After discussion, the Commission agreed that paragraph 1 should cover parties to the conciliation, conciliators and third persons whether or not they participated in the proceedings including those from a conciliation institution charged with administering the proceedings.

85. As a matter of drafting, it was suggested that in subparagraph (b) the words “a party in the conciliation” should read “a party to the conciliation”.

86. The Commission adopted the substance of paragraph 1.

Paragraph 2

87. The Commission adopted the substance of paragraph 2 without comment.

Paragraph 3

88. Concern was raised as to the meaning of the reference to “the law” in the second sentence of paragraph 3 and whether it was intended to cover both court decisions and legislation, with a preference being expressed that it be limited to legislation. It was observed in response that that matter was one of interpretation and might be addressed in the Guide.

89. The Commission adopted the substance of paragraph 3 without change.

Paragraphs 4 and 5

90. The Commission adopted the substance of paragraphs 4 and 5 without comment.

91. The Commission referred article 11 as adopted to the drafting group.

Article 12. Termination of conciliation

92. Draft article 12 as considered by the Commission was as follows:

“The conciliation proceedings are terminated:

“(a) By the conclusion of a settlement agreement by the parties, on the date of the agreement;

“(b) By a written declaration of the conciliator or the panel of conciliators, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

“(c) By a written declaration of the parties addressed to the conciliator or the panel of conciliators to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

“(d) By a written declaration of a party to the other party and the conciliator or the panel of conciliators, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.”

93. Concern was raised as to how cases where the parties agreed orally to end their conciliation or by their conduct indicated that they would not proceed with conciliation should be treated given the terms of article 12. In response to that concern, and noting that other articles of the draft Model Law did not contain requirements for writing, and that conciliation could be an informal procedure, it was

proposed that the requirement for a “written” declaration in subparagraphs (b) to (d) should be deleted. A different view was that the requirement for the declaration to be in writing should be maintained as it related to other articles, such as article X in the footnote to article 4 and articles 10 and 11, and the need for certainty as to when conciliation proceedings had terminated. It was also pointed out in that regard that there was also a need for certainty as to when conciliation proceedings had commenced, which was addressed in article 4. It was observed that subparagraphs (b) to (d) dealt with failure of the conciliation, where the dispute remained on foot and parties would likely have recourse to arbitration or judicial proceedings for its resolution. In those cases, the courts and arbitral tribunals had to be certain that the conciliation proceedings had terminated and that the parties were entitled to commence those subsequent proceedings. The absence of a written declaration was likely to create uncertainty as to that issue. The particular importance of a written declaration to subparagraph (d), which involved a unilateral declaration, was emphasized. After discussion, the Commission decided that the arguments relating to informality prevailed and that the requirement for the declaration in subparagraphs (b) to (d) to be in writing should be deleted.

94. On a related matter, it was suggested that the proposal to delete the requirement for writing did not cover cases of abandonment of the conciliation procedure after it had commenced where this could only be judged by the conduct of the parties. Proposals to address that concern included adding a further paragraph to the article, or adding words to the effect of “after a reasonable attempt to consult” or “after inviting the parties to consult” as a substitute for “after consultation” in subparagraph (b). Those different proposals received some support. A different view was that subparagraph (b) would cover those cases because the phrase “after consultation with the parties” should be interpreted to include those cases where the conciliator had contacted the parties in an attempt to consult and received no response. That suggestion was generally supported and it was proposed that that interpretation should be confirmed in the Guide.

95. A different concern related to those cases where the parties had a prior contractual agreement to conciliate and it was suggested that as a minimum, to satisfy requirements of good faith, parties should be required or encouraged to engage in conciliation for some reasonable period. To reflect that concern it was proposed that the words “after reasonable delay” or “after a reasonable time frame” should be added to subparagraph (d). That proposal did not receive support on the basis that agreements to conciliate varied widely, expressing different degrees of commitment to conciliate, and that it would be inappropriate to impose a single obligatory rule in all cases. It was also pointed out that the success of conciliation depended on both parties being willing participants and that it made no sense to force an unwilling party to conciliate. It was pointed out that the comment would imply no consequences with respect to any party’s failure to comply with a contractual obligation to participate in a conciliation. It was also pointed out that the consequences of a failure to comply with a prior agreement to conciliate depended upon the applicable contract law and were not sought to be resolved in the Model Law.

96. It was suggested that, while the word “written” should be deleted as a general matter, a State adopting article X might wish to require that termination should be in writing since precision was required in determining when the conciliation ended so that the courts could properly determine the prescription period. In that context, it was noted that, if a written declaration was required for termination, it might also be required for commencement of the conciliation. It was requested that that be reflected in the Guide.

97. As a matter of drafting, it was suggested that the heading of article 12 should refer to “conciliation proceedings” rather than simply to “conciliation”.

98. The Commission referred the substance of article 12 as adopted to the drafting group.

Article 13. Conciliator acting as arbitrator

99. Draft article 13 as considered by the Commission was as follows:

“Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator in respect of a dispute that was or is the subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or any related contract.”

100. Recalling its earlier discussion of the proviso “unless otherwise agreed” (see para. 80 above), the Commission considered the question of whether that proviso should be retained in draft article 13. Differing views were expressed. One view was that the proviso stated the obvious and should, therefore, be deleted as superfluous. In support of that view, it was stated that the proviso could even be counterproductive, because it could give the wrong impression that there were two different degrees of party autonomy, a higher and a lesser one. However, the prevailing view was that the proviso was useful and should be retained. It was stated that, like arbitration, conciliation was subject to party autonomy and, therefore, the agreement of the parties should be respected. In addition, it was observed that, even if the proviso stated the obvious, the issue was so important to a number of countries that the proviso could serve as a useful reminder to the parties so that they would not need to refer to draft article 3 which, in any case, would not address it directly. On the understanding that an explanation of the reasons for retaining the proviso would be included in the Guide, the Commission decided to retain it.

101. Concern was expressed that, to the extent draft article 13 did not address the question of whether a conciliator might act as a representative, counsel or witness, it might be incomplete and inconsistent with article 19 of the UNCITRAL Conciliation Rules. In order to address that concern, it was suggested that draft article 13 should be aligned with article 19 of the UNCITRAL Conciliation Rules. That suggestion was objected to. It was recalled that, in view of the differing approaches taken in the various legal systems with respect to that question, the Working Group had decided not to address it in the Model Law and to refer to the various practices in the Guide (see A/CN.9/506, paras. 117 and 118).

102. In response to a question, it was explained that “another dispute” referred to in the draft article could involve parties other than the parties in the conciliation proceedings. The Commission affirmed that understanding and decided that it should be included in the Guide.

103. Concern was expressed that, in referring only to contracts, draft article 13 might be narrower in scope than draft article 1, paragraph 2, which referred to contractual or other legal relationships. In order to address that concern, several suggestions were made. One suggestion was to revise the last words of draft article 13 along the following lines: “the same or related contract or legal relationship”. Another suggestion was to refer to “the same or a related legal relationship”. Another suggestion was to refer to “closely related disputes”. Yet another suggestion was to refer to “the same factual situation”. There was sufficient support in the Commission for expanding draft article 13 to refer to contractual or other legal relationships in line with draft article 1, paragraph 2.

104. It was suggested that the title of the article should be amended to indicate a greater consistency and correlation with its content, which referred expressly to an inability of the conciliator to act as an arbitrator. In that respect it was suggested to entitle the article “Inability of the conciliator to act as arbitrator”. That proposal was not adopted.

105. Subject to the change referred to above (see para. 103), the Commission adopted draft article 13 and referred it to the drafting group.

Arbitrator acting as a conciliator

106. The Commission considered a suggestion to reinstate as a footnote to draft article 13 a provision which read as follows (see A/CN.9/506, para. 130):

“[It is not incompatible with the function of an arbitrator if the arbitrator raises the question of a possible conciliation and, to the extent agreed to by the parties, participates in efforts to reach an agreed settlement.]”

107. In support of that suggestion, it was stated that the laws of a number of countries expressly provided for that practice. The Model Law should not ignore a practice that was accepted as a good practice in many countries. In addition, it was observed that the Working Group had not objected to the content of former draft article 16 but had agreed that it should be dealt with in the Guide, since it more properly belonged in a law on arbitration rather than in a law on conciliation. In that connection, it was said that such an argument was not convincing, since the draft Model Law included several provisions addressing issues relating to arbitration.

108. While there was support for that suggestion, a number of objections were also raised. One objection was that a footnote along the lines of former draft article 16 would be inconsistent with draft article 1, paragraph 8, according to which the draft Model Law did not deal with cases where a judge or arbitrator, in the course of a court or an arbitral proceeding, attempted to facilitate a settlement. Another objection was that such a footnote would be

inconsistent with draft article 13, the principle of which was that a conciliator could not act as an arbitrator. It was mentioned that in some countries a situation dealt with in the proposed provision was viewed as unethical.

109. With a view to reaching a compromise solution, several suggestions were made, including suggestions to include in the draft Model Law a footnote describing the various practices but not a model legislative provision; and to discuss the various practices in the Guide, drawing the attention of countries to the consequences of taking one or the other approach.

110. After discussion, as the Commission decided that former draft article 16 should not be reinstated as a footnote, the Commission reaffirmed the decision of the Working Group that the matter should be discussed in the Guide (see A/CN.9/506, para. 132).

Article 14. Resort to arbitral or judicial proceedings

111. Draft article 14 as considered by the Commission was as follows:

“1. Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specified period of time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with.

“2. A party may nevertheless initiate arbitral or judicial proceedings where, in its sole discretion, it considers such proceedings necessary to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.”

112. While support was expressed for the concept of draft article 14, a number of concerns were also expressed. One concern was that, in allowing parties to resort to arbitral or judicial proceedings at their discretion, paragraph 2 nullified the effect of paragraph 1. In order to address that concern, it was suggested reinstating the structure and approach of former draft article 14 (see A/CN.9/506, para. 124), which would prevent a party from unilaterally initiating arbitral or judicial proceedings when that was contrary to their express agreement. In support of that suggestion, it was stated that a provision along the lines of former draft article 15 would, on the one hand, give effect to express undertakings by parties not to initiate arbitral or judicial proceedings and, on the other hand, allow the parties to resort to arbitral or judicial proceedings in common situations in which the parties agreed to conciliate without concluding a specific agreement not to initiate arbitral or judicial proceedings during a specified period. However, that suggestion was widely opposed. It was stated that the Working Group had considered the matter, found a number of problems with the former draft article 15 (see A/CN.9/506, para. 127) and decided in favour of the approach taken in the current draft article 14 (see A/CN.9/506, para. 129). In addition, it was stated that the decision of the Working

Group was acceptable, since inability of the party to initiate court proceedings in certain situations would discourage parties from entering into conciliation agreements. Moreover, it was said that preventing access to courts even in the case of an express waiver of that right by the parties might raise constitutional law issues in that access to courts was in some jurisdictions regarded as an inalienable right.

113. It was suggested that draft article 14 should address itself only to the parties (as did article 16 of the UNCITRAL Conciliation Rules) and not the arbitral tribunal or the court. That suggestion was not accepted.

114. A suggestion was made that draft Model Law did not go far enough in ensuring the effectiveness of conciliation agreements in that it addressed only express waivers of the right to initiate arbitral or judicial proceedings, while the draft Model Law did not deal with the effectiveness of the more usual conciliation agreements which were not combined with an express waiver of such a right during a specified period of time. According to that suggestion it should be clarified, either in the Model Law or in the Guide, that, when the parties agreed to conciliate, such agreement was binding in the sense that the parties committed themselves to making a good faith attempt to conciliate and that therefore the arbitral or judicial tribunal should stay the proceedings until such a good faith attempt had been made. While there was no fundamental opposition to the idea underlying that suggestion, namely that agreements to conciliate were binding under their own terms, it was observed that agreements to conciliate were drafted in many different ways reflecting a broad spectrum of expectations of parties regarding their behaviour in case of a dispute. It was considered in response that the effect of agreements to conciliate should depend on the manner in which such agreements were interpreted pursuant to the applicable law of contract, which, however, the Model Law did not attempt to unify. Thus, the Commission confirmed its decision made by the Working Group that the Model Law should deal only with the effect of express waivers of the right to initiate arbitral or judicial proceedings and not with the contractual effects of agreements to conciliate with respect to such right.

115. Concern was expressed that paragraph 2, by allowing a party to initiate adversary proceedings “in its sole discretion”, which constituted a purely subjective criterion, could render the rule enshrined in paragraph 1 ineffective. In order to address that concern, it was suggested that the words “in its sole discretion” should be deleted. That suggestion was met with a number of objections. It was stated that, in the absence of such a subjective criterion, a party would run the risk of losing its rights if it were unable to take steps, including the initiation of arbitral or judicial proceedings (including insolvency proceedings). The Commission considered that the draft Model Law should be drafted to control that risk. It was explained that, for that reason, article 16 of the UNCITRAL Conciliation Rules allowed a party to initiate arbitral or judicial proceedings where, “in his opinion”, such proceedings were necessary for preserving his rights. In addition, it was said that, by providing comfort to the parties that they would not run the risk of losing their rights, the Model Law would promote the use of conciliation. Moreover, the opinion was

expressed that deciding what was “necessary” to preserve rights (para. 2) involved judgement not only as a matter of law but also commercial judgement, which could only be left to the subjective assessment of the affected party. It was added that, if the ability of the parties to determine what was commercially necessary for them was taken away from them, they would be inclined to avoid conciliation.

116. Yet another concern was that the juxtaposition of the duty of the court to give effect to the parties’ waiver of the right to initiate arbitral or judicial proceedings and the right of the parties to initiate arbitral or judicial proceedings to preserve their rights gave the impression that paragraph 2 was inconsistent with paragraph 1. In order to address that concern, it was suggested to merge the two paragraphs by adding at the end of paragraph 1 the words “except to the extent necessary for a party, in its opinion”, deleting the words “a party may nevertheless initiate arbitral or judicial proceedings where, in its sole discretion, it considers such proceedings necessary” and adding, after the words “in its opinion”, the words “to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.” In support of that suggestion, it was stated that the suggested revision of draft article 14 would clarify that the right of the parties to resort to arbitral or judicial proceedings was an exception to the duty of arbitral or judicial tribunals to stay any proceeding in the case of a waiver by the parties of the right to initiate arbitral or judicial proceedings. While some doubt was expressed as to whether the words “in its opinion”, which were contained in article 16 of the UNCITRAL Conciliation Rules, had a different meaning from the words “in its sole discretion”, the Commission nevertheless adopted the suggestion. The Commission also noted that some additional clarification of the operation of article 14 should be provided in the Guide.

117. In response to a question, it was explained that article 14 did not refer only to proceedings to obtain provisional measures of protection but also to any action before an arbitral or judicial tribunal, including action taken by a party to preserve its rights before expiration of a prescription period. In the discussion, it was suggested that the Guide should clarify that a party might initiate court or arbitral proceedings also where one of the parties remained passive and thus hindered implementation of the conciliation agreement. On the other hand, it was stated that in such a case the other party could initiate judicial or arbitral proceedings after the conciliation proceedings were terminated pursuant to draft article 12.

118. Subject to the decided change, the Commission adopted draft article 14 and referred it to the drafting group.

Article 15. Enforceability of settlement agreement

119. Draft article 15 as considered by the Commission was as follows:

“If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and

enforceable . . . [the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement].”

120. It was observed that, as referred to in draft article 15, the nature of the settlement agreement was left open-ended. It was suggested that its contractual nature should be indicated in the draft provision. As to the notion of the settlement agreement being “enforceable”, it was also suggested that the draft provision should explain whether the settlement agreement should benefit from some form of expedited recognition of its enforceability, for example by equating a settlement agreement with an arbitral award or a judicial decision.

121. The view was expressed that converting a conciliation settlement into an arbitral award was not acceptable since it would amount to attaching the same status to a contract between two private persons as to a court or arbitral decision. Two possibilities were envisaged: either the conciliation settlement was turned into a “real” arbitral award, with the risk that the proceedings would become far more cumbersome and more expensive for the parties (thus running counter to the whole spirit of conciliation); or else there could be a kind of quasi-automatic equating of the conciliation settlement to an arbitral award, which would entail some degree of exposure to abuse since the contract (conciliation settlement) would not generally be subject to scrutiny by a court of the country in which the settlement was invoked (see A/CN.9/513, comment by France).

122. With a view to enhancing the legal value of settlement agreements, yet preserving all the options that an enacting State might wish to consider in dealing with the issue of enforceability of a settlement agreement, and avoiding the reference to an arbitral award, the following wording was proposed as a substitute for draft article 15: “If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding. The authority of *res judicata* and/or the enforceability of such agreement shall, as appropriate, be recognized or granted by the law or the competent authority of [the country in which the agreement is invoked] [the enacting State]”. No support was expressed for the proposal.

123. The discussion then focused on the opening words of draft article 15 (“If the parties reach and sign an agreement”). It was pointed out that the requirement that the settlement agreement should be signed might be important to facilitate the adduction of evidence regarding the existence and contents of the settlement agreement. A proposal was made that the opening words of draft article 15 should read along the following lines: “The settlement agreement is to be signed if such a signature requirement is necessary to ensure the enforceability under the law of the enacting State”. No support was expressed for the proposal. The prevailing view was that, in line with modern contract law and consistent with the need to facilitate electronic commerce, no writing or signature requirement should be imposed regarding the conclusion of the settlement agreement. After discussion, it was agreed that the opening words of draft article 15 should read as follows: “If the parties conclude an agreement”. It was also agreed that the

Guide should make it clear that the purpose of the Model Law was not to prohibit the laws of the enacting State from imposing form requirements such as a requirement for signature or written form where such a requirement was considered essential.

124. The Commission proceeded to consider the implications of using the words “binding and enforceable”. It was generally agreed that those words were intended to reflect the common understanding that conciliation settlements were contractual in nature. While the word “binding” reflected the creation of a contractual obligation as between the parties to the settlement agreement, the word “enforceable” reflected the nature of that obligation as susceptible to enforcement by courts, without specifying the nature of such enforcement. It was thus agreed that the two words “binding” and “enforceable” served distinct purposes and were not merely repetitious. It was pointed out that the Model Law provided no new regulations concerning the formation of settlement agreements or their enforcement, and left those matters to be determined in accordance with the applicable municipal law. In that connection, it was noted that some States considered settlement agreements to be subject to the same rules of formation and enactment as other commercial contracts, while other States had special regimes regulating those matters, including, in some States, mechanisms for expediting execution of settlements. Accordingly, the Model Law included at the end of article 15 words in italics stating that an enacting State might insert a description or reference to its own system governing enforcement of settlement agreements. It was pointed out, however, that, in certain legal systems or in certain language versions, the word “enforceable” might be interpreted in a manner that suggested a high degree of executability of the settlement agreement, thus deviating from the above-mentioned neutrality. For example, “enforceable” might be construed as indicating that the court would enforce a settlement agreement in a more expeditious way than it would enforce other types of contracts. However, in other legal systems or language versions the words “binding and enforceable” were used simply to refer to the legal value of contracts in general. To avoid any misinterpretation, it was suggested that the word “enforceable” should not be used. Instead, draft article 15 should recognize the right of any party to the settlement agreement to present that agreement before a court to obtain its execution where the applicable law so permitted. Under that suggestion, the Guide could provide examples of procedures that might be used to obtain such execution and list the defences to enforcement that might be admissible. While some support was expressed in favour of that suggestion, the prevailing view was that the issue of enforcement, defences to enforcement, and designation of courts or other authorities from whom enforcement of a settlement agreement might be sought should be left to applicable municipal law.

125. After discussion, the Commission decided that the words “binding and enforceable” should be retained. In those language versions where the word “enforceable” might give rise to ambiguity, it was found that a more neutral wording should be used, along the lines of “susceptible to enforcement”.

126. The Commission adopted the substance of article 15 as amended and referred it to the drafting group.

Continuation of the discussion of article 3

127. Having completed its deliberations regarding the substantive provisions of the draft Model Law, the Commission reverted to the text of article 3, with a view to determining whether provisions in addition to article 2 and article 7, paragraph 3, should be listed as mandatory.

128. The view was expressed that article 14 should be listed among those provisions of the Model Law that were not open to contractual derogation. It was pointed out that, since article 14 had been structured into a rule that operated only where a specific agreement had been concluded between the parties, and an extremely broad range of unilaterally decided exceptions to that rule, it was difficult to imagine how contractual derogations under article 3 would fit in the overall structure of article 14. In the view of other delegations, the reason for listing article 14 as mandatory was that a party should not be permitted to vary the application of a provision that guaranteed what was regarded by those delegations as the constitutional right of the parties to initiate judicial proceedings, irrespective of any undertaking that might have been made not to use that right. Yet another view was that, although article 14 contained provisions of contract law that should be open to contractual derogation, article 14 also contained provisions of procedural law that should be regarded as mandatory.

129. Various views were expressed, however, in favour of not listing article 14 as a mandatory provision. In the view of a number of delegations that criticized the structure and contents of article 14, article 3 provided a welcome opportunity for the parties to set aside the entire mechanism of article 14, thus allowing, for example, those parties to agree on effective undertakings not to initiate judicial proceedings during the conciliation. In the view of other delegations, the preservation of party autonomy required that the parties who had mutually agreed not to initiate judicial proceedings under article 14 should be allowed to come to a different agreement at a later stage. Another view was that article 14 should not be listed as a mandatory provision because it was logically susceptible to derogations.

130. A question was raised regarding the interplay between articles 3 and 14 in circumstances where, for example, the parties had agreed to conciliate, expressly undertaken not to initiate judicial proceedings during a specified period of time, and subsequently terminated the conciliation proceedings before the expiration of that period of time. In such a case, the question might arise whether the parties continued to be bound by their original undertaking not to initiate judicial proceedings or whether that undertaking was modified by the termination of conciliation proceedings. The Commission did not discuss all aspects of that question and it was understood that the result depended on the terms of the commitment not to initiate court proceedings and of any agreement to terminate the conciliation proceedings.

131. After discussion, the Commission decided not to include article 14 among those provisions of the Model Law which could not be excluded or varied by agreement of the parties.

132. The view was expressed that article 15 should be listed among those provisions of the Model Law that were not open to contractual variation. It was stated that, to the extent article 15 established the rule that settlement agreements were binding, no contractual derogation to that rule was logically acceptable. It was also stated that, while no contractual derogation should be allowed regarding the binding nature of the settlement agreement, the parties would remain free to agree that the result of a conciliation process would take a form different from that of a settlement agreement. While some support was expressed in favour of that view, it was pointed out that excluding the possibility of a contractual derogation to article 15 might unduly undermine the right of the parties to agree on a settlement that would have a lesser degree of enforceability than that contemplated in article 15.

133. The view was also expressed that partners often turned to conciliation because of its non-binding nature, using it as a way forward from a dispute. Excluding article 15 from the possibility of variation by the parties would run counter to parties using conciliation for that purpose.

134. After discussion, the Commission decided not to include article 15 among those provisions of the Model Law which could not be excluded or varied by agreement of the parties.

Footnote 1 to draft article 1

135. The proposed draft text for incorporation in footnote 1 of article 1 (by reference to paragraph numbers of article 1 as contained in document A/CN.9/506, annex) as considered by the Commission was as follows:

“1. In article 1, paragraph 1, delete the word “international”.

“Delete paragraph 3* of article 1.

“Delete paragraph 4* of article 1.

“[Delete paragraph 5* of article 1] [Replace paragraph 5 of article 1 with the words “This Law also applies when the parties so agree.”].

“2. Proposed text for inclusion in paragraph 47 of the draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation:

“States that enact this Model Law to apply to domestic as well as international conciliation may wish, in paragraph 5 of article 6, to delete the words “and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties”. Alternatively, such States may wish to modify paragraph 5 of article 6 by replacing the words “and, with respect to a sole or third conciliator,

shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties” with “and, with respect to a sole or third conciliator, shall in the case of an international dispute, take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties” and including a definition of both “international” and “place of business” along the lines of paragraphs 3 and 4 of article 1.”

136. Concern was expressed that, in respect of the proposal concerning paragraph 5 of article 1, the text appearing in the second set of square brackets of the proposed footnote [“This Law applies where the parties so agree.”] should be aligned with the text of paragraph 5 as it would apply in the case of international conciliation, by adding a reference to commercial conciliation: “This Law applies to commercial conciliation where the parties so agree”. Without that addition, it was suggested that the Model Law would apply differently in the two cases; in international conciliation, it would be limited to commercial conciliation, but, where it applied to both domestic and international conciliation, that limitation would not operate.

137. It was observed that the drafting of the proposed text of paragraph 1 of footnote 1 was intended to cover several circumstances where it might be appropriate for the parties to be able to agree to the application of the Model Law. Those circumstances included very informal conciliation proceedings where it was uncertain whether the Model Law would apply under article 1, paragraph 2; conciliation proceedings that were conducted, for example, using electronic means between parties located in a number of different States and in which it was not clear what was the applicable law and whether or not the Model Law would apply; and circumstances where it was not clear whether the dispute would fall within the definition of commercial in article 1. Some support was expressed in favour of such a flexible approach and in favour of retaining the text in the second set of square brackets in paragraph 1 of the proposed footnote.

138. A contrary view was that the Model Law should only apply to commercial conciliation, whether that conciliation was international or domestic, and a reference to commercial conciliation should be included in the text of the footnote as proposed. In that case, the text of the footnote would reflect the text of paragraph 5 of article 1 as earlier adopted by the Commission. It was proposed that the same result could also be achieved by adopting the text appearing in the first set of square brackets in paragraph 1 of the proposed footnote text, resulting in the deletion of paragraph 6 of article 1 where States wished to apply the Model Law to both domestic and international commercial conciliation. Wide support was expressed in favour of the application of the Model Law to commercial conciliation, whether domestic or international, and in favour of the adoption of the text in the first set of square brackets in paragraph 1 of the proposed footnote text. The Commission adopted that approach.

139. A concern was expressed that, where the Model Law was to apply to domestic conciliation, the reference to its international origin in article 2 might not be appropriate. In

*Paragraphs renumbered in Model Law.

response, it was pointed out that that same paragraph appeared in a number of other UNCITRAL texts (for example, the UNCITRAL Model Law on Electronic Commerce) that could apply both domestically and internationally. It was of considerable use in promoting uniform interpretation by reference to international standards even where the text applied domestically. Without such a reference, there was a significant possibility of domestic interpretations differing from the interpretation of the text where it applied internationally, an undesirable result in view of the goal of uniformity.

140. The Commission adopted the substance of the text of the proposed footnote to draft article 1, retaining the text in the first set of square brackets in paragraph 1, and referred it to the drafting group.

D. Adoption of the UNCITRAL Model Law on International Commercial Conciliation

141. The Commission, after consideration of the text of the draft Model Law as revised by the drafting group, adopted the following decision at its 750th meeting, on 24 June 2002:

"The United Nations Commission on International Trade Law,

"Recognizing the value of conciliation or mediation as a method of amicably settling disputes arising in the context of international commercial relations,

"Noting in this connection that the expression 'conciliation' includes mediation and other processes of similar import,

"Convinced that the establishment of a model law on conciliation that is acceptable to States with different legal, social and economic systems would contribute to the development of harmonious international economic relations,

"Believing that the UNCITRAL Model Law on International Commercial Conciliation will significantly assist States in enhancing their legislation governing the use of modern conciliation or mediation techniques and in formulating such legislation where none currently exists,

"Noting that the preparation of the UNCITRAL Model Law on International Commercial Conciliation was the subject of due deliberation and extensive consultation after circulation of the draft text for observations of Governments and interested organizations,

"Convinced that the Model Law, together with the UNCITRAL Conciliation Rules,⁴ recommended by the General Assembly in its resolution 35/52 of 4 December 1980, significantly contributes to the establishment of a unified legal framework for the fair and efficient settlement of disputes arising in international commercial relations,

"1. Adopts the UNCITRAL Model Law on International Commercial Conciliation as it appears in annex I to the report of the United Nations Commission on International Trade Law on its thirty-fifth session;

"2. Requests the Secretary-General to transmit the text of the UNCITRAL Model Law on International Commercial Conciliation, together with travaux préparatoires from the thirty-fifth session of the Commission, and with the Guide to Enactment and Use of the Model Law to be finalized by the Secretariat based on the deliberations of the Commission at that thirty-fifth session, to Governments and to dispute settlement institutions and other interested bodies, such as chambers of commerce;

"3. Recommends that all States give due consideration to the Model Law on International Commercial Conciliation, in view of the desirability of uniformity of the law of dispute settlement procedures and the specific needs of international commercial conciliation or mediation practice."

⁴United Nations publication, Sales No. E.81.V.6."

E. Draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation

142. The Commission entrusted the Secretariat with the finalization of the Guide to Enactment and Use of the Model Law, based on the draft prepared by the secretariat (A/CN.9/514) and on the deliberations of the Commission at its current session. The Secretariat was invited to publish the finalized Guide together with the Model Law. It was generally agreed that, in preparing the final version of the Guide, the Secretariat should take into account the comments and suggestions expressed in the course of the discussion by the Commission but that the Secretariat should have discretion regarding the manner and the extent to which such comments and suggestions should be reflected in the Guide.

143. The Commission proceeded with a detailed review of the draft Guide (A/CN.9/514).

Purpose of the Guide

Paragraphs 1-4

144. The Commission decided that paragraph 4 of the Guide should read along the lines of: "The Commission entrusted the Secretariat with the finalization of the Guide, based on the draft prepared by the Secretariat (A/CN.9/514) and on the deliberations of the Commission at its current session, taking into account comments and suggestions made in the course of discussions by the Commission and other suggestions in the manner and the extent that the Secretariat determined in its discretion. The Secretariat was invited to publish the finalized Guide together with the Model Law."

Notion of conciliation and purpose of the Model Law

Paragraphs 5-10

145. With respect to paragraph 5, it was suggested that, in describing conciliation, the Guide should make it clear that an essential feature of conciliation was that it was based on a request addressed by the parties in dispute to a third party. As to paragraph 7, it was pointed out that, should the notion of “alternative dispute resolution” be used, the Guide should make it clear that the various techniques encompassed under that notion were to be regarded as alternatives to judicial dispute resolution and thus included arbitration. With respect to paragraph 9, it was suggested that the Guide should make it clear that procedural issues such as the admissibility of evidence in judicial or arbitral proceedings were not governed mainly by rules such as the UNCITRAL Conciliation Rules but by applicable statutory law. More generally with respect to paragraphs 5-10, it was suggested that the Guide might need to describe more extensively the attractive features of conciliation as a dispute settlement technique.

The Model Law as a tool for harmonizing legislation

Paragraphs 11 and 12

146. No comment was made in respect of paragraphs 11 and 12.

Background and history

Paragraphs 13-17

147. In the context of paragraph 13, doubts were expressed as to whether the use of “non-adjudicative dispute settlement methods” would increase “stability in the marketplace”. It was suggested that a reference to “cost-effectiveness in the marketplace” might be more accurate. With respect to paragraph 14, it was suggested that stating that “the objectives of the Model Law . . . are essential for fostering economy and efficiency in international trade” might overstate the point. It was suggested that the Guide should state that the objectives of the Model Law were important for fostering economy and efficiency in international trade. As to paragraph 16, the view was expressed that too much emphasis was being placed on the description of arbitration. As to paragraph 17, a question was raised as to the usefulness of providing in the Guide such a level of historical detail. A suggestion was made that the history of the Model Law might be dealt with in tabular form in an annex to the Guide. It was widely agreed in response that a detailed account of the legislative history of the Model Law might be regarded as particularly helpful in certain countries considering enactment of the Model Law. Furthermore, it was pointed out that recording in the body of a guide the detailed history of the text was in line with the practice followed in respect of previous model laws adopted by UNCITRAL and accompanied by a guide to enactment.

Scope

Paragraphs 18 and 19

148. No comment was made in respect of paragraphs 18 and 19.

Structure of the Model Law

Paragraphs 20-23

149. With respect to paragraph 22, it was suggested that the Guide should reflect more clearly that, in structuring the Model Law, the drafters had focused on avoiding information being spilled over from conciliation proceedings into arbitral or court proceedings. No further comment was made on paragraphs 20-23.

Assistance from the UNCITRAL secretariat

Paragraphs 24 and 25

150. No comment was made in respect of paragraphs 24 and 25.

Article 1. Scope of application

Paragraphs 26-35

151. With respect to paragraph 27, it was suggested that the Guide should make it clear that the text of footnote 2 was not intended to provide a definition of the term “commercial”. Instead, that footnote provided an illustrative and open-ended list of relationships that might be described as “commercial” in nature. In the context of paragraphs 29 and 30, it was suggested that, in verifying whether, in a given factual situation, the elements set forth in paragraph 2 of article 1 for the definition of conciliation were met, courts should be invited to consider any evidence of conduct of the parties showing that they were conscious (and had an understanding) of being involved in a process of conciliation. With respect to paragraph 31, it was suggested that the Guide should make it clear that article 1 was not intended to interfere with the operation of the rules of private international law.

152. With respect to paragraph 35, several suggestions were made. One suggestion was that the Guide should make it clear that, in referring to “attempts [by a judge or arbitrator] to facilitate a settlement”, paragraph 8 of article 1 was intended to distinguish between cases where the court or the arbitrator would act as a facilitator and those cases where the court or the arbitrator would act as a conciliator. In the former case, the judge or the arbitrator would take the initiative of acting as facilitator. In that case, the action of the judge or arbitrator acting as facilitator would not be covered by the Model Law. In the latter case, however, the action of the judge or arbitrator as a conciliator would be the result of the request of the parties in dispute and would fall within the scope of the Model Law. Another suggestion was that paragraph 35 should

contain an indication along the following lines: “The Model Law is not intended to indicate whether or not a judge or an arbitrator may conduct conciliation in the course of court or arbitral proceedings.”

153. No further comment was made in respect of paragraphs 26-35.

Article 2. Interpretation

Paragraphs 36 and 37

154. No comment was made in respect of paragraphs 36 and 37.

Article 3. Variation by agreement

Paragraph 38

155. It was suggested that the Guide might need to establish a distinction between the general rule set forth in article 3, under which parties might freely “agree to exclude or vary any of the provisions of [the Model] Law”, and the meaning of the words “unless otherwise agreed”, which had been inserted in certain provisions of the Model Law. Under the suggested distinction, the general rule would simply recognize the possibility for the parties to avoid by contract the application of those provisions of the Model Law that were not specifically established as mandatory by article 3. However, article 3 would not establish the freedom of the parties to create an entirely new set of contractual obligations distinct from those established under the Model Law. The full autonomy of the parties would thus only be recognized by those provisions that were prefaced by the words “unless otherwise agreed”. The suggestion was not adopted by the Commission. It was widely agreed that the Guide should not seek to establish any shade of meaning between article 3 and those provisions prefaced by the words “unless otherwise agreed”. It was agreed that, in both cases, the Model Law was intended to reflect full autonomy of the parties to derogate from the provisions of the Model Law and to create a contractual framework entirely distinct from the provisions of the Model Law. The words “unless otherwise agreed” had been included in certain provisions mainly for educative reasons. It was suggested that the Guide should include wording along the following lines: “The use of the phrase ‘unless otherwise agreed’ does not mean that article 3 does not apply where that phrase does not appear.” No further comment was made in respect of paragraph 38.

Article 4. Commencement of conciliation proceedings

Paragraphs 39-44

156. With respect to paragraph 44, it was suggested that the Guide should alert enacting States to the risks that might result from the adoption of article X. It was generally agreed in response that the Guide should reflect the arguments exchanged both against and in favour of the adoption of article X, as reflected in paragraphs 33 and 34

above. No further comment was made in respect of paragraphs 39-44 of the draft Guide.

Articles 5 and 6. Number and appointment of conciliators

Paragraphs 45-48

157. With respect to paragraph 46, it was pointed out that, as currently drafted, the Guide suggested that conciliation was necessarily conducted between two parties. It was suggested that the final text should reflect the multiparty approach to conciliation adopted by the Commission. With respect to paragraph 47, it was suggested that the words “reference has to be had” connoted an obligation and should be replaced with wording along the lines of “reference may be had”. Another suggestion was that the Guide should make it clear that a failure to disclose facts that might give rise to justifiable doubts within the meaning of paragraph 6 of article 6 should not create a ground for setting aside a settlement agreement that would be additional to the grounds already available under applicable contract law (see para. 50 above). No further comment was made in respect of paragraphs 45-48.

Article 7. Conduct of conciliation

Paragraphs 49-53

158. With respect to paragraph 51, it was suggested that the Guide should reflect that the Model Law set out a standard of conduct to be applied by a conciliator. It was also suggested that the sentence “some concern was expressed that the inclusion of a provision governing the conduct of the conciliation could have the unintended effect of inviting parties to seek annulment of the settlement agreement by alleging unfair treatment” should be deleted since it was unnecessary to advise the parties in that respect. It was recalled that the Commission had agreed that the Guide should make it clear that paragraph 3 of article 7 was intended to govern the conduct of the conciliation proceedings and that it did not address the contents of the settlement agreement (see para. 58 above).

159. It was generally felt that paragraph 52 should be deleted, since there was no need for the Guide to restate the UNCITRAL Conciliation Rules or to discuss the merits of national laws in the context of that article. No further comment was made in respect of paragraphs 49-53.

Article 8. Communication between conciliator and parties

Paragraphs 54 and 55

160. Doubts were expressed as to whether the notion of “equality of treatment” should be used and, more generally, as to whether paragraph 55 should be retained in the Guide. It was recalled in response that paragraph 55 reflected a compromise reached by the Working Group at its thirty-fourth session (A/CN.9/487, para. 129), which the

Commission did not wish to revise. After discussion, it was generally agreed that the substance of paragraph 55 should be relocated in the section of the Guide dealing with paragraph 3 of article 7. No further comment was made in respect of paragraphs 54 and 55.

**Article 9. Disclosure of information
between the parties**

Paragraphs 56 and 57

161. With respect to paragraph 56, the view was expressed that the tone of the last sentence was overly derogatory regarding the practice under which the consent of a party giving information should be sought before any communication of that information might be given to the other party. It was recalled that such practice was widely followed with good results in a number of countries. It was suggested that paragraph 55 should be redrafted to make it clear that, in certain countries, such practice was enshrined in mediation rules. The Model Law provided a recommendation for parties that did not have such a rule and was consistent with the UNCITRAL Conciliation Rules. It was recalled that the Commission had earlier agreed that the Guide should contain a clear recommendation to conciliators that they should inform the parties that information communicated to a conciliator might be disclosed unless the conciliator was informed otherwise (see para. 70 above). It was suggested that paragraph 56 should be redrafted to emphasize the intent to foster candid communication between each party and the conciliator.

162. With respect to the words “the substance of that information”, it was suggested that the Guide should make it clear that the current wording, along the lines of article 10 of the UNCITRAL Conciliation Rules, had been preferred to the words “that information” to avoid burdening the conciliator with an obligation to communicate the literal content of any information received from the parties (see para. 71 above).

163. It was recalled that the title of article 9 had been amended to read “Disclosure of information”. No further comment was made in respect of paragraphs 56 and 57.

Article 10. Duty of confidentiality

Paragraphs 58-60

164. The Commission was reminded of a proposal to delete the words “duty of” from the title and to include an explanation as to the meaning of draft article 10 in the Guide (see para. 76 above).

**Article 11. Admissibility of evidence
in other proceedings**

Paragraphs 61-68

165. The Commission was reminded of the need to adjust the last sentence of paragraph 61 to align it to the text of the draft article as revised.

166. A number of suggestions were made. One suggestion was that in paragraphs 62-67 it should be made clear that draft article 11 provided for two results with respect to admissibility of evidence in other proceedings: an obligation incumbent upon the parties not to rely on the types of evidence specified in article 11; and an obligation of courts to treat such evidence as inadmissible. Another suggestion was that the Guide should clarify that the term “similar proceedings” covered discovery and depositions in countries where such methods of obtaining evidence were used. Yet another suggestion was that in paragraph 67 it should be made clear that statements inadmissible in other proceedings included “documents prepared solely for the conciliation proceedings”.

167. Yet another suggestion was that the Guide should explain that the term “law” in draft article 11, paragraph 3, meant legislation rather than orders by arbitral or judicial tribunals ordering a party to a conciliation, at the request of another party, to disclose the information mentioned in draft article 11, paragraph 1. In support, it was stated that, without such a statement, the confidentiality of information used in conciliation would be seriously compromised, since the second sentence of draft article 11, paragraph 3, seemed to introduce a broad exception to the principle of non-admissibility of such evidence. While it was widely agreed that the term “law” should be given a narrow interpretation, it was noted that orders by a court (such as disclosure orders combined with a threat of sanctions, including criminal sanctions, directed to a party or another person who could give evidence referred to in draft article 11, paragraph 1), were normally based on legislation and that certain types of such orders (in particular, if based on the law of criminal procedure or laws protecting public safety or professional integrity) might be regarded as exceptions to the rule of article 11, paragraph 1. However, it was considered that, when disclosure of evidence was requested by a party so as to support its position in litigation or similar proceedings (without there being overriding public policy interests such as those referred to in paragraph 67 of the draft Guide), the court would be barred from issuing a disclosure order. The Commission requested the Secretariat to express that narrow meaning of the expression “law” in the Guide, recognizing that, in certain systems, the term “law” included not only the texts of statutes, but also court decisions. The examples given in paragraph 67 of the draft Guide were to be reviewed so as to ensure that they would be properly understood in interpreting the last sentence of article 11, paragraph 3.

Article 12. Termination of conciliation

Paragraph 69

168. A number of suggestions were made. One suggestion was that the Guide should explain that States adopting a provision along the lines of draft article X, in the interest of certainty with respect to the time of suspension and resumption of limitation periods, might need to consider requiring a written declaration for the termination of conciliation. It was widely felt that such clarification should be made in the context of the discussion in the Guide of draft article X.

169. Another suggestion was that the Guide should make it clear that conciliation could be terminated by conduct, such as an expression of a negative opinion by a party about the prospects of the conciliation, or refusal of a party to consult or to meet with the conciliator when invited. Some doubt was expressed as to the need to refer to conduct as a way to terminate conciliation, in particular, since in the case of abandonment of the proceedings by a party, the conciliator or the other party could declare them terminated. It was said in reply that conciliation was an informal process and that in some situations it might not be clear whether the parties were involved in settlement negotiations covered by the Model Law and that therefore informal methods of termination (including by conduct) should be allowed. However, it was pointed out that it was in the interest of legal certainty (in particular in regard to subparagraph (d)) that conduct per se, without a statement or action that could be equated with a "declaration", would not terminate conciliation proceedings. Yet another suggestion was that, to the extent a reference to "data message" appeared in the footnote, it should include a clarification of the meaning of the term "data message".

Article 13. Conciliator acting as arbitrator

Paragraphs 70-74

170. One suggestion was that it should be made clear that, while in some legal systems conciliators were permitted to act as arbitrators if parties so agreed and, in other legal systems, that was subject to rules in the nature of codes of conduct, the draft Model Law was neutral on that point. Another suggestion was that, in any event, the agreement of the parties and the conciliator should be able to override any such limitation, even where the matter was subject to rules in the nature of codes of conduct. A further suggestion was that it should be made clear that draft article 13 did not deal with situations in which arbitrators acted as conciliators, which was permitted in some legal systems. Yet another suggestion was that considerations governing a conciliator acting as an arbitrator might be relevant also in situations where a conciliator acted as a judge, and it was recalled that those situations were not addressed in the draft Model Law because they were rarer and because their regulation might interfere with national rules governing the judiciary. It was proposed mentioning those situations in the Guide so that enacting States would consider whether any special rule was needed in the context of their national rules governing the judiciary.

Article 14. Resort to arbitral or judicial proceedings

Paragraphs 75 and 76

171. Paragraphs 75 and 76 were not commented upon.

Article 15. Enforceability of settlement agreement

Paragraphs 77-81

172. A number of suggestions were made. One suggestion was that paragraphs 79 and 80 should be deleted, since

such detail was not necessary and could cause confusion. That suggestion was objected to. It was stated that paragraphs 79 and 80 appropriately gave examples of ways in which settlement agreements could be enforced, in particular since draft article 15 left that matter to law applicable outside the draft Model Law. It was suggested that examples based on legislation of only two countries did not give a picture of the variety of approaches found in international practices and therefore should not be included. It was also observed that references to the laws of certain countries in paragraph 81 needed to be reviewed and corrected. Another suggestion was that paragraph 81 should be revised to avoid inadvertently giving the impression that draft article 15 was the result of an unhappy compromise.

Use of conciliation in multiparty situations

173. In order to emphasize the importance of conciliation in multiparty situations (and, inter alia, in cases of corporate insolvency), it was suggested that wording along the following lines should be included in the Guide:

"Experience in some jurisdictions suggests that the Model Law would also be useful to foster the non-judicial settlement of disputes in multiparty situations, especially those where interests and issues are complex and multilateral rather than bilateral. Notable examples of these are disputes arising during insolvency proceedings or disputes whose resolution is essential to avoid the commencement of insolvency proceedings. Such disputes involve issues among creditors or classes of creditors and the debtor or among creditors themselves, a situation often compounded by disputes with debtors or contracting parties of the insolvent debtor. These issues may arise, for example, in connection with the content of a reorganization plan for the insolvent company; claims for avoidance of transactions that result from allegations that a creditor or creditors were treated preferentially; and issues between the insolvency administrator and a debtor's contracting party regarding the implementation or termination of a contract and the issue of compensation in such situations."

174. Support was expressed for that suggestion. It was stated that conciliation was being used with success in the case of complex, multiparty disputes. The example was given of conciliation before and after commencement of insolvency proceedings. It was observed that one of the benefits of the settlement of disputes through conciliation was the avoidance of insolvency. It was also said that, without overriding the insolvency proceedings, conciliation often usefully supplemented them, in particular in the case of reorganization. In addition, it was observed that, in many countries, insolvency courts were not prevented from attempting to facilitate a settlement. It was agreed that the text for the Guide should be carefully drafted, drawing attention to the need that conciliation proceedings should not interfere with the objectives of insolvency proceedings as expressed by the law governing such insolvency proceedings.

175. However, concern was expressed that such a detailed reference to the use of conciliation in insolvency

proceedings could inadvertently give the impression that the application of conciliation was somehow limited. In order to address that concern, the suggestion was made that the proposed paragraph should be included in the footnote to the Model Law that contained the definition of the term “commercial”. There was no support for that suggestion. The suggestion was also made that reference should be made to other examples, such as disputes arising in the context of construction contracts, syndicated loans, franchising and distribution agreements and co-insurance policies. While interest was expressed in that suggestion, a note of caution was struck that having another list next to the practices listed as being commercial might cause confusion.

176. In response to a question, it was noted that the reference to multiparty relations might fit into the discussion on draft article 1.

177. After discussion, the Commission agreed to include in the Guide a reference to the use of conciliation in multiparty relations, taking into account the views and concerns expressed.

IV. ARBITRATION

178. At its thirty-second session, in 1999, the Commission had before it a note by the Secretariat entitled “Possible future work in the area of international commercial arbitration” (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.²

179. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration, and decided that the priority items for the Working Group should be conciliation,³ requirement of written form for the arbitration agreement,⁴ enforceability of interim measures of protection⁵ and possible enforceability of an award that had been set aside in the State of origin.⁶

180. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction

and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”) (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (i)); and the power of the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to “online” arbitrations (that is, arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁷

181. At its thirty-fourth session, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely the requirement of the written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.⁸

182. At its current session, the Commission took note with appreciation of the report of the Working Group on the work of its thirty-sixth session (A/CN.9/508). The Commission commended the Working Group for the progress accomplished thus far regarding the issues under discussion, namely the requirement of written form for the arbitration agreement and the issues related to interim measures of protection.

183. With regard to the requirement of written form for the arbitration agreement, the Commission noted that the Working Group had considered the draft model legislative provision revising article 7, paragraph 2, of the Model Law

²See *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, para. 337.

³*Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, paras. 340-343.

⁴*Ibid.*, paras. 344-350.

⁵*Ibid.*, paras. 371-373.

⁶*Ibid.*, paras. 374 and 375.

⁷*Ibid.*, *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, para. 396.

⁸*Ibid.*, *Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3)*, para. 312.

on Arbitration (A/CN.9/WG.II/WP.118, para. 9) and discussed a draft interpretative instrument regarding article II, paragraph 2, of the 1958 New York Convention (paras. 25 and 26). The Commission noted that the Working Group had not reached consensus on whether to prepare an amending protocol or an interpretative instrument to the New York Convention and that both options should be kept open for consideration by the Working Group or the Commission at a later stage. The Commission noted the decision of the Working Group to offer guidance on interpretation and application of the writing requirements in the New York Convention with a view to achieving a higher degree of uniformity. A valuable contribution to that end could be made in the guide to enactment of the draft new article 7 of the UNCITRAL Model Law on Arbitration, which the Secretariat was requested to prepare for future consideration by the Working Group, by establishing a "friendly bridge" between the new provisions and the New York Convention, pending a final decision by the Working Group on how best to deal with the application of article II, paragraph 2, of the Convention (A/CN.9/508, para. 15). The Commission was of the view that member and observer States participating in the Working Group's deliberations should have ample time for consultations on those important issues, including the possibility of examining further the meaning and effect of the more-favourable-right provision of article VII of the New York Convention, as noted by the Commission at its thirty-fourth session.⁹ For that purpose, the Commission considered that it might be preferable for the Working Group to postpone its discussions regarding the requirement of written form for the arbitration agreement and the New York Convention until its thirty-eighth session, in 2003.

184. With regard to the issues related to interim measures of protection, the Commission noted that the Working Group had considered a draft text for a revision of article 17 of the Model Law (A/CN.9/WG.II/WP.119, para. 74) and that the Secretariat had been requested to prepare revised draft provisions, based on the discussion in the Working Group, for consideration at a future session. It was also noted that a revised draft of a new article prepared by the Secretariat for addition to the Model Law regarding the issue of enforcement of interim measures of protection ordered by an arbitral tribunal (para. 83) would be considered by the Working Group at its thirty-seventh session (A/CN.9/508, para. 16).

V. INSOLVENCY LAW

185. At its thirty-second session, in 1999, the Commission had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. According to that proposal, the Commission, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, was an appropriate forum for the discussion of insolvency law issues. The Commission was urged in that proposal to consider entrusting

a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

186. The Commission recognized the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a "front-line" factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

187. To facilitate such further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session.¹⁰ That session was held in Vienna from 6 to 17 December 1999.

188. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Working Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

189. It was agreed that, in carrying out its task, the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund, the Asian Development Bank, the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the UNCITRAL secretariat, in cooperation with INSOL and IBA, organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium at Vienna, from 4 to 6 December 2000.¹¹

190. At its thirty-fourth session, in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

⁹Ibid., para. 313.

¹⁰Ibid., *Fifty-fourth Session, Supplement No. 17 (A/54/17)*, paras. 381-385.

¹¹Ibid., *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 400-409.

The Commission took note of the report with satisfaction and commended the work accomplished thus far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and the interpretation of the mandate given to the Working Group by the Commission at its thirty-third session.

191. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.¹²

192. At its current session, the Commission noted with appreciation the reports of the Working Group on the work of its twenty-fourth (A/CN.9/504), twenty-fifth (A/CN.9/507) and twenty-sixth sessions (A/CN.9/511). The Commission commended the Working Group for the progress accomplished thus far in developing the legislative guide and stressed the importance of continued cooperation with intergovernmental and non-governmental organizations having expertise and interest in insolvency law.

193. With respect to the treatment of security interests in insolvency proceedings, the Commission emphasized the need for a consistent approach by Working Groups V (Insolvency Law) and VI (Security Interests). In that connection, the Commission noted with satisfaction that the Working Groups had already coordinated their work and had agreed on principles for treating issues of common concern (see A/CN.9/511, paras. 126 and 127, and A/CN.9/512, paras. 88-90). The Commission stressed the need for continued coordination and requested the Secretariat to consider organizing a joint session of the two Working Groups in December 2002.

194. The Commission also noted that, at its twenty-sixth session, Working Group V (Insolvency Law) had discussed the likely timing for the completion of its work and had considered that it would be in a better position to make a recommendation to the Commission after its twenty-seventh session (Vienna, 9-13 December 2002) when it would have the opportunity to review a further draft of the legislative guide. The Commission requested the Working Group to continue the preparation of the legislative guide and to consider its position with respect to completion of its work at its twenty-seventh session.

Judicial colloquiums

195. The Commission also noted the report of the 4th Multinational Judicial Colloquium on Cross-Border Insolvency (London, 16-17 July 2001) that the secretariat and INSOL had jointly organized (A/CN.9/518). It was noted that over 60 judges and government officials from 29 States had attended the Colloquium. It was also noted that the Colloquium had considered the progress of adoption of the UNCITRAL Model Law on Cross-Border Insolvency by States and the application of legislation enacting the Model Law to cross-border insolvency issues, as well as aspects of judicial training and education. In addition, it was noted that the Colloquium had provided an opportunity for judges to further their understanding of the various national approaches to cross-border insolvency issues.

196. The Commission further noted that participants in the Colloquium had generally recognized the need for continued judicial education and training to ensure proper and efficient functioning not only of the regime for cross-border insolvency issues, but also for insolvency laws in general. It was suggested that training and education programmes should be based upon an assessment of needs that would enable the programmes and their delivery to be tailored to the requirements (legal, social and cultural) of the local jurisdiction and be compatible with its budget, the caseload demands of judges and the availability of international assistance, including both financial and human resources.

197. The Commission expressed its satisfaction to the UNCITRAL secretariat for organizing the Multinational Judicial Colloquium and requested the secretariat to continue cooperating actively with INSOL and other organizations with a view to organizing further such colloquiums in the future, to the extent its resources permitted. The Commission also agreed that the participation of judges from developing countries was particularly important and requested the secretariat to explore ways of facilitating their participation in future colloquiums, as well as organizing regional or national colloquiums, in cooperation with organizations that might be able to cover expenses of participating judges from developing countries. The Commission also expressed the hope that Governments would reserve funds necessary for delegating judges to such events in view of the potential benefits that would result therefrom in terms of enhanced knowledge and improved court practices in insolvency matters.

VI. SECURITY INTERESTS

198. At its thirty-third session, in 2000, the Commission considered a report of the Secretary-General on possible future work in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that the issue of security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the

¹²Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), paras. 296-308.

cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries, and in the share such parties had in the benefits of international trade. A note of caution was struck in that regard, however, to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be coordinated with efforts on insolvency law.¹³

199. At its thirty-fourth session, in 2001, the Commission considered a note by the Secretariat on security interests (A/CN.9/496). At that session, the Commission agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macroeconomic benefits. In the short term, namely when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security interests could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.¹⁴

200. While some concerns were expressed with respect to the feasibility of work in the field of secured credit law, the Commission noted that those concerns were not widely shared and went on to consider the scope of work.¹⁵ It was widely felt that work should focus on security interests in goods involved in a commercial activity, including inventory. It was also agreed that securities and intellectual property should not be dealt with.¹⁶ As to the form of work, the Commission considered that a model law might be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include, where feasible, model legislative provisions.¹⁷ After discussion, the Commission decided to entrust a working group with the task of

developing an efficient legal regime for security interests in goods involved in a commercial activity, including inventory. Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry, the Commission recommended that a two- to three-day colloquium should be held.¹⁸ The colloquium was held in Vienna from 20 to 22 March 2002. The report of the colloquium is contained in document A/CN.9/WG.VI/WP.3.

201. At its current session, the Commission had before it the report of Working Group VI (Security Interests) on the work of its first session (A/CN.9/512). The Commission commended the Secretariat for having prepared a first, preliminary draft of a legislative guide on secured transactions (A/CN.9/WG.VI/WP.2 and Adds. 1-12), for having organized, in cooperation with the Commercial Finance Association, an international colloquium on secured transactions at Vienna from 20 to 22 March 2002, and for having prepared the report on the colloquium (A/CN.9/WG.VI/WP.3).

202. At the outset, the Commission expressed its appreciation to the Working Group for the progress made in its work and in particular for having considered chapters I through V and X of the draft Guide. It was widely felt that, with the legislative guide, the Commission had a great opportunity to assist States in adopting modern secured transactions legislation, which was generally thought to be a necessary, albeit not sufficient in itself, condition for increasing access to low-cost credit, thus facilitating the cross-border movement of goods and services, economic development and ultimately friendly relations among nations. In that connection, the Commission noted with satisfaction that the project had attracted the attention of international, governmental and non-governmental organizations and that some of these had taken an active part in the deliberations of the Working Group. The comments submitted to Working Group VI in particular by the European Bank for Reconstruction and Development (A/CN.9/WG.VI/WP.4) were mentioned as an indication of that interest.

203. In addition, the feeling was widely shared that the timing of the Commission's initiative was most opportune both in view of the relevant legislative initiatives under way at the national and the international level and in view of the Commission's own initiative in the field of insolvency law. In that connection, the Commission noted with particular satisfaction the efforts undertaken by Working Group VI and Working Group V (Insolvency Law) towards coordinating their work on a subject of common interest such as the treatment of security interests in the case of insolvency proceedings. Strong support was expressed for such coordination, which was generally thought to be of crucial importance for providing States with comprehensive and consistent guidance with respect to the treatment of security interests in insolvency proceedings. The Commission endorsed a suggestion made to revise chapter X of the draft legislative guide on secured transactions in light of the core principles agreed by Working Groups V and VI (see A/CN.9/511, paras. 126 and 127, and A/CN.9/512, paras. 88-90). The Commission stressed the need for

¹³Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 459.

¹⁴Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 351.

¹⁵Ibid., paras. 352-354.

¹⁶Ibid., paras. 355 and 356.

¹⁷Ibid., para. 357.

¹⁸Ibid., paras. 358 and 359.

continued coordination and requested the Secretariat to consider organizing a joint session of the two Working Groups in December 2002.

204. After discussion, the Commission confirmed the mandate given to Working Group VI (Security Interests) at its thirty-fourth session to develop an efficient legal regime for security interests in goods, including inventory.¹⁹ The Commission also confirmed that the mandate of the Working Group should be interpreted widely to ensure an appropriately flexible work product, which should take the form of a legislative guide.

VII. ELECTRONIC COMMERCE

205. At its thirty-fourth session, in 2001, the Commission endorsed a set of recommendations for future work that had been made by the Working Group on Electronic Commerce at its thirty-eighth session (New York, 12-23 March 2001).²⁰ They included the preparation of an international instrument dealing with selected issues on electronic contracting and consideration of three other topics, namely: (a) a comprehensive survey of possible legal barriers to the development of electronic commerce in international instruments; (b) a further study of the issues related to transfer of rights, in particular rights in tangible goods, by electronic means and mechanisms for publicizing and keeping a record of acts of transfer or the creation of security interests in such goods; and (c) a study discussing the UNCITRAL Model Law on International Commercial Arbitration, as well as the UNCITRAL Arbitration Rules, to assess their appropriateness for meeting the specific needs of online arbitration (see A/CN.9/484, para. 134).

206. At its current session, the Commission took note of the report of the Working Group on the work of its thirty-ninth session (A/CN.9/509), which was held in New York from 11 to 15 March 2002. The Commission noted with appreciation that the Working Group had started its consideration of a possible international instrument dealing with selected issues on electronic contracting. The Commission reaffirmed its belief that an international instrument dealing with certain issues of electronic contracting might be a useful contribution to facilitate the use of modern means of communication in cross-border commercial transactions. The Commission commended the Working Group for the progress made in that regard. However, the Commission also took note of the varying views that were expressed within the Working Group concerning the form and scope of the instrument, its underlying principles and some of its main features. The Commission noted, in particular, the proposal that the Working Group's considerations should not be limited to electronic contracts, but should apply to commercial contracts in general, irrespective of the means used in their negotiation. The Commission was of the view that member and observer States participating in the Working Group's deliberations should have ample time for consultations on those important issues. For that purpose, the

Commission considered that it might be preferable for the Working Group to postpone its discussions on a possible international instrument dealing with selected issues on electronic contracting until its forty-first session, in 2003.

207. The Commission took note of the progress made thus far by the Secretariat in connection with a survey of possible legal barriers to the development of electronic commerce in international trade-related instruments. The Commission reiterated its belief concerning the importance of that project and its support for the efforts of the Working Group and the Secretariat in that respect. The Commission requested the Working Group to devote most of its time at its fortieth session, in October 2002, to a substantive discussion of various issues relating to legal barriers to electronic commerce that had been raised in the Secretariat's initial survey (A/CN.9/WG.IV/WP.94).

208. The Commission was informed, in that connection, that the Secretariat had invited member and observer States to submit written comments on that project and requested international organizations, including organizations of the United Nations system and other intergovernmental organizations, to offer their views to the Secretariat as to whether there were international trade instruments, in respect of which those organizations or their member States acted as depositaries, that those organizations would wish to be included in the survey. The Commission invited member and observer States, as well as international intergovernmental and interested non-governmental organizations, to submit their comments to the Secretariat at their earliest convenience. The views of member and observer States, as well as the comments from other international organizations, were said to be particularly important to ensure that the survey being conducted by the Secretariat would reflect trade-related instruments emanating from the various geographical regions represented on the Commission.

209. The Commission affirmed its understanding that all topics referred to in paragraph 205 above should remain under consideration by the Working Group as items of its short- and medium-term work programmes. As had already been indicated at the Commission's thirty-third session, the work to be carried out by the Working Group could involve consideration of several topics in parallel as well as preliminary discussion of the contents of possible uniform rules on certain aspects of the above-mentioned topics.²¹ With respect to the issue of online dispute resolution, the Commission received information on the work under way or currently being considered in other international organizations. The Commission requested the Secretariat to continue monitoring closely such activities, with a view to developing suggestions, when appropriate, for future work by UNCITRAL in that field.

VIII. TRANSPORT LAW

210. At its twenty-ninth session, in 1996,²² the Commission considered a proposal to include in its work programme a review of current practices and laws in the area

¹⁹Ibid., para. 358.

²⁰Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), paras. 291-293.

²¹Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 387.

²²Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), para. 210.

of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.²³

211. The Commission had been informed that existing national laws and international conventions had left significant gaps regarding various issues. Those gaps constituted an obstacle to the free flow of goods and increased the cost of transactions. The growing use of electronic means of communication on the carriage of goods further aggravated the consequences of fragmentary and disparate laws and also created the need for uniform provisions addressing the issues particular to the use of new technologies.²²

212. The Commission also decided that the secretariat should gather information, ideas and opinions as to the problems that arose in practice and possible solutions to those problems, so as to be able to present a report to the Commission at a later stage. It was agreed that such information-gathering should be broadly based and should include, in addition to Governments, the international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the *Comité Maritime International* (CMI), the International Chamber of Commerce, the International Union of Marine Insurance, the International Federation of Freight Forwarders Associations, the International Chamber of Shipping and the International Association of Ports and Harbors.²⁴

213. At its thirty-first session, in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the Secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information.²⁵

214. At the thirty-second session of the Commission, in 1999, it was reported on behalf of CMI that a CMI working group had been instructed to prepare a study on a broad range of issues in international transport law with the aim of identifying the areas where unification or harmonization was needed by the industries involved.²⁶

215. It was also reported that the CMI working group had sent a questionnaire to all CMI member organizations covering a large number of legal systems. The intention of CMI, once the replies to the questionnaire had been received, was to create an international subcommittee to analyse the data and find a basis for further work towards harmonizing the law in the area of international transport of goods. The Commission had been assured that CMI would provide it with assistance in preparing a universally acceptable harmonizing instrument.²⁷

216. At its thirty-third session, in 2000, the Commission had before it a report of the Secretary-General on possible future work in transport law (A/CN.9/476), which

described the progress of the work carried out by CMI in cooperation with the Secretariat. It also heard an oral report on behalf of CMI that the CMI working group had, in cooperation with the Secretariat, launched an investigation based on the questionnaire. It was also noted that, at the same time, a number of round-table meetings had been held in order to discuss features of the future work with international organizations representing various industries. Those meetings showed the continued support for and interest of the industry in the project.

217. In conjunction with the thirty-third session of the Commission, a transport law colloquium, organized jointly by the secretariat and CMI, was held in New York on 6 July 2000. The purpose of the colloquium was to gather ideas and expert opinions on problems that arose in the international carriage of goods, in particular the carriage of goods by sea, identifying issues in transport law on which the Commission might wish to consider undertaking future work and, to the extent possible, suggesting possible solutions. On the occasion of that colloquium, a majority of speakers acknowledged that existing national laws and international conventions left significant gaps regarding issues such as the functioning of a bill of lading and a seaway bill, the relationship of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provided financing to a party to a contract of carriage. There was general consensus that, with the changes wrought by the development of multimodalism and the use of electronic commerce, the transport law regime was in need of reform to regulate all transport contracts, whether applying to one or more modes of transport and whether the contract was made electronically or in writing.

218. At its thirty-fourth session, in 2001, the Commission had before it a report of the Secretary-General (A/CN.9/497) that had been prepared pursuant to the request by the Commission. That report summarized the considerations and suggestions that had resulted thus far from the discussions in the CMI International Subcommittee. The purpose of the report was to enable the Commission to assess the thrust and scope of possible solutions and decide how it wished to proceed. The issues described in the report that would have to be dealt with in the future instrument included the following: the scope of application of the instrument; the period of responsibility of the carrier; the obligations of the carrier; the liability of the carrier; the obligations of the shipper; transport documents; freight; delivery to the consignee; right of control of parties interested in the cargo during carriage; transfer of rights in goods; the party that had the right to bring an action against the carrier; and time bar for actions against the carrier.

219. The report suggested that consultations conducted by the Secretariat pursuant to the mandate it received from the Commission in 1996 indicated that work could usefully commence towards an international instrument, possibly having the nature of an international treaty, that would modernize the law of carriage, take into account the latest developments in technology, including electronic commerce, and eliminate legal difficulties in the international transport of goods by sea that were identified by the Commission.

²³Ibid., para. 210.

²⁴Ibid., para. 215.

²⁵Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), para. 264.

²⁶Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 413.

²⁷Ibid., para. 415.

220. At its thirty-fourth session, the Commission decided to entrust the project to the Working Group on Transport Law.²⁸

221. As to the scope of the work, the Commission, after some discussion, decided that the working document to be presented to the Working Group should include issues of liability. The Commission also decided that the considerations in the Working Group should initially cover port-to-port transport operations; however, the Working Group would be free to study the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations, and, depending on the results of those studies, recommend to the Commission an appropriate extension of the Working Group's mandate. It was stated that solutions embraced in the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991) should also be carefully taken into account. It was also agreed that the work would be carried out in close cooperation with interested intergovernmental bodies involved in work on transport law (such as the United Nations Conference on Trade and Development (UNCTAD), the Economic Commission for Europe (ECE) and other regional commissions of the United Nations, and the Organization of American States, as well as international non-governmental organizations.²⁸

222. At its current session, the Commission had before it the report of the ninth session of the Working Group on Transport Law, held in New York from 15 to 26 April 2002, at which the consideration of the project commenced (A/CN.9/510). At that session, the Working Group undertook a preliminary review of the provisions of the draft instrument on transport law, contained in the annex to the note by the Secretariat (A/CN.9/WG.III/WP.21). The Working Group had before it also the comments prepared by ECE and UNCTAD, which were reproduced in an addendum to the note by the Secretariat (A/CN.9/WG.III/WP.21/Add.1, annexes I and II). In the absence of sufficient time, the Working Group did not complete its consideration of the draft instrument, which was left for finalization at its tenth session. The Commission noted that the Secretariat had been requested to prepare revised provisions of the draft instrument based on the deliberations and decisions of the Working Group (A/CN.9/510, para. 21). The Commission expressed appreciation for the work that had already been accomplished by the Working Group.

223. The Commission noted that the Working Group, conscious of the mandate given to it by the Commission (and in particular of the fact that the Commission had decided that the deliberations of the Working Group should initially cover port-to-port transport operations, but that it would be free to consider the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations), had adopted the view

that it would be desirable to include within its discussions also door-to-door operations and to deal with those operations by developing a regime that resolved any conflict between the draft instrument and provisions governing land carriage in cases where sea carriage was complemented by one or more land carriage segments (for the deliberations of the Working Group on the issue of the scope of the draft instrument, see A/CN.9/510, paras. 26-32). It was also noted that the Working Group considered that it would be useful for it to continue its discussions on the draft instrument under the provisional working assumption that it would cover door-to-door transport operations. Consequently, the Working Group had requested the Commission to approve that approach (A/CN.9/510, para. 32).

224. With respect to the scope of the draft instrument, strong support was expressed by a number of delegations in favour of the working assumption that the scope of the draft instrument should extend to door-to-door transport operations. It was pointed out that harmonizing the legal regime governing door-to-door transport was a practical necessity, in view of the large and growing number of practical situations where transport (in particular transport of containerized goods) was operated under door-to-door contracts. While no objection was raised against such an extended scope of the draft instrument, it was generally agreed that, for continuation of its deliberations, the Working Group should seek participation from international organizations such as the International Road Transport Union, the Intergovernmental Organisation for International Carriage by Rail, and other international organizations involved in land transportation. The Working Group was invited to consider the dangers of extending the rules governing maritime transport to land transportation and to take into account, in developing the draft instrument, the specific needs of land carriage. The Commission also invited member and observer States to include land transport experts in the delegations that participated in the deliberations of the Working Group. The Commission further invited Working Groups III (Transport Law) and IV (Electronic Commerce) to coordinate their work in respect of dematerialized transport documentation. While it was generally agreed that the draft instrument should provide appropriate mechanisms to avoid possible conflicts between the draft instrument and other multilateral instruments (in particular those instruments that contained mandatory rules applicable to land transport), the view was expressed that avoiding such conflicts would not be sufficient to guarantee the broad acceptability of the draft instrument unless the substantive provisions of the draft instrument established acceptable rules for both maritime and land transport. The Working Group was invited to explore the possibility of the draft instrument providing separate yet interoperable sets of rules (some of which might be optional in nature) for maritime and road transport. After discussion, the Commission approved the working assumption that the draft instrument should cover door-to-door transport operations, subject to further consideration of the scope of application of the draft instrument after the Working Group had considered the substantive provisions of the draft instrument and come to a more complete understanding of their functioning in a door-to-door context.

²⁸Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 345.

IX. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

225. At its thirty-third session, in 2000, the Commission adopted the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, consisting of the legislative recommendations (A/CN.9/471/Add.9), with the amendments adopted by the Commission at that session and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the Secretariat was authorized to finalize in the light of the deliberations of the Commission.²⁹ The Legislative Guide was published in all official languages in 2001.

226. The Commission also considered a proposal for future work in that area. It was suggested that, although the Legislative Guide would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure, it would be nevertheless desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues.³⁰

227. After consideration of that proposal, the Commission decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the Legislative Guide should be considered by the Commission at its thirty-fourth session, in 2001. In order to assist the Commission in making an informed decision on the matter, the Secretariat was requested to organize a colloquium, in cooperation with other interested international organizations or international financial institutions, to disseminate knowledge about the Legislative Guide.³¹

228. A Colloquium under the title "Privately Financed Infrastructure: Legal Framework and Technical Assistance" was organized with the co-sponsorship and organizational assistance of the Public-Private Infrastructure Advisory Facility, a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. It was held from 2 to 4 July 2001 in Vienna, during the second week of the thirty-fourth session of the Commission.

229. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the results of the Colloquium as summarized in a note by the Secretariat (A/CN.9/488). The Commission expressed its gratitude to the Public-Private Infrastructure Advisory Facility for its financial and organizational support, and to the various international intergovernmental and non-governmental organizations represented and the speakers who participated in the Colloquium.

230. The Commission considered the desirability and feasibility of further work of the Commission in the field of

privately financed infrastructure projects.³² After discussion, the Commission agreed that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work in the field of privately financed infrastructure projects was to be accomplished within a reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the Legislative Guide. Accordingly, it was agreed that the first session of such a working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the Legislative Guide, could be formulated.³³

231. The Working Group, named Working Group I (Privately Financed Infrastructure Projects), held its fourth session (the first devoted to that item), in Vienna from 24 to 28 September 2001. The Working Group decided to use the legislative recommendations contained in the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects as a basis for its deliberations.

232. In accordance with a suggestion that had been made at the Colloquium (A/CN.9/488, para. 19), the Working Group was invited to devote its attention to a specific phase of infrastructure projects, namely the selection of the concessionaire, with a view to formulating specific drafting proposals for legislative provisions. Nevertheless, the Working Group was of the view that model legislative provisions on various other topics might be desirable (see A/CN.9/505, paras. 18-174). The Working Group requested the Secretariat to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on its deliberations and decisions, to be presented to the fifth session of the Working Group for review and further discussion.

233. At its current session, the Commission noted with appreciation the report of the Working Group on the work of its fourth session (A/CN.9/505). The Commission commended the Working Group and the Secretariat for the progress accomplished thus far in developing a set of draft model legislative provisions for the legislative guide. The Commission requested the Working Group to review the draft model legislative provisions with a view to completing its work at its fifth session. It was stated that early finalization of the draft model legislative provisions by the Working Group would facilitate timely distribution of the draft model legislative provisions to States and organizations for comments and their consideration for adoption by the Commission, as an addendum to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, at its thirty-sixth session, in 2003.

X. MONITORING IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION

234. It was noted that the Commission, at its twenty-eighth session, in 1995, had approved the project,

²⁹*Ibid.*, Fifty-fifth Session, Supplement No. 17 (A/55/17), paras. 195-372.

³⁰*Ibid.*, para. 375.

³¹*Ibid.*, para. 379.

³²*Ibid.*, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), paras. 366-368.

³³*Ibid.*, para. 369.

undertaken jointly with Committee D of IBA, aimed at monitoring the legislative implementation of the New York Convention.³⁴ It was also noted that the purpose of the project, as approved by the Commission, was limited to that aim and, in particular, that its purpose was not to monitor individual court decisions applying the Convention. Moreover, it was noted that, as at the beginning of the current session of the Commission, the Secretariat had received 61 replies to the questionnaire sent to the States parties to the Convention (of a current total of 130 States parties) relating to the legal regime in those States governing the recognition and enforcement of foreign awards.

235. The Commission urged the Secretariat to intensify its efforts to obtain information necessary for preparing the report and for that purpose to recirculate the questionnaire to the States parties to the Convention that had not yet replied to the questionnaire, requesting them to reply as soon as possible or, to the extent necessary, to inform the Secretariat about any new developments since their previous replies to the questionnaire. The Secretariat was also urged to obtain information from other sources, in particular intergovernmental and non-governmental organizations. After discussion, the Secretariat was requested to prepare, for a future session of the Commission, a note presenting the findings based on the analysis of the information gathered, which could be updated.

236. In the discussion on the importance of the project, the Commission's attention was drawn to the example of the cotton industry. As noted in a recent letter to the Secretariat from the International Cotton Advisory Committee, an intergovernmental organization of States having an interest in the production, export, import and consumption of cotton, in 2001 about two thirds of all arbitral awards issued in conjunction with international trade in cotton were ignored by the party at fault and that fact undermined confidence in the cotton trading system and imposed costs throughout the cotton chain. It was widely felt that non-compliance with arbitral awards was a serious matter that required immediate attention since it could undermine the efficiency of arbitration and the reliability of contracts, which could seriously disrupt international trade. In that connection, it was emphasized that there was a need for increased efforts by the Commission in the field of training and assistance and that judicial colloquiums could usefully be held in order to foster an exchange of views among judges as to the interpretation and the application of the Convention. It was noted that additional secretariat resources could be devoted to that effort only if the secretariat of the Commission was strengthened (for the continuation of the discussion on the issue of the strengthening of the secretariat of the Commission, see paras. 258-271, below).

XI. ENLARGEMENT OF THE MEMBERSHIP OF THE COMMISSION

237. The Commission took note of General Assembly decision 56/422 of 12 December 2001, by which the

Assembly, on the recommendation of the Sixth Committee and after having considered a report of the Secretary-General (A/56/315), decided to defer consideration of and a decision on the enlargement of the membership of the Commission until its fifty-seventh session, under the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session".

238. It was generally agreed that the membership of the Commission should be enlarged as soon as possible. Recalling a similar discussion at its thirty-fourth session,³⁵ the Commission generally felt that such an enlargement of the Commission would ensure that the Commission remained representative of all legal traditions and economic systems, in particular in view of the substantial increase in the membership of the Organization. In addition, it was observed that an enlargement of the Commission would assist the Commission in better implementing its mandate by drawing on a pool of experts from an increased number of countries and by enhancing the acceptability of its texts. It was also stated that such an enlargement would adequately reflect the increased importance of international trade law for economic development and the preservation of peace and stability. Moreover, it was said that such an enlargement of the Commission would foster participation of those States that could not justify the human and other resources necessary for the preparation for and attendance at the meetings of the Commission and its working groups unless they were members. It was also stated that an enlargement would facilitate coordination with the work of other organizations active in the unification of private law to the extent that the overlap between the membership of the Commission and the membership of those organizations would be increased. It was also observed that an enlargement of the Commission would not affect its efficiency or its working methods, in particular, the participation as observers of non-member States and international organizations, active in the field of international trade law, whether governmental or non-governmental, and the principle of reaching decisions by consensus without a formal vote.

239. As to the size of the enlargement, some preference was expressed for 60 member States, while reference was made also to 72 member States. As to the distribution of seats among geographic groups, divergent views were expressed. Views were expressed that the distribution of the membership to each regional group was to be considered on the basis of equal and fair treatment in order to avoid any underrepresentation, referring to the underlying principles of equal representation of the Charter of the United Nations, Article II, paragraph 1. However, views were also expressed that the current proportion among regional groups should be maintained. After discussion, it was agreed that both matters should be left to the Sixth Committee.

³⁴Ibid., *Fiftieth Session, Supplement No. 17 (A/50/17)*, paras. 401-404.

³⁵Ibid., *Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3)*, paras. 371.

XII. CASE LAW ON UNCITRAL TEXTS (CLOUT)

A. Case law

240. The Commission noted with appreciation the ongoing work under the system that had been established for the collection and dissemination of case law on UNCITRAL texts (CLOUT), consisting of the preparation of case abstracts, compilation of full texts of decisions and the preparation of research aids and analytic tools such as thesauri and indices. It was observed that, as at the date of the current Commission session, 36 issues of CLOUT had been published, dealing with 420 cases. It was noted that CLOUT represented an important aspect of the overall training and technical assistance information activities undertaken by UNCITRAL. In that regard, it was observed that the wide distribution of CLOUT in both print and electronic formats (see www.uncitral.org under "CLOUT") promoted the uniform interpretation and application of UNCITRAL texts by enabling interested persons, such as judges, arbitrators, lawyers or parties to commercial transactions to take into account decisions and awards of other jurisdictions when rendering their own judgements or opinions or adjusting their actions to the prevailing interpretation of those texts.

241. The Commission expressed appreciation to the national correspondents for their work in the collection of relevant decisions and arbitral awards and their preparation of case abstracts. It also expressed its appreciation for the compiling, editing, issuing and distributing of case abstracts, as well as for the preparation of a new, web-enhanced thesaurus on the Model Arbitration Law, which had been finalized after distribution to national correspondents for their comments.

242. The Commission noted that at present CLOUT predominantly contained cases interpreting the United Nations Convention on Contracts for the International Sale of Goods and the Model Arbitration Law. It was agreed that an effort should be made to extend the scope of materials contained within CLOUT to include cases and arbitral decisions interpreting other UNCITRAL texts, such as the Model Law on Electronic Commerce, the United Nations Convention on the Carriage of Goods by Sea (Hamburg Rules) and the Model Procurement Law.

B. Digest of case law on the United Nations Sales Convention

243. The Commission recalled that, at its thirty-fourth session, it had requested the Secretariat to prepare, in cooperation with experts and national correspondents, a text in the form of an analytical digest of court and arbitral decisions identifying trends in the interpretation of the United Nations Convention on Contracts for the International Sale of Goods. It was noted that the drafting process was under way and that it was anticipated that a draft text would be circulated to national correspondents and finalized by the Secretariat in the light of comments received. It was also noted that the Secretariat was working with the assistance of experts and national correspondents

to collect cases, evaluate their significance and prepare initial drafts. The Commission expressed its appreciation to the experts and national correspondents for their efforts in the preparation of the initial draft chapters of the digest on the Convention. In view of the importance of international commercial arbitration and the relevance of the UNCITRAL Model Law on International Commercial Arbitration in that context, the Commission requested the Secretariat to prepare a similar digest of case law on the Model Law. The Commission also considered that the Secretariat should explore the feasibility of preparing such a digest on the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

XIII. TRAINING AND TECHNICAL ASSISTANCE

244. The Commission had before it a note by the Secretariat (A/CN.9/515) setting forth the training and technical assistance activities undertaken since its thirty-fourth session and indicating the direction of future activities being planned, in particular in view of the increase in the requests received by the Secretariat. It was noted that training and technical assistance activities were typically carried out through seminars and briefing missions, which were designed to explain the salient features of UNCITRAL texts and the benefits to be derived from their adoption by States. It was also noted that such seminars and briefing missions were often followed by assistance in the drafting or finalizing of legislation based on an UNCITRAL text.

245. It was reported that, since the previous session, the following seminars and briefing missions had been organized: Vilnius (11-13 June 2001); Ouagadougou (18-22 June 2001); Santo Domingo (20 and 21 June 2001); Nairobi (10-13 September 2001); Minsk (26-28 September 2001); Kiev (2-4 October 2001); Dubrovnik, Croatia (1-5 October 2001); Lima (15 and 16 October 2001); Arequipa, Peru (18 and 19 October 2001); Bogota (25 and 26 October 2001); Hanoi (6-12 December 2001); Phnom Penh (3-5 April 2002); and Jakarta (8-10 April 2002). Members of the UNCITRAL secretariat had participated as speakers in a number of meetings convened by other organizations. The secretariat reported that a number of requests had had to be turned down for lack of sufficient resources and that for the remainder of 2002 only some of the requests made by countries in Africa, Asia, Latin America and Eastern Europe could be met.

246. The Commission expressed its appreciation to the UNCITRAL secretariat for the activities undertaken since its previous session and emphasized the importance of the training and technical assistance programme for the unification and harmonization efforts that were at the heart of the Commission's mandate. It was widely felt that training and technical assistance were particularly useful for developing countries and countries with economies in transition lacking expertise in the areas of trade and commercial law covered by the work of UNCITRAL. It was also stated that the training and technical assistance activities of the secretariat could play an important role in the economic integration efforts being undertaken by many countries.

247. The Commission noted the various forms of technical assistance that might be provided to States preparing legislation based on UNCITRAL texts, such as review of preparatory drafts of legislation from the point of view of UNCITRAL texts, preparation of regulations implementing such legislation and comments on reports of law reform commissions, as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL texts as embodied in national legislation. The Commission agreed that the upsurge in commercial law reform represented a crucial opportunity for the Commission to further its objectives significantly, as envisaged by the General Assembly in its resolution 2205 (XXI) of 17 December 1966. It was also widely felt that, with its balanced work over the last 35 years aimed at facilitating the development of international trade in a globalized economy on the basis of equality and mutual benefit, the Commission could make a unique contribution towards the goal of spreading the benefits of globalization to all States in a balanced and fair way.

248. The Commission took note with appreciation of the contributions made by Cyprus, France, Greece and Switzerland towards the training and technical assistance programme. It also expressed its appreciation to Austria, Cambodia, Cyprus, Kenya, Mexico and Singapore for their contributions to the trust fund established to provide travel assistance to developing countries that are members of UNCITRAL since its establishment. The Commission furthermore expressed its appreciation to other States and organizations that had contributed to its programme of training and assistance by providing funds or staff or by hosting seminars.

249. Stressing the importance of extrabudgetary funding for carrying out training and technical assistance activities, the Commission appealed once again to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL trust funds so as to enable the Secretariat to meet the increasing demands in developing countries and newly independent States for training and assistance and to enable delegates from developing countries to attend UNCITRAL meetings. It was also suggested that the Secretariat should make efforts to actively seek contributions from donor countries and organizations, for instance by formulating concrete proposals for projects to support its training and technical assistance activities.

250. In view of the limited resources available to the secretariat of the Commission, whether from budgetary or extrabudgetary resources, strong concern was expressed that the Commission could not fully implement its mandate with regard to training and technical assistance. Concern was also expressed that, without effective cooperation and coordination between the secretariat and development assistance agencies providing or financing technical assistance, international assistance might lead to the adoption of national laws that did not represent internationally agreed standards, including UNCITRAL conventions and model laws.

251. The Commission noted with appreciation the initial steps taken in the direction of implementation of a request

of the General Assembly made last year for the Secretary-General to increase substantially both the human and the financial resources available to the UNCITRAL secretariat. However, the Commission also noted that those efforts had not yet been completed and that two members of its secretariat who had left since its last session had not yet been replaced. Therefore, in order to ensure the effective implementation of its training and assistance programme and the timely publication and dissemination of its work, the Commission decided to recommend that the General Assembly should consider requesting the Secretary-General to intensify and expedite efforts to strengthen the secretariat of the Commission within the bounds of the resources available in the Organization (paras. 258-271, below).

XIV. STATUS AND PROMOTION OF UNCITRAL LEGAL TEXTS

252. On the basis of a note by the Secretariat (A/CN.9/516), the Commission considered the status of the conventions and model laws emanating from its work, as well as the status of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). The Commission noted with pleasure the new action of States and jurisdictions subsequent to 13 July 2001 (the date of the conclusion of the thirty-fourth session of the Commission) regarding the following instruments:

(a) Convention on the Limitation Period in the International Sale of Goods, concluded at New York on 14 June 1974, as amended by the Protocol of 11 April 1980. Number of States parties: 17;

(b) [Unamended] Convention on the Limitation Period in the International Sale of Goods (New York, 1974). Number of States parties: 24;

(c) United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). Number of States parties: 28;

(d) United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). New actions by Colombia and Israel; number of States parties: 61;

(e) United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988). New action by Honduras. The Convention has three States parties; it requires seven additional actions for entry into force;

(f) United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991). The Convention has two States parties; it requires three additional actions for entry into force;

(g) United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995). New action by Belarus; number of States parties: 6;

(h) Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). New actions by Iceland, Islamic Republic of Iran and Zambia; number of States parties: 129;

(i) UNCITRAL Model Law on International Commercial Arbitration, 1985. New jurisdiction that has enacted legislation based on the Model Law: Croatia;

(j) UNCITRAL Model Law on International Credit Transfers, 1992;

(k) UNCITRAL Model Law on Procurement of Goods, Construction and Services, 1994. New jurisdictions that have enacted legislation based on the Model Law: Mauritius, Mongolia, Slovakia and United Republic of Tanzania;

(l) UNCITRAL Model Law on Electronic Commerce, 1996. New jurisdictions that have enacted legislation based on the Model Law: Ireland, Philippines, Slovenia and the States of Jersey (Crown Dependency of the United Kingdom of Great Britain and Northern Ireland);

(m) UNCITRAL Model Law on Cross-Border Insolvency, 1997. New jurisdiction that has enacted legislation based on the Model Law: within Yugoslavia, Montenegro.

253. It was also reported that Luxembourg had signed the United Nations Convention on the Assignment of Receivables in International Trade. Appreciation was expressed for the legislative actions on the texts of the Commission. A request was directed to States that had enacted or were about to enact a model law prepared by the Commission, or were considering legislative action regarding a convention resulting from the work of the Commission, to inform the secretariat of the Commission. Such information would be useful to other States in their consideration of similar legislative action. It was suggested that consideration might be given to reporting activities towards legislative action on an UNCITRAL text and legislations influenced by an UNCITRAL text.

254. Representatives and observers of a number of States reported that official action was being considered with a view to adherence to various conventions and to the adoption of legislation based on various model laws prepared by UNCITRAL. The view was also expressed that the work of the Commission had a general beneficial impact by emphasizing the benefits to be derived from uniform law texts, even before their adoption by States.

255. The Commission generally felt that its efforts towards the unification and harmonization of trade law had a general beneficial impact but could not be complete and produce concrete results unless texts prepared by the Commission were adopted by States and applied in a uniform way. In order to ensure that result, the Commission requested the Secretariat to increase its efforts aimed at assisting States in considering texts prepared by the Commission for adoption (see also para. 250 above). The Commission also appealed to States and relevant organizations in the public and the private sectors to assist the Secretariat in those efforts, for example, by making contributions to the UNCITRAL Trust Fund for Symposia or by joining efforts with the Secretariat in their law reform assistance programmes. The Commission also directed an appeal to the representatives and observers who had been participating in the meetings of the Commission and its working groups to contribute, to the extent that they in their discretion deemed appropriate, to facilitating consideration of texts of the Commission by legislative organs in their countries.

XV. GENERAL ASSEMBLY RESOLUTIONS ON THE WORK OF THE COMMISSION

256. The Commission took note with appreciation of General Assembly resolutions 56/79 on the report of the Commission on the work of its thirty-fourth session, 56/80 on the UNCITRAL Model Law on Electronic Signatures, referring also to the Guide to Enactment of the Model Law, and 56/81 on the United Nations Convention on the Assignment of Receivables in International Trade, all of which were adopted on 12 December 2001.

257. The Commission also took note of General Assembly decision 56/422 of 12 December 2001 by which the General Assembly, on the recommendation of the Sixth Committee and having considered a report of the Secretary-General (A/56/315), decided to defer consideration of and a decision on the enlargement of the membership of the Commission to its fifty-seventh session, under the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session".

Strengthening of the UNCITRAL secretariat

258. The Commission took note of paragraph 13 of General Assembly resolution 56/79 of 12 December 2001 on the report of the Commission on the work of its thirty-fourth session which read as follows:

"Reiterates, in view of the increased work programme of the Commission, its request to the Secretary-General to strengthen the secretariat of the Commission within the bounds of the resources available in the Organization so as to ensure and enhance the effective implementation of the programme of the Commission."

259. On 9 April 2002, in conformity with General Assembly resolutions 48/218 B of 29 July 1994 and 54/244 of 23 December 1999, the Secretary-General had transmitted a report of the Office of Internal Oversight Services on the in-depth evaluation of legal affairs (E/AC.51/2002/5). The report had been reviewed by the relevant departments and offices. The Secretary-General had taken note of its findings and concurred with its recommendations.

260. The overall assessment of the activities of the International Trade Law Branch, which functioned as the UNCITRAL secretariat, was highly positive. Interviews with members of the Commission, delegates from Member States and representatives of non-governmental organizations and other agencies indicated that the quality of the secretariat support was effective, technically competent and timely. Particular mention was made of the Branch's ability to maintain a balanced approach to issues. Yet, the review of the Office of Internal Oversight Services also identified a few areas for improvement, namely in the areas of coordination with other organizations, promotion of uniform application and interpretation of UNCITRAL texts and technical assistance for trade law reform. Accordingly, the report included two recommendations for increased coordination with trade law organizations (recommendation 13) and for promotion of wider participation in international

trade law conventions and use of model laws (recommendation 14). The Commission noted that measures were being considered to implement those recommendations.

261. With respect to the UNCITRAL expanded programme of work, the report of the Office of Internal Oversight Services stated as follows (E/AC.51/2002/5, para. 66):

“In recent years, UNCITRAL has been considering the implications of increasing its membership. In December 2001, the General Assembly deferred the membership issue for consideration at a later date. There has also been a review of the working methods of the Commission. From the proposals contained in the secretariat’s note on working methods, the Commission expressed its preference for increasing the number of working groups by reducing the duration of each working group session from two weeks to one week. *While this will enable the number of working groups to be increased from three to six (within existing conference allocations) and accommodate the demand for work on more topics, it will require increased input from the International Trade Law Branch.* It is anticipated that this will only in part be met by streamlining working methods. Participants and observers of the work of the Commission stated to [the Office of Internal Oversight Services] that the expansion of the working groups was recognized as an indication of the growing importance of, *and increased demand for uniform trade law standards in a globalized economy.* The limitation of the duration of the groups was also welcomed as it would facilitate attendance. However, doubts were repeatedly expressed as to whether the International Trade Law Branch would be able to maintain the quality and efficiency of its work. Aside from the addition of one Professional post at the P-4 level in 2001, staff resources have remained at the 1968 levels, that is, of 10 Professional and 7 General Service staff. An analysis and reappraisal of the requirements in terms of staff and other support to the expanded working groups appears timely. Given that the issues tackled are of interest to other organizations, the International Trade Law Branch could also consider more strategic efforts to raise funds from partners within and from outside the United Nations, in line with General Assembly resolution 51/161. The Commission decided to review the practical applications of the new working methods at a future session.”

262. The corresponding recommendation read as follows:

“Recommendation 15: UNCITRAL expanded programme of work

“[The Office of Legal Affairs] should review the secretariat requirements that an expansion from 3 to 6 UNCITRAL working groups require and present to UNCITRAL, at its upcoming review of the practical applications of the new working methods, different options that would ensure the necessary level of secretariat services.”

263. In making that recommendation, the Office of Internal Oversight Services was mindful of its possible financial implications and noted that the Office believed that

“implementation of a number of recommendations, in particular recommendations 4 (a), 4 (b), 7 and 15, may require additional resources for which [the Office of Legal Affairs] should prepare a detailed justification for review through the appropriate programme and budget review processes” (E/AC.51/2002/5, para. 82).

264. The follow-up to recommendation 15 of the report was discussed within the Office of Legal Affairs. The preliminary conclusion of the internal discussions was that a sustainable solution for ensuring enhanced efficiency in the work of the Commission might not bear fruit, if it was not accompanied by a significant strengthening of the Commission’s secretariat. It should be recalled that, as a result of the demands emanating from Member States for UNCITRAL to prepare legal standards in an increasing number of areas, the UNCITRAL secretariat was currently fully occupied with at least eight major ongoing projects, which meant that the number of major projects on the agenda of the Commission had more than doubled in the year 2001 as compared with previous years. That meant, in practical terms, that no more than one legal officer was currently available to concentrate on each project, in addition to that legal officer’s other duties in connection with research and drafting of documents for various working groups and the Commission and also with activities relating to the coordination of work of organizations active in the preparation of trade law texts, training and assistance, publications and information. Thus, the only workable options were either to reduce drastically the current programme of work of UNCITRAL or to increase significantly the resources of the UNCITRAL secretariat.

265. The Commission noted that a possible reduction in the programme of work of UNCITRAL would appear to run counter to several major objectives of the United Nations. Promoting higher standards of living, social progress and sustainable economic development were among the most important goals of the United Nations. Those goals had become even more pertinent following the Millennium Summit of the United Nations, at which heads of State and Government from the entire world committed themselves to substantially improving living conditions for their citizens through a number of concrete measures set forth in the United Nations Millennium Declaration. Economic growth, political modernization, the protection of human rights and other larger objectives of the United Nations all hinged, at least in part, on “the rule of law”. Policy makers in developing countries and countries with economies in transition were thus seeking ways to establish or strengthen the rule of law in their countries. The economic development that resulted from countries modernizing and harmonizing their trade laws paid direct dividends to all segments of a developing country’s population. Children’s health and education improved along with economic growth as they were no longer needed as a source of manual labour. Women were able to increase their participation in the marketplace. The environment could be protected as farmers and fishermen were given opportunities to develop less destructive practices. Peace and human rights were enhanced as the foundation of stability. In a number of instances, UNCITRAL had made and continued to make a significant contribution to facilitating a number of economic activities that formed the basis of an orderly

functioning of the open economy, thus helping developing countries to fully participate in the benefits of the global marketplace. Examples where UNCITRAL should be given credit for its action and where it continued to be indispensable included the following: facilitating the access of small enterprises to international markets through electronic commerce; enhancing the framework for environmentally sound infrastructure development through proper legislation on privately financed infrastructure projects; curbing corruption in government contracting through modernization of legislation on government contracting and public procurement; facilitating access to credit, including cross-border credit, to commercial enterprises by elaborating models for legislation on secured transactions; and strengthening the stability of national economies by preparing models for national insolvency legislation. Those achievements not only illustrated the positive role of UNCITRAL but also called for an increase in its action and certainly not for a reduction in its work programme.

266. With respect to the need to promote wider participation in international trade law conventions and use of model laws, the Commission noted that more work was also required, as pointed out by the Secretary-General in his report on the work of the Organization, to establish the rule of law in international affairs as a central priority.³⁶ As noted by the Secretary-General, much remained to be done; all too often individuals and corporations found that they were denied the rights and benefits that international law and treaties provided for.³⁷ Many States failed to sign or ratify treaties, not because of any lack of political will, but because of a simple shortage of technical expertise when it came to the implementation of treaty provisions. One of the central objectives of the United Nations was to assist Governments in establishing the necessary conditions for compliance with treaty commitments.³⁸

267. The need to increase substantially the resources of the UNCITRAL secretariat was reflected in the proposed revisions to the medium-term plan for the period 2002-2005. As regards UNCITRAL and the International Trade Law Branch (which acts as the UNCITRAL secretariat), it was proposed in the medium-term plan that, in order to enable the Branch to carry out the work programme of the Commission, it was necessary to implement the request of the General Assembly and the Commission to strengthen the secretariat of the Commission in view of its increased work programme. Since the costs of strengthening the UNCITRAL secretariat had to be "within the bounds of the resources available in the Organization", the Organization as a whole would have to consider its priorities and decide on the amount of resources it wished to allocate to that area of its activity. The Commission noted the suggested revised structure of the UNCITRAL secretariat, which would be upgraded to the level of a division within the Office of Legal Affairs. The proposed revisions to the medium-term plan for the period 2002-2005 had been transmitted to the Committee for Programme and Coordination, whose deliberations were crucial for the preparation of the session of

the Fifth Committee of the General Assembly, which would be taking the ultimate budgetary decision.

268. It was submitted that the strengthening of the UNCITRAL secretariat was necessary for several reasons: one was that there was a clear demand from Member States for UNCITRAL to prepare legal standards for a globalized economy in areas where until recently the United Nations had not been active; a second was the increased need for coordination among a growing number of international organizations (whether intergovernmental or non-governmental) that formulated rules and standards for international trade; and a third was the increased need for technical assistance, in particular in developing countries, that required particular attention on the part of UNCITRAL as the formulating agency when national Governments considered implementation of international standards in domestic legislation.

269. The Commission welcomed the request of the General Assembly, in paragraph 13 of its resolution 56/79, paragraph 13, to the Secretary-General to strengthen the secretariat of the Commission within the bounds of the resources available in the Organization so as to ensure and enhance the effective implementation of the programme of the Commission (see para. 258 above).

270. However, while appreciating the initial steps taken by the Assembly, the Commission noted with concern that, if the secretariat of the Commission was not significantly strengthened, the Commission would have to reduce its work programme.

271. After discussion, the Commission adopted the following recommendation:

"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 particularly those of developing countries, in the extensive development of international trade,

"Convinced that the establishment of modern private law standards on international trade in a manner that is acceptable to States with different legal, social and economic systems significantly contributes to the development of harmonious international relations, respect for the rule of law, peace and stability, and is indispensable for designing a sustainable economy,

"Convinced also that modernization of private law standards in international trade is essential for supporting economic development and is indispensable for designing a sustainable economy,

"Noting a clear demand that emanates from Member States, in particular developing countries, for UNCITRAL to prepare legal standards for a globalized economy in an increasing number of areas, and that as

³⁶Ibid., *Fifty-fifth Session, Supplement No. 1 (A/55/1)*, para. 273.

³⁷Ibid., para. 278.

³⁸Ibid., *Fifty-sixth Session, Supplement No. 1 (A/56/1 and Corr.1)*, paras. 219 and 220.

a result of those demands the number of major projects on the agenda of the Commission has more than doubled in the year 2001 as compared with previous years,

“Noting also the increased need for coordination among a growing number of international organizations (whether intergovernmental or non-governmental) that formulate rules and standards for international trade, and the specific function to be performed by UNCITRAL in that respect, as mandated by the General Assembly in its resolution 2205 (XXI) and reiterated by the General Assembly in subsequent resolutions,

“Noting further the increased need for technical assistance, in particular in developing countries, that requires particular attention on the part of UNCITRAL as the formulating agency to assist national Governments when they consider modernizing domestic trade laws and rules of practice through implementation of international standards,

“Believing that one of the essential conditions of the successful development and enactment of the legal standards elaborated by UNCITRAL is the high level of quality and professionalism constantly maintained by the International Trade Law Branch of the United Nations Office of Legal Affairs, serving as the substantive secretariat of the Commission,

“Concerned about the considerably increased demands on personnel resources of the secretariat of the Commission resulting from the increased work programme, and its inability to continue servicing the Commission’s working groups and performing other related tasks such as assisting Governments in establishing the necessary work for compliance with treaty commitments,

“Being aware that, if the secretariat of the Commission is not given sufficient resources to carry out the tasks entrusted to it, the Commission will have to defer or discontinue work on topics on its agenda and reduce the number of its working groups,

“Noting the recommendation contained in the report of the Office of Internal Oversight Services on the in-depth evaluation of legal affairs¹ that the Office of Legal Affairs should review the secretariat requirements that an expansion from three to six UNCITRAL working groups require and present to UNCITRAL, at its upcoming review of the practical applications of the new working methods, different options that would ensure the necessary level of secretariat services,

“Noting also the comments provided by OLA at the opening of the thirty-fifth session of the Commission regarding the recommendation contained in the report of the Office of Internal Oversight Services,

“Convinced that the current working methods of the Commission have proved their efficiency,

“Requests the Secretary-General to consider measures to strengthen significantly the UNCITRAL

secretariat within the bounds of the resources available in the Organization, if possible already during the current biennium and in any case during the 2004-2005 biennium.”

¹ E/AC.51/2002/5.

XVI. COORDINATION AND COOPERATION

A. Asian-African Legal Consultative Organization

272. On behalf of the Asian-African Legal Consultative Organization (AALCO), it was stated that, in view of the importance AALCO attached to the Commission’s work, it had made it a practice to consider at its annual sessions the report of the Commission. AALCO welcomed the completion of the UNCITRAL Model Law on International Commercial Conciliation. The Commission was reminded of the interest of AALCO in the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the UNCITRAL Model Law on International Commercial Arbitration. In that connection, reference was made to the success of regional arbitration centres in Kuala Lumpur, Cairo and Lagos, Nigeria. Reference was also made to another regional arbitration centre to become operational in Tehran in the near future. In addition, it was observed that AALCO had a special interest in the Commission’s work on electronic commerce. Thus, support was expressed for the UNCITRAL Model Laws on Electronic Commerce and Electronic Signatures, as well as for the current work towards an international text on electronic contracting. AALCO also welcomed the work of the Commission on insolvency law, security interests, transport law and privately financed infrastructure projects. Moreover, AALCO strongly urged the Commission to enlarge its membership to accommodate the interests of various countries in the light of their importance in international trade. AALCO also expressed interest in an international trade law workshop to be held in cooperation with the secretariat of the Commission with a view to disseminating information on the work of the Commission in the Asian region. An invitation was addressed to members and observers of the Commission and to the UNCITRAL secretariat to attend the forty-first annual session of AALCO, to be held in Abuja from 15 to 20 July 2002.

B. International Development Law Institute

273. On behalf of the International Development Law Institute (IDLI), it was stated that IDLI, which promoted the rule of law and good governance and the use of legal resources in the development process in developing countries and countries with economies in transition, fulfilled its mandate through training, technical assistance, research and publications. It was also observed that IDLI had worked with over 12,000 legal professionals from 163 countries, had fostered the founding of IDLI alumni associations in 31 countries and maintained and supported a network of counterpart organizations in the other countries in which it had worked. Those organizations carried out in their countries the same kind of work that IDLI carried out on an international level.

274. In addition, it was observed that IDLI had taken note of document A/CN.9/515, which described the training and technical assistance activities carried out by UNCITRAL in pursuit of its mandate, and wished to report that in the implementation of its training and technical assistance activities it had found that the demand for training and technical assistance in the field of international trade law was high. It was also observed that IDLI had responded to that demand by providing training in many of its regular and tailor-made courses and had provided technical assistance on international trade law in several countries. In that work, it was said, IDLI often provided training on the UNCITRAL texts in the relevant field.

275. IDLI tabled for consideration the following ways in which it could cooperate with UNCITRAL on training and technical assistance on international trade law with particular reference to the UNCITRAL texts:

- (a) Joint or IDLI organization of training programmes or conferences;
- (b) Development of training materials;
- (c) Identification of experts from the IDLI staff or from its expert network for training or technical assistance;
- (d) Training of trainers;
- (e) Developing the capacities of the IDLI alumni associations and counterpart organizations to provide training and technical assistance in that area;
- (f) Reporting on the work of UNCITRAL in IDLI publications.

276. It was also said that information on current IDLI programmes and activities could be found on the IDLI web site at www.idli.org.

277. Moreover, it was stated that, at its meeting on 5 November 2001, the Board of Directors had urged the IDLI secretariat to find ways of cooperating with UNCITRAL and suggested finding ways to encourage participation by IDLI staff and IDLI alumni in the work of UNCITRAL in order to help UNCITRAL secure quality participation of legal professionals from its developing country members. To that end, IDLI said that it looked forward to following up on preliminary discussions with UNCITRAL on ways for IDLI alumni to be represented in the work of UNCITRAL as an organized delegation selected by IDLI on the basis of criteria to be agreed upon by IDLI and UNCITRAL. It was also pointed out that, for those forms of cooperation that required other than incidental financial resources available in the two organizations' regular budgets, IDLI invited the UNCITRAL secretariat to explore with it ways to mobilize such resources.

C. Global Center for Dispute Resolution Research

278. On behalf of the Global Center for Dispute Resolution Research, a non-governmental, non-profit, international organization, it was stated that the Center conducted fact-based research on dispute resolution matters and would be prepared to assist the Commission, for example, with its work on monitoring legislative implementation of the 1958 New York Convention.

XVII. OTHER BUSINESS

A. Possible study of commercial and financial fraud

279. It was observed that, while the work of the Commission had ably focused on legislative and non-legislative texts in order to harmonize and facilitate international commerce, there was another dimension of commercial law and practice of importance that had not been sufficiently dealt with by international bodies, namely fraudulent practices that affected legitimate instruments of trade and finance. Such fraud, typically international in character, had a significant adverse economic impact on world trade and negatively affected the legitimate devices used in it.

280. It was stated that, although such schemes might be obvious in retrospect, they appealed to thousands of sophisticated investors throughout the world. While no figures had been calculated for the reported losses from such schemes, in 2000 informal average estimates from entities involved in combating high yield, financial-instrument fraud alone placed annual worldwide losses at \$15 billion. Even more discouraging was the growth of such fraud despite attempts at cautionary warnings and exposure. It was observed that the advent of the Internet had offered additional avenues to the perpetrators. The figures, however, did not detail fully the consequences of the schemes. It was reported to the Commission that such consequences included the following:

(a) Compromise of legitimate instruments of trade and commerce, since the schemes cast a pall of suspicion on the legitimate instruments that they used;

(b) Misuse of international organizations, since misappropriation of names or use of the names of major international organizations were common in such schemes. As a result, major international organizations, including the World Bank, the International Monetary Fund, the Bank for International Settlements and regional development banks, had been associated with the schemes, as had central banks of every major country. The organizations were regularly compelled to use their resources to rebut such references and deny their role and the existence or legitimacy of the schemes; loss of time and energy was also experienced by individuals who might directly or indirectly be victims of fraudulent schemes;

(c) Loss of confidence in the mechanisms of international monetary transfer, since a regular feature of the schemes was reference to and use of the international monetary transfer system in the transfer of funds. The schemes included false and misleading references to the systems and their components and use of the systems to channel funds from victims to perpetrators in such a manner that they were difficult to trace. In addition, the systems were used regularly to mask transfers of funds and to channel them in order to avoid governmental scrutiny;

(d) Increased costs to international trade and commerce, since the growing fraudulent use of documentation led to a downgrading of existing trade systems and channels. Many of the schemes involved non-existent goods, falsified or forged documents such as bills of lading or warehouse receipts, sales of non-existent commodities or multiple sales of the same goods. Additional costs to trade

were also caused by fraud involving rings and use of intermediaries acting in concert to defraud legitimate traders and businesses.

281. It was observed that, while criminal law implications should not be the focus, an UNCITRAL project regarding commercial and financial fraud might provide useful elements for fighting organized crime. While the role of organized crime in financial fraud schemes was not yet apparent, such schemes offered a fertile ground for breeding such associations. In addition, the schemes offered a potential means for illegal operatives to conveniently obtain funds.

282. It was pointed out that, while the illegitimate character of such schemes had long been apparent to authorities, there had been extensive and serious difficulties in combatting them. The problems included the following issues:

(a) The international nature that was deliberately conferred on most fraudulent schemes. The relative roles and contribution of the various parties involved were often difficult to piece together and understand. Moreover, the parties were typically located in different jurisdictions. Moreover, all typically proclaimed their own innocence and pointed to the misconduct of others, who inevitably were not accessible in the same jurisdiction as the cause of any loss. On an international level, the difficulties and complexities faced domestically in pursuing such schemes were multiplied. As a result, few civil or criminal prosecutors were able to muster the resources to pursue the perpetrators or the funds;

(b) The existence of multiple domestic jurisdictions. Unlike violent crime, the fraudulent schemes did not fit into any one regulatory category. They might involve criminal elements as well as civil ones. Moreover, in both of those fields, they generally involved multiple dimensions, including the law governing ocean carriage, storage of goods, various types of transportation, documents of title, securities, bank regulation, insurance regulation, consumer protection, pension fund regulation, regulation of securities brokers and regulation of professional attorneys and accountants. Often the jurisdictional limits were not well defined and overlapped, leading to confusion and reluctance to utilize limited resources to combat them;

(c) The multiple disciplines involved. Most of the schemes cleverly included a variety of esoteric elements so that few professionals could address all of their components. As a result, most professionals were reluctant to state opinions regarding the matters involved because they extended beyond their expertise. Unfortunately, the perpetrators suffered from no such inhibitions;

(d) Existence of hidden and dispersed funds. In addition to the international locations of the perpetrators of the schemes, the funds were typically sent to other nations and divided among the various players in a confusing manner increasing the difficulties of pursuit, proof and recovery. Recovery often presented difficulties when the funds had been transferred to jurisdictions that did not support actions to redress the defrauded parties. Where money-laundering was involved, difficulties of discovery were further compounded.

283. The view was expressed that the Commission combined a governmental perspective with internationally recognized expertise in international commerce along with a long-standing tradition of cooperation with international organizations in the private sector and collaboration with recognized international experts. The Commission was also well placed to appreciate the workings of institutions of commerce and finance whose cooperation was essential for success and whose operations must not be unduly disrupted.

284. In addition to the competence of the Commission to undertake such an effort, many financial fraud schemes touched on matters that had been specifically addressed by texts elaborated by the Commission, including the United Nations Convention on the Assignment of Receivables in International Trade, the UNCITRAL Model Law on International Credit Transfers, the UNCITRAL Model Law on Procurement of Goods, Construction and Services, the UNCITRAL Model Law on Cross-Border Insolvency and the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit. The topic of fraud had been considered during the deliberations that produced those texts, all of which contained important principles and mechanisms to encourage transparency and reduce the occasion for fraud, corruption and self-dealing.

285. It was suggested that a study could be prepared by the Secretariat to describe fraudulent financial and trade practices in various areas of trade and finance, and describe the ways in which the risk of common types of fraud affected the value of contractual and financial commitments (such as commercial paper, bills of lading and guarantees). Further, the study could identify weaknesses in commercial laws, non-legislative commercial and financial rules and trade and financial practices that were being exploited by perpetrators and other criminals. The study might also, to the extent feasible, describe trade law and civil regulatory measures that some countries might have taken to combat such crime.

286. It was proposed that the topic should be studied and placed before the thirty-sixth session of the Commission, in 2003, so as to enable the Commission to take any action it might wish with respect to the issue. On the basis of such a study, the Commission could consider the need for any measures, such as legislative and other recommendations, as to how to prevent such illicit actions more effectively, with a focus on trade laws, rules and practices. Even if ultimately the Commission would find that preparing such recommendations was not feasible, the study would in itself be a useful product that would raise awareness of the problems and foster a change of attitudes and practices.

287. In response to the proposal, views were expressed recognizing that financial and commercial fraud constituted a growing problem and that measures to counter it were of great concern to Governments. It was also recognized that such fraud adversely affected trust in the mechanisms of trade, finance and investment and had a destabilizing effect on markets. Commercial entities from developing countries, inasmuch as they had limited experience with instruments of international trade, were particularly vulnerable and would benefit from information and advice as to how

to avoid being defrauded. The work of the Commission would also help States, intergovernmental and non-governmental organizations to design or adjust legislative and non-legislative private law regimes that were better suited to prevent fraudulent schemes.

288. Serious reservations were also expressed regarding the feasibility of the project. It was stressed that the work, if it was to be undertaken, had the potential of addressing or having implications for areas that were dealt with by other organizations, whose focus was not trade law, and that care should be taken that the Commission should not be called on to consider issues that fell outside its established area of work and expertise. It was also considered that, assuming the project would deal with private law aspects of fraud, the scope of the project was undefined and needed careful consideration.

289. A number of delegations shared the view that the project, despite its potential usefulness, could not be undertaken given the alarming situation regarding the personnel resources of the UNCITRAL secretariat (see para. 268 above). Statements were made that it was ill-advised to add new projects at a time when the Commission might be compelled to slow down or reduce its current work programme for lack of sufficient resources, and that undertaking the proposed study was contingent on additional personnel resources being made available to the secretariat of the Commission. In addition, statements were made that the proposed project should not be given a high priority and that the Commission should rather place more emphasis on its training and technical assistance activities.

290. After discussion, the Commission was in agreement that it would be useful to prepare the proposed study for the consideration of the Commission, without, at the present stage, committing the Commission to any action being taken on the basis of the study. In requesting the Secretariat to undertake work on the study, the Commission did not put any time limit on the request. It was understood that the work on the study should be undertaken only to the extent that work did not claim resources needed for other projects on the Commission's agenda.

B. Bibliography

291. The Commission noted with appreciation the bibliography of recent writings related to the work of the Commission (A/CN.9/517). The Commission stressed the importance for the bibliography to be as complete as possible and, for that reason, requested Governments, academic institutions, other relevant organizations and individual authors to send copies of recent publications to the secretariat.

C. Willem C. Vis International Commercial Arbitration Moot

292. It was noted that the Institute of International Commercial Law at Pace University School of Law, New York, had organized the eighth Willem C. Vis International

Commercial Arbitration Moot in Vienna from 22 to 28 March 2002. In addition, it was noted that legal issues dealt with by the teams of students participating in the Moot had been based on the United Nations Convention on Contracts for the International Sale of Goods, the United Nations Convention on the Assignment of Receivables in International Trade and the Arbitration Rules of the International Chamber of Commerce. Moreover, it was noted that, in the 2002 Moot, some 108 teams had participated from law schools in some 36 countries, involving about 650 students and about 275 arbitrators. The best team in oral arguments was that of the National University of Singapore. It was also noted that the ninth Moot was to be held at Vienna from 11 to 17 April 2003. It was also noted that the secretariat of the Commission had offered a series of lectures on texts prepared by UNCITRAL to about 120 of the Moot participants.

293. The Commission expressed its appreciation to the Institute of International Commercial Law at Pace University School of Law for organizing the Moot and to the secretariat for sponsoring it and offering a series of lectures. It was widely felt that the Moot, with its broad international participation, was an excellent method of disseminating information about uniform law texts and teaching international trade law.

D. UNCITRAL web site

294. The Commission expressed its appreciation for the UNCITRAL web site (www.uncitral.org). It was noted that the web site was an important component of the Commission's overall programme of information activities and training and technical assistance, which attracted some 900 users per day from approximately 95 jurisdictions. In that connection, it was stated that the web site provided delegates to working groups and the Commission with rapid access to working texts in the six official languages of the United Nations, thus promoting transparency and facilitating the work of the Commission. It was also noted that the web site provided global free access for a wide range of interested users, including parliamentarians, judges, practitioners and academics, and that materials on the web site included, *inter alia*, adopted texts, up-to-date reports on the status of conventions and adopted texts, court and arbitral decisions interpreting UNCITRAL texts (CLOUT) and bibliographies of scholarly writing related to the work of the Commission. It was further noted that the Secretariat anticipated completing the placement of all Yearbooks and *travaux préparatoires* of all adopted texts on the web site by the next Commission session. The Commission noted with appreciation the expanded availability on the web site of documents in the six official languages of the United Nations and urged the Secretariat to continue its efforts in increasing the range of available archival texts.

XVIII. DATE AND PLACE OF FUTURE MEETINGS

A. Thirty-sixth session of the Commission

295. The Commission approved holding its thirty-sixth session in Vienna from 30 June to 18 July 2003. It was

noted that the duration of the session might be shortened, should a shorter session become advisable in view of the draft texts produced by the various working groups.

B. Sessions of working groups up to the thirty-sixth session of the Commission

296. The Commission approved the following schedule of meetings for its working groups, subject to possible cancellation of working group sessions being decided by the respective working groups in situations where, for lack of the necessary resources, the Secretariat could not envisage the timely production of the necessary documentation:

(a) Working Group I (Privately Financed Infrastructure Projects) would hold its fifth session at Vienna from 9 to 13 September 2002, immediately before the tenth session of Working Group III, and its sixth session, if necessary, in New York from 24 to 28 March 2003, immediately before the eleventh session of Working Group III;

(b) Working Group II (Arbitration) would hold its thirty-seventh session at Vienna from 7 to 11 October 2002, immediately before the fortieth session of Working Group IV, and its thirty-eighth session in New York from 12 to 16 May 2003, immediately after the forty-first session of Working Group IV. (It may be noted that the Commission originally approved the thirty-eighth session of Working Group II to be held from 28 April to 2 May 2003. However, those dates had to be revised to the current dates owing to the unavailability of a conference room.);

(c) Working Group III (Transport Law) would hold its tenth session at Vienna from 16 to 20 September 2002, immediately after the fifth session of Working Group I, and its eleventh session in New York from 31 March to 4 April 2003, immediately after the sixth session of Working Group I;

(d) Working Group IV (Electronic Commerce) would hold its fortieth session at Vienna from 14 to 18 October 2002, immediately after the thirty-seventh session of Working Group II, and its forty-first session in New York from 5 to 9 May 2003, immediately before the thirty-eighth session of Working Group II;

(e) Working Group V (Insolvency Law) would hold its twenty-seventh session at Vienna from 9 to 13 December 2002, immediately before the second session of Working Group VI, and its twenty-eighth session in New York from 24 to 28 February 2003, immediately before the third session of Working Group VI;

(f) Working Group VI (Security Interests) would hold its second session at Vienna from 16 to 20 December 2002, immediately after the twenty-seventh session of Working Group V, and its third session in New York from 3 to 7 March 2003, immediately after the twenty-eighth session of Working Group V.

C. Sessions of working groups after the thirty-sixth session of the Commission, in 2003

297. The Commission noted that tentative arrangements had been made for working group meetings after its thirty-sixth session (with the arrangements subject to the approval of the Commission at its thirty-sixth session) as follows:

(a) Working Group I (Privately Financed Infrastructure Projects) would hold its seventh session, if necessary, at Vienna from 6 to 10 October 2003;

(b) Working Group II (Arbitration) would hold its thirty-ninth session at Vienna from 10 to 14 November 2003;

(c) Working Group III (Transport Law) would hold its twelfth session at Vienna from 13 to 17 October 2003;

(d) Working Group IV (Electronic Commerce) would hold its forty-second session at Vienna from 17 to 21 November 2003;

(e) Working Group V (Insolvency Law) would hold its twenty-ninth session at Vienna from 1 to 5 September 2003;

(f) Working Group VI (Security Interests) would hold its fourth session at Vienna from 8 to 12 September 2003.

ANNEXES

Annexes I and II to the report of UNCITRAL at its thirty-fifth session are reproduced in Part Three of the present Yearbook.

B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board on its forty-ninth session (TD/B/49/15 (Vol. I))

Progressive development of the law of international trade: thirty-fifth annual report of the United Nations Commission on International Trade Law

At its 935th plenary meeting, on 17 October 2002, the Board took note of the report of UNCITRAL on the work of its thirty-fifth session (A/57/17).

C. General Assembly: Report of the Sixth Committee on the report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session (A/57/562 and Corr.1)

Rapporteur: Mr. Karim Medrek (Morocco)

I. INTRODUCTION

1. At its 19th plenary meeting, on 20 September 2002, the General Assembly, on the recommendation of the General Committee, decided to include in the agenda of its fifty-seventh session the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session" and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 4th, 5th and 16th to 19th meetings, on 30 September and 17, 18, 22 and 24 October 2002. The views of the representatives who spoke during the Committee's consideration of the item are reflected in the relevant summary records (A/C.6/57/SR.4, 5 and 16-19).

3. For its consideration of the item, the Committee had before it the following documents:

(a) Report of the United Nations Commission on International Trade Law on its thirty-fifth session;¹

(b) Report of the Secretary-General on the increase in the membership of the United Nations Commission on International Trade Law (A/56/315).

4. At the 4th meeting, on 30 September, the Chairman of the United Nations Commission on International Trade Law at its thirty-fifth session introduced the report of the Commission on the work of that session (see A/C.6/57/SR.4).

II. CONSIDERATION OF PROPOSALS

A. Draft resolution A/C.6/57/L.12

5. At the 16th meeting, on 17 October, the representative of Austria, on behalf of Algeria, Argentina, Armenia, Australia, Austria, Azerbaijan, Belarus, Belgium, Benin, Brazil, Burkina Faso, Canada, Chile, China, Costa Rica, Croatia, Cyprus, Denmark, Ecuador, Ethiopia, Fiji, Finland, France, Georgia, Germany, Ghana, Greece, Guatemala, Hungary, India, Indonesia, the Islamic Republic of Iran, Ireland, Israel, Italy, Japan, Jordan, Kenya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malaysia, Malta, Mexico, Morocco, the Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Paraguay, Peru, the Philippines, Poland, Portugal, the Republic of Korea, Romania, the Russian Federation, Senegal, Sierra Leone, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, the Sudan, Suriname, Sweden, Switzerland, Thailand, Trinidad and Tobago, Turkey, the United Kingdom of Great Britain and Northern Ireland, Uruguay and Venezuela, subsequently joined by Djibouti and the former Yugoslav Republic of Macedonia, introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session" (A/C.6/57/L.12).

6. At its 17th meeting, on 18 October, the Committee adopted draft resolution A/C.6/57/L.12 without a vote (see para. 15, draft resolution I).

B. Draft resolution A/C.6/57/L.13

7. At the 16th meeting, on 17 October, the Chairman of the Committee introduced a draft resolution entitled "Model Law on International Commercial Conciliation of the United Nations Commission on International Trade Law" (A/C.6/57/L.13).

8. At its 17th meeting, on 18 October, the Committee adopted draft resolution A/C.6/57/L.13 without a vote (see para. 15, draft resolution II).

C. Draft resolution A/C.6/57/L.14

9. At the 16th meeting, on 17 October, the Chairman of the Committee introduced a draft resolution entitled "Enhancing coordination in the area of international trade law and strengthening the secretariat of the United Nations Commission on International Trade Law" (A/C.6/57/L.14).

10. At its 17th meeting, on 18 October, the Committee adopted draft resolution A/C.6/57/L.14 without a vote (see para. 15, draft resolution III).

11. Before the adoption of the draft resolution, the representative of Mexico made a statement in explanation of position (see A/C.6/57/SR.17).

D. Draft resolution A/C.6/57/L.15

12. At the 18th meeting, on 22 October, the Chairman introduced a draft resolution entitled "Enlargement of the membership of the United Nations Commission on International Trade Law" (A/C.6/57/L.15).

13. At its 19th meeting, on 24 October, the Committee adopted draft resolution A/C.6/57/L.15 without a vote (see para. 15, draft resolution IV).

14. Before the adoption of the draft resolution, the representative of Sierra Leone made a statement in explanation of position (see A/C.6/57/SR.19).

III. RECOMMENDATIONS OF THE SIXTH COMMITTEE

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

[The text of the draft resolutions is not reproduced in this section. The draft resolutions were adopted, with editorial changes, as General Assembly resolutions 57/17, 57/18, 57/19 and 57/20 (see section D below).]

¹Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17).

D. General Assembly resolutions 57/17, 57/18, 57/19 and 57/20 of 19 November 2002

Resolutions adopted by the General Assembly on the report of the Sixth Committee (A/57/562 and Corr.1)

57/17. Report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established 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 to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Reaffirming its belief 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 contribute significantly 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,

Having considered the report of the Commission on its thirty-fifth session,¹

Concerned that activities undertaken by other bodies of the United Nations system in the field of international trade law without adequate coordination with the Commission might lead to undesirable duplication of efforts and would not be in keeping with the aim of promoting efficiency, consistency and coherence in the unification and harmonization of international trade law, as stated in its resolution 37/106 of 16 December 1982,

Reaffirming the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in this field,

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

2. *Takes note with satisfaction* of the completion and adoption by the Commission of the United Nations Commission on International Trade Law Model Law on International Commercial Conciliation;²

3. *Commends* the Commission for the progress made in its work on arbitration, insolvency law, electronic commerce, privately financed infrastructure projects, security interests and transport law;

4. *Reaffirms* the importance, in particular for developing countries, of the work of the Commission concerned with training and technical assistance in the field of international trade law, and in this connection:

(a) Expresses its appreciation to the Commission for organizing seminars and briefing missions in Brazil, Cambodia, Ecuador, Indonesia and Viet Nam;

(b) Expresses its appreciation to the Governments whose contributions enabled the seminars and briefing missions to take place, and appeals to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the United Nations Commission on International Trade Law Trust Fund for Symposia and, where appropriate, to the financing of special projects, and otherwise to assist the secretariat of the Commission in financing and organizing seminars and symposia, in particular in developing countries, and in the award of fellowships to candidates from developing countries to enable them to participate in such seminars and symposia;

(c) Reiterates its appeal to the United Nations Development Programme and other bodies responsible for development assistance, such as the International Bank for Reconstruction and Development and regional development banks, as well as to Governments in their bilateral aid programmes, to support the training and technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission;

5. *Stresses* the importance of bringing into effect the conventions emanating from the work of the Commission for the global unification and harmonization of international trade law, and to this end urges States that have not yet done so to consider signing, ratifying or acceding to those conventions;

6. *Appeals* to Governments, the relevant bodies of the United Nations system, organizations, institutions and individuals to make voluntary contributions to the trust fund established to provide travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General;

7. *Decides*, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to continue, in the competent Main Committee during the fifty-seventh session of the General Assembly, its consideration of granting travel assistance to the least developed countries that are members of the Commission, at their request and in consultation with the Secretary-General;

8. *Reiterates*, in view of the increased work programme of the Commission, its request to the Secretary-General to strengthen the secretariat of the Commission within the bounds of the resources available in the

¹Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17).

²Ibid., annex I.

Organization so as to ensure and enhance the effective implementation of the programme of the Commission, if possible during the current biennium and, in any case, during the biennium 2004-2005.

*52nd plenary meeting
19 November 2002*

57/18. Model Law on International Commercial Conciliation of the United Nations Commission on International Trade Law

The General Assembly,

Recognizing the value for international trade of methods for settling commercial disputes in which the parties in dispute request a third person or persons to assist them in their attempt to settle the dispute amicably,

Noting that such dispute settlement methods, referred to by expressions such as conciliation and mediation and expressions of similar import, are increasingly used in international and domestic commercial practice as an alternative to litigation,

Considering that the use of such dispute settlement methods results in significant benefits, such as reducing the instances where a dispute leads to the termination of a commercial relationship, facilitating the administration of international transactions by commercial parties and producing savings in the administration of justice by States,

Convinced that the establishment of model legislation on these methods that is acceptable to States with different legal, social and economic systems would contribute to the development of harmonious international economic relations,

Noting with satisfaction the completion and adoption by the United Nations Commission on International Trade

Law of the Model Law on International Commercial Conciliation,¹

Believing that the Model Law will significantly assist States in enhancing their legislation governing the use of modern conciliation or mediation techniques and in formulating such legislation where none currently exists,

Noting that the preparation of the Model Law was the subject of due deliberation and extensive consultations with Governments and interested circles,

Convinced that the Model Law, together with the Conciliation Rules recommended by the General Assembly in its resolution 35/52 of 4 December 1980, contributes significantly to the establishment of a harmonized legal framework for the fair and efficient settlement of disputes arising in international commercial relations,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for completing and adopting the Model Law on International Commercial Conciliation, the text of which is contained in the annex to the present resolution, and for preparing the Guide to Enactment and Use of the Model Law;

2. *Requests* the Secretary-General to make all efforts to ensure that the Model Law, together with its Guide to Enactment, becomes generally known and available;

3. *Recommends* that all States give due consideration to the enactment of the Model Law, in view of the desirability of uniformity of the law of dispute settlement procedures and the specific needs of international commercial conciliation practice.

*52nd plenary meeting
19 November 2002*

¹Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17), annex I.

ANNEX

MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

Article 1. Scope of application and definitions

1. This Law applies to international² commercial³ conciliation.

²States wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text:

- Delete the word “international” in paragraph 1 of article 1; and
- Delete paragraphs 4, 5 and 6 of article 1.

³The term “commercial” should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.

2. For the purposes of this Law, “conciliator” means a sole conciliator or two or more conciliators, as the case may be.

3. For the purposes of this Law, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person or persons (“the conciliator”) to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator does not have the authority to impose upon the parties a solution to the dispute.

4. A conciliation is international if:

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

(b) The State in which the parties have their places of business is different from either:

- (i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or
- (ii) The State with which the subject matter of the dispute is most closely connected.

5. For the purposes of this article:

(a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

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

6. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.

7. The parties are free to agree to exclude the applicability of this Law.

8. Subject to the provisions of paragraph 9 of this article, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.

9. This Law does not apply to:

(a) Cases where a judge or an arbitrator, in the course of judicial or arbitral proceedings, attempts to facilitate a settlement; and

(b) [...].

Article 2. Interpretation

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

Article 3. Variation by agreement

Except for the provisions of article 2 and article 6, paragraph 3, the parties may agree to exclude or vary any of the provisions of this Law.

Article 4. Commencement of conciliation proceedings⁴

1. Conciliation proceedings in respect of a dispute that has arisen commence on the day on which the parties to that dispute agree to engage in conciliation proceedings.

⁴The following text is suggested for States that might wish to adopt a provision on the suspension of the limitation period:

Article [...] Suspension of limitation period

1. When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

2. Where the conciliation proceedings have terminated without a settlement agreement, the limitation period resumes running from the time the conciliation ended without a settlement agreement.

2. If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

Article 5. Number and appointment of conciliators

1. There shall be one conciliator, unless the parties agree that there shall be two or more conciliators.

2. The parties shall endeavour to reach agreement on a conciliator or conciliators, unless a different procedure for their appointment has been agreed upon.

3. Parties may seek the assistance of an institution or person in connection with the appointment of conciliators. In particular:

(a) A party may request such an institution or person to recommend suitable persons to act as conciliator; or

(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

4. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, where appropriate, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

5. When a person is approached in connection with his or her possible appointment as conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.

Article 6. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, on the manner in which the conciliation is to be conducted.

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator may conduct the conciliation proceedings in such a manner as the conciliator considers appropriate, taking into account the circumstances of the case, any wishes that the parties may express and the need for a speedy settlement of the dispute.

3. In any case, in conducting the proceedings, the conciliator shall seek to maintain fair treatment of the parties and, in so doing, shall take into account the circumstances of the case.

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

Article 7. Communication between conciliator and parties

The conciliator may meet or communicate with the parties together or with each of them separately.

Article 8. Disclosure of information

When the conciliator receives information concerning the dispute from a party, the conciliator may disclose the substance of that information to any other party to the conciliation. However, when a party gives any information to the conciliator, subject to a specific condition that it be kept confidential, that information shall not be disclosed to any other party to the conciliation.

Article 9. Confidentiality

Unless otherwise agreed by the parties, all information relating to the conciliation proceedings shall be kept confidential, except where disclosure is required under the law or for the purposes of implementation or enforcement of a settlement agreement.

Article 10. Admissibility of evidence in other proceedings

1. A party to the conciliation proceedings, the conciliator and any third person, including those involved in the administration of the conciliation proceedings, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding any of the following:

(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;

(b) Views expressed or suggestions made by a party in the conciliation in respect of a possible settlement of the dispute;

(c) Statements or admissions made by a party in the course of the conciliation proceedings;

(d) Proposals made by the conciliator;

(e) The fact that a party had indicated its willingness to accept a proposal for settlement made by the conciliator;

(f) A document prepared solely for purposes of the conciliation proceedings.

2. Paragraph 1 of this article applies irrespective of the form of the information or evidence referred to therein.

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement.

4. The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.

5. Subject to the limitations of paragraph 1 of this article, evidence that is otherwise admissible in arbitral or judicial or similar

proceedings does not become inadmissible as a consequence of having been used in a conciliation.

Article 11. Termination of conciliation proceedings

The conciliation proceedings are terminated:

(a) By the conclusion of a settlement agreement by the parties, on the date of the agreement;

(b) By a declaration of the conciliator, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

(c) By a declaration of the parties addressed to the conciliator to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

(d) By a declaration of a party to the other party or parties and the conciliator, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

Article 12. Conciliator acting as arbitrator

Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator in respect of a dispute that was or is the subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or legal relationship or any related contract or legal relationship.

Article 13. Resort to arbitral or judicial proceedings

Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specified period of time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with, except to the extent necessary for a party, in its opinion, to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.

Article 14. Enforceability of settlement agreement⁵

If the parties conclude an agreement settling a dispute, that settlement agreement is binding and enforceable . . . [the enacting State may insert a description of the method of enforcing settlement agreements or refer to provisions governing such enforcement].

⁵When implementing the procedure for enforcement of settlement agreements, an enacting State may consider the possibility of such a procedure being mandatory.

57/19. Enhancing coordination in the area of international trade law and strengthening the secretariat of the United Nations Commission on International Trade Law

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established 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 to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Having considered the report of the Commission on its thirty-fifth session,¹

Noting the demand from Member States, in particular developing countries, for the Commission to provide technical assistance and to prepare legal standards in an increasing number of areas and that, as a result, the number of projects of the Commission has more than doubled as compared with previous years,

Noting also the increased need for coordination among a growing number of international organizations that formulate rules and standards for international trade, and the specific function to be performed by the Commission in that respect, as mandated by the General Assembly in its resolution 2205 (XXI) and reiterated in subsequent resolutions,

Satisfied that the current working methods of the Commission have proved their efficiency,

Concerned, however, about the increased demands on personnel resources of the secretariat of the Commission resulting from the increased work programme and its impending inability to continue servicing the working groups of the Commission and performing other related tasks such as assisting Governments, which could lead to the Commission having to defer or discontinue work on topics on its agenda and to reduce the number of its working groups,

1. *Emphasizes* the need for higher priority to be given to the work of the United Nations Commission on International Trade Law in view of the increasing value of the modernization of international trade law for global economic development and, thus, for the maintenance of friendly relations among States;

2. *Takes note* of the recommendation contained in the report of the Office of Internal Oversight Services of the Secretariat on the in-depth evaluation of legal affairs² that the Office of Legal Affairs should review the requirements of the secretariat of the Commission entailed by the expansion in the number of working groups from three to

six and present to the Commission, at its upcoming review of the practical applications of the new working methods, different options that would ensure the necessary level of secretariat services;

3. *Requests* the Secretary-General to consider measures to strengthen the secretariat of the Commission within the bounds of the resources available in the Organization, if possible during the current biennium and, in any case, during the biennium 2004–2005.

*52nd plenary meeting
19 November 2002*

57/20. Enlargement of the membership of the United Nations Commission on International Trade Law

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established 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 to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Recalling also its resolution 3108 (XXVIII) of 12 December 1973, by which it increased the membership of the Commission from twenty-nine to thirty-six States,

Being satisfied with the practice of the Commission of inviting States not members of the Commission and relevant intergovernmental and international non-governmental organizations to participate as observers in the sessions of the Commission and its working groups and to take part in the formulation of texts by the Commission, as well as with the practice of reaching decisions by consensus without a formal vote,

Observing that the considerable number of States that have participated as observers and made valuable contributions to the work of the Commission indicates that there exists an interest in active participation in the Commission beyond the current thirty-six member States,

Convinced that wider participation of States in the work of the Commission would further the progress of its work and that an increase in the membership of the Commission would stimulate interest in its work,

Having considered comments by States, as well as the report of the Secretary-General on the implications of increasing the membership of the Commission,¹ submitted pursuant to paragraph 13 of General Assembly resolution 55/151 of 12 December 2000,

¹Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17 (A/57/17).

²E/AC.51/2002/5, recommendation 15.

¹A/56/315.

1. *Takes note* of the fact that the impact of an increase in the membership of the United Nations Commission on International Trade Law on the secretariat services required to properly facilitate the work of the Commission would not be material enough to quantify and that the increase would therefore have no financial implications;

2. *Decides* to increase the membership of the Commission from thirty-six to sixty States, bearing in mind that the Commission is a technical body whose composition reflects, *inter alia*, the specific requirements of the subject matter; the regional representation resulting from this increase in membership, which takes those requirements into account, shall not be a precedent for the enlargement of other bodies in the United Nations system;

3. *Decides also* that the twenty-four additional members of the Commission shall be elected by the General Assembly for a term of six years, except as provided in subparagraph (b) below, in accordance with the following rules:

(a) In electing the additional members, the General Assembly shall observe the following distribution of seats:

- (i) Five from African States;
- (ii) Seven from Asian States;
- (iii) Three from Eastern European States;
- (iv) Four from Latin American and Caribbean States;
- (v) Five from Western European and other States;

(b) Of the twenty-four additional members elected at the first election, to be held during the fifty-eighth session of the General Assembly, the term of thirteen members shall expire on the last day prior to the beginning of the fortieth session of the Commission, in 2007; the President of the General Assembly shall, by drawing lots, select these members as follows:

- (i) Two from those elected from African States, two from those elected from Eastern European States and two from those elected from Western European and other States;
- (ii) Four from those elected from Asian States;
- (iii) Three from those elected from Latin American and Caribbean States;

(c) The twenty-four additional members elected at the first election shall take office from the first day of the thirty-seventh session of the Commission, in 2004;

(d) The provisions of section II, paragraphs 4 and 5, of General Assembly resolution 2205 (XXI) shall also apply to the additional members;

4. *Appeals* to Governments, the relevant United Nations organs, organizations, institutions and individuals, in order to ensure full participation by the Member States in the sessions of the Commission and its working groups, to consider making voluntary contributions to the trust fund established to provide travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General.

*52nd plenary meeting
19 November 2002*

Part Two

STUDIES AND REPORTS ON SPECIFIC SUBJECTS

I. INTERNATIONAL COMMERCIAL ARBITRATION AND CONCILIATION

A. Report of the Working Group on Arbitration on the work of its thirty-fifth session (Vienna, 19-30 November 2001)

(A/CN.9/506) [Original: English]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it named the Working Group on Arbitration, and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (i)); and the power by the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to "online" arbitrations (that is,

arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group on Arbitration had considered articles 1-16 of the draft model legislative provisions (see A/CN.9/WG.II/WP.113/Add.1 and Corr.1). It was generally felt that work on the draft model legislative provisions could be expected to be completed by the Working Group at its subsequent session. The Commission requested the Working Group to proceed with the examination of the provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.⁷

6. At the close of its thirty-fourth session, the Working Group requested the Secretariat to prepare revised drafts of the articles, based on the discussion in the Working Group, for consideration at its subsequent session (A/CN.9/487, para. 20).

7. At its thirty-fifth session (Vienna, 19-30 November 2001) the Working Group was attended by the following States members: Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, India, Islamic Republic of Iran, Italy, Japan, Kenya, Lithuania, Mexico, Morocco, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

8. The session was attended by observers from the following States: Argentina, Australia, Chile, Croatia, Cuba, Czech Republic, Ecuador, Finland, Guatemala, Indonesia, Iraq, Israel, Lebanon, Nigeria, Peru, Philippines, Republic of Korea, Saudi Arabia, Slovakia, Slovenia, Switzerland, Turkey and Yemen.

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), para. 315.

9. The session was attended by observers from the following United Nations Secretariat unit and other international organizations: Economic Commission for Europe, NAFTA Advisory Committee on Private Commercial Disputes, Permanent Court of Arbitration, Cairo Regional Centre for International Commercial Arbitration, Chartered Institute of Arbitrators, International Chamber of Commerce and Queen Mary (University of London) School of International Arbitration.

10. The Working Group elected the following officers:

Chairman: José María ABASCAL ZAMORA (Mexico);

Rapporteur: V. G. HEGDE (India).

11. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.II/WP.114);

(b) Note by the Secretariat: Model legislative provisions on international commercial conciliation (A/CN.9/WG.II/WP.115);

(c) Note by the Secretariat: Draft guide to enactment of the UNCITRAL [Model Law on International Commercial Conciliation] (A/CN.9/WG.II/WP.116).

12. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of model legislative provisions on international commercial conciliation.
4. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

13. The Working Group discussed agenda item 3 on the basis of the documents prepared by the Secretariat (A/CN.9/WG.II/WP.115 and A/CN.9/WG.II/WP.116). The deliberations and conclusions of the Working Group with respect to the item are reflected below. Having completed its consideration of the substance of the provisions of the draft model legislative provisions on international commercial conciliation, the Working Group requested the Secretariat to establish a drafting group to review the entire text with a view to ensuring consistency between the various draft articles in the various language versions. The final version of the draft provisions as approved by the Working Group is contained in the annex to the present report, in the form of a draft model law on international commercial conciliation. The Secretariat was requested to revise the text of the draft guide to enactment and use of the model law, based on the deliberations in the Working Group. It was noted that the draft Model Law, together with the draft guide to enactment and use, would be circulated to member States and observers for comment and presented to the Commission for review and adoption at its thirty-fifth session, to be held in New York from 17 to 28 June 2002.

Article 1. Scope of application

14. The text of draft article 1 as considered by the Working Group was as follows:

“1. These model legislative provisions apply to international commercial* conciliation, as defined in articles 2 and 3,

(a) if the place of conciliation, as agreed upon by the parties or, in the absence of such agreement, as determined with the assistance of the conciliator or panel of conciliators, is in this State; or

(b) if the place of conciliation has not been agreed or otherwise determined as provided for in subparagraph (a), the place of conciliation is deemed to be in this State if any of the following places is in this State: the place of the institution that administered the conciliation proceedings; the place of residence of the conciliator or the place of business of both parties if that place is in the same country.

“2. These model legislative provisions also apply to a commercial conciliation that is not international in the sense of article 3 if the parties have [expressly] agreed that the model legislative provisions are applicable to the conciliation.

“3. Articles . . . apply also if the place of conciliation is not in this State.

“4. These model legislative provisions apply irrespective of whether a conciliation is carried out on the initiative of one party after a dispute has arisen, in compliance with a mutual agreement of the parties made before the dispute arose, or pursuant to a direction or [request] [invitation] of a court or competent governmental entity.

“5. These model legislative provisions do not apply to:

(a) cases where a judge or an arbitrator, in the course of adjudicating a particular dispute, conducts a conciliatory process; and

(b) [. . .].”

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

Paragraph 1

Internationality

15. Various views were expressed as to whether the sphere of application of the draft Model Law should cover only international conciliation. One view was that the

Model Law should be made equally applicable to domestic and to international commercial conciliation. In support of doing away with the distinction between domestic and international cases, it was pointed out that modern commercial practices made it increasingly difficult to establish a workable test of internationality in the field of conciliation. With a view to avoiding such an artificial distinction unduly restricting the scope of the Model Law, it was suggested that draft article 1 should establish as a principle that the Model Law would govern commercial conciliation in general. In addition to that provision, a footnote or any appropriate explanation in the guide to enactment could make it clear for those States that wished to restrict the scope of the Model Law to international conciliation that they were at liberty to do so.

16. As expressed in the draft guide to enactment, a widely shared view was that the acceptability of the draft Model Law would be enhanced if no attempt was made to interfere with domestic conciliation. However, the draft Model Law contained no provision that would, in principle, be unsuitable for domestic cases. In line with that thinking, parties were allowed to opt in to the draft Model Law as provided for in article 1(2). It was pointed out that in some jurisdictions, particularly in federal States, considerable difficulties might arise in distinguishing international trade from domestic trade. The draft Model Law should not be interpreted as encouraging enacting States to limit its applicability to international cases (see A/CN.9/WG.II/WP.116, para. 36).

17. On the above understanding, the Working Group agreed that the provision defining the scope of the draft Model Law should continue to refer to "international" conciliation to avoid unnecessary interference with domestic law. It was also agreed that a footnote to draft article 1 should make it clear that the Model Law could be made applicable to domestic conciliation by enacting States. The matter was referred to the drafting group. It was decided that the discussion should be reopened after completion of the review of the substantive articles of the draft Model Law to verify whether the footnote would need to suggest changes to the text for those States which might wish to enact the Model Law to apply to domestic as well as international conciliation.

Place of conciliation

18. The discussion initially focused on the various elements listed under subparagraphs (a) and (b) for determining the place of conciliation as a criterion for the application of the draft Model Law. Various views were expressed with respect to those subparagraphs. One view was that the reference to the place of conciliation being "determined with the assistance of the conciliator or panel of conciliators" was inconsistent with the contractual nature of the conciliation and should be deleted from both subparagraphs (a) and (b) so as not to suggest that the conciliator or the panel of conciliators had the power to impose a decision upon the parties. The opposite view was that, in practice, the application of the draft Model Law would be greatly facilitated if it expressly provided for determination of the place of conciliation by the conciliator. A related

view was that the words "determined by the conciliator or panel of conciliators after consultation with the parties" should replace the words "determined with the assistance of the conciliator or panel of conciliators". Yet another view was that subparagraphs (a) and (b) should be merged and the word "because" should be inserted before the text currently in subparagraph (b).

19. Another view was that the reference to the place of residence of the conciliator should be deleted from subparagraph (b) on the grounds that it might not provide a workable criterion in cases where the conciliation was conducted by a panel of conciliators. Moreover, it was observed that the place of residence of conciliators was inappropriate as a key element determining the application of the draft Model Law. As a matter of drafting, it was suggested that the words "the institution that administered" should be replaced by the words "the institution administering" so as not to suggest that the place of conciliation could only be determined after termination of the conciliation proceedings. Yet another view was that, as currently drafted, subparagraphs (a) and (b) did not sufficiently address the needs of multiparty conciliation. The following proposal was made as a possible substitute for paragraph 1:

"1. These model legislative provisions apply to international commercial conciliation, as defined in articles 2 and 3,

"(a) if the place of conciliation, as agreed upon by the parties, is in this State; or

"(b) where the place of conciliation has not been agreed upon by the parties, if the place of conciliation is deemed to be in this State.

"1A. Where the place of conciliation has not been agreed upon by the parties, the place of conciliation is deemed to be in a particular State:

"(a) if the entire conciliation takes place in that State;

"(b) where the conciliation takes place in more than one State, if the principal place of business of the institution that administered the conciliation proceedings is in that State;

"(c) where the conciliation takes place in more than one State and the conciliation proceedings are not administered by any institution, if the principal place of business of all parties to the conciliation is in that State; or

"(d) where the conciliation takes place in more than one State, the conciliation proceedings are not administered by any institution and the principal places of business of the parties to the conciliation are in different States, if the place of residence of the conciliator or the panel of conciliators is in that State."

20. In the context of the above discussion, it was proposed that paragraph 1 should be deleted altogether. It was observed that the place of conciliation as one of the main elements triggering the application of the draft Model Law had been retained so far as a result of an analogy being made with the place of arbitration in article 1, paragraph 2, of the UNCITRAL Model Law on International

Commercial Arbitration. It was pointed out that the place of conciliation might not need to play the same central role as might have been given to the place of arbitration in earlier texts of uniform law. In addition, it was pointed out that relying too heavily on the place of conciliation to determine the scope of application of the draft Model Law might be inconsistent with current practice. Since parties often did not formally designate a place of conciliation and since, as a practical matter, the conciliation process could occur in several places, it was believed to be problematic to use the somewhat artificial idea of the place of conciliation as the primary basis for triggering the application of the draft Model Law. Examples were also given of situations where a purely domestic conciliation might take place in a foreign country without the parties intending that place to produce any consequence as to the legal regime applicable to the conciliation. Another example was that of conciliation conducted as part of an online dispute resolution mechanism, where it might be extremely difficult to determine a physical location as the “place of conciliation”, except on an arbitrary and artificial basis.

21. It was widely felt that there was no compelling reason for the draft Model Law to provide an objective rule for determining the place of conciliation. Strong support was expressed in favour of deleting subparagraph (b). As to the subjective determination of the place of conciliation by the parties, it was felt that the text might be easier to apply if it did not rely on a determination of the place of conciliation but recognized expressly the possibility for the parties to opt in to the legislation enacting the draft Model Law (which might be different from the law governing domestic conciliation in States that chose to maintain the distinction between domestic and international conciliation). As to the main criterion that should be used for determining the scope of application of the draft Model Law in the absence of a determination by the parties, it was generally agreed that “internationality” should be used, along the lines of paragraphs 1 and 3 of article 1 of the UNCITRAL Model Law on International Commercial Arbitration. After discussion, it was agreed that paragraph 1 should be redrafted along the lines of “This Law applies to international commercial conciliation.”

Paragraph 2

22. In line with the approval of an opting-in mechanism to trigger the application of the draft Model Law, the Working Group was in general agreement with the objectives of paragraph 2. As a matter of drafting, it was generally felt that the opting-in provision should address both the situation where the parties agreed that the conciliation was to be regarded as international and the situation where the parties decided directly that the draft Model Law should apply, irrespective of the domestic or international nature of the conciliation.

Paragraph 3

23. In view of its decision to delete the reference to the place of conciliation from paragraph 1, the Working Group agreed that paragraph 3 should be deleted.

Paragraph 4

24. The view was expressed that paragraph 4 should be deleted since any listing of the grounds on which conciliation was initiated ran the risk of being incomplete and might lend itself to misinterpretation as to its exhaustive or non-exhaustive character. In support of deletion, it was stated that the draft Model Law should apply only to conciliation carried out as a result of an agreement by the parties. Situations where conciliation was mandated by law or resulted from a decision of a court or an arbitral tribunal raised policy issues that should not be interfered with by the draft Model Law.

25. The prevailing view, however, was that a provision along the lines of paragraph 4 should be retained. As a matter of drafting, it was suggested that the words “a conciliation carried out on the initiative of a party” were ambiguous and insufficiently reflective of the practice where a conciliation was carried out upon the invitation of one party accepted by the other. Additional suggestions were that paragraph 4 should expressly refer to cases where a conciliation was mandated by law and cases where it was carried out at the request of an arbitral tribunal. It was also pointed out that paragraph 4 should make it clear that the draft Model Law applied equally, whether the agreement to conciliate had been reached before or after the dispute had arisen. Those suggestions were found generally acceptable.

Paragraph 5

26. It was suggested that paragraph 5 should be deleted, so as to avoid any misinterpretation as to whether a judge or an arbitrator did or did not have the power to conduct a conciliation under the draft Model Law. It was widely felt, in response, that paragraph 5 was necessary to make it clear that the draft Model Law did not interfere with any procedural law that might or might not create such power for judges and arbitrators.

27. As a matter of drafting, it was stated that the words “a conciliatory process” introduced unnecessary confusion as to how a “conciliatory process” could be distinguished from “conciliation proceedings”. It was suggested that the words “conciliatory process” should be replaced by “settlement conference” or any other reference to attempts made by a judge or conciliator in the course of judicial or arbitral proceedings to facilitate a settlement.

Article 2. Conciliation

28. The text of draft article 2 as considered by the Working Group was as follows:

“For the purposes of these model legislative provisions, conciliation means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them [in an independent and impartial manner] [and without the authority to impose a binding decision on the parties] in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contract or other legal relationship.”

29. There was general agreement with the substance of the draft article. As to the first set of words between square brackets (“in an independent and impartial manner”), it was widely felt that the issue of independence and impartiality of the conciliator should not be dealt with as part of the definition of what constituted conciliation. The Working Group decided that those words should be deleted.

30. With respect to the second set of words between square brackets (“and without the authority to impose a binding decision on the parties”), it was stated that the issue of the distinction between arbitration and conciliation might not need to be addressed in a definition of “conciliation”. Accordingly, it was suggested that those words should be deleted. The prevailing view, however, was that, for the avoidance of any ambiguity, it was useful for the definition to refer to the fact that a conciliator or a panel of conciliators did not have the authority to impose upon the parties a solution of the dispute.

31. As a matter of drafting, it was suggested that the readability of the draft Model Law would be improved if the definition of “conciliation” was placed closer to the beginning of the text, possibly as part of draft article 1. That suggestion was generally approved by the Working Group.

Article 3. International conciliation

32. The text of draft article 3 as considered by the Working Group was as follows:

“1. A conciliation is international if:

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

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

“(i) the place of conciliation; or

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

“2. For the purposes of this article:

“(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

“(b) if a party does not have a place of business, reference is to be made to the party’s habitual residence.”

33. The discussion focused on the text of paragraph 1(b). Consistent with the decision taken as to the reference to the place of conciliation in draft article 1, it was generally agreed that subparagraph (b)(i) should be deleted. In the context of the discussion, it was recalled that, in practice, in some cases, parties to an otherwise domestic conciliation

would agree for convenience on a place of conciliation abroad, without intending to make the conciliation “international”. Accordingly, it was suggested that, in addition to the opting-in provision under draft article 1, the text should include an opting-out provision to the effect that parties would be free to exclude the applicability of the legislation enacting the draft Model Law. That proposal was met with general support.

34. As to the reference to “the place with which the subject-matter of the dispute is most closely connected”, it was stated that it might unnecessarily narrow the scope of the draft Model Law. A proposal was made to refer instead to “the place with which the subject-matter of the dispute is connected”. It was generally felt, however, that the initial wording, which mirrored that of article 1, paragraph 3, of the UNCITRAL Model Law on International Commercial Arbitration, should be maintained.

35. With respect to paragraph 2, it was pointed out that the reference to “the place of business which has the closest relationship to the agreement to conciliate” might unnecessarily complicate the determination of the relevant place of business by suggesting a distinction between the place of business most closely connected to the underlying contract between the parties and the place of business most closely connected to the agreement to conciliate. It was pointed out that the draft Model Law would more logically establish the relevance of “the place of business with which the dispute is most closely connected”. After discussion, the Working Group decided that the initial wording should be retained for reasons of consistency with article 1, paragraph 3, of the UNCITRAL Model Law on International Commercial Arbitration.

36. At the close of the discussion, it was widely agreed that, with a view to enhancing the readability of the draft Model Law and to ensuring greater consistency with the UNCITRAL Model Law on International Commercial Arbitration, the provisions of draft article 3 should be merged into draft article 1.

Restructuring of draft articles 1, 2 and 3

37. In view of the above discussion, the Working Group decided that the texts of draft articles 1, 2 and 3 should be merged into a single provision that should read along the following lines:

“Article 1. Scope of application and definitions

“1. This Law applies to international* commercial** conciliation.

“2. For the purposes of this Law, ‘conciliation’ means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contract or other legal relationship. The conciliator or the panel of conciliators does not have the authority to impose upon the parties a solution of the dispute.

“3. A conciliation is international if:

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

“(b) the State in which the parties have their places of business is different from either:

“(i) the State in which a substantial part of the obligations of the commercial relationship is to be performed; or

“(ii) the State with which the subject-matter of the dispute is most closely connected.

“4. For the purposes of this article:

“(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

“(b) if a party does not have a place of business, reference is to be made to the party’s habitual residence.

“5. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.

“6. The parties are free to agree to exclude the applicability of this Law.

“7. Subject to the provisions of paragraph 8, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.

“8. This Law does not apply to:

“(a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and

“(b) [...]”

“* States wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text: [...]”

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

The text of draft article 1 was referred to the drafting group. It was suggested that the guide to enactment should explain that draft article 1 was not intended to deal with the jurisdiction of the courts of any enacting State.

Article 17. Enforceability of settlement

38. In view of the fact that there had not been sufficient time during the thirty-fourth session of the Working Group to fully discuss draft article 17, and also in view of the overall importance of any rule that might deal with the enforcement of settlement agreements under the draft Model Law and of its possible impact on other articles, the Working Group decided that draft article 17 should be discussed in a preliminary way before other substantive provisions of the draft Model Law.

39. The text of draft article 17 as considered by the Working Group was as follows:

“[Variant A]

“If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable [*the enacting State inserts provisions specifying provisions for the enforceability of such agreements*].

“[Variant B]

“If the parties reach agreement on a settlement of the dispute, that agreement is binding and enforceable as a contract.

“[Variant C]

“If the parties reach agreement on a settlement of the dispute, they may appoint an arbitral tribunal, including by appointing the conciliator or a member of the panel of conciliators, and request the arbitral tribunal to record the settlement in the form of an arbitral award on agreed terms.

“[Variant D]

“If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable as an arbitral award.”

Variant B

40. It was noted that variant B reflected the widely shared view that, in determining its enforceability, a settlement agreement should be dealt with as a contract. It was recalled that most legal systems of the world would recognize a settlement agreement as a contract. However, while variant B might constitute a common denominator between those various legal systems, it was generally felt that a provision along the lines of variant B might be read as merely restating the obvious and that every effort should be made to establish a more effective enforcement regime through which a settlement agreement would be accorded a higher degree of enforceability than any unspecified contract.

Variant C

41. While limited support was expressed in favour of variant C, it was widely felt that a provision along those lines would result in an overly complex architecture. It was stated that it might be inappropriate for the draft Model Law to suggest in a general manner that all conciliation proceedings leading to a settlement agreement should result in the appointment of an arbitral tribunal. Although such a two-stage process might be justified in certain complex cases, it would be too cumbersome to apply as a default rule. It was recalled that, whether or not a provision along the lines of variant C was included in the draft Model Law, the parties would normally be free to appoint an arbitral tribunal as a follow-up to the conciliation process if they so wished (except in those legal systems where the absence of an existing dispute, due to the dispute having been resolved by the settlement agreement, was regarded as an obstacle to arbitration).

Variant D

42. Strong support was expressed in favour of variant D. It was recalled that the notion of a settlement agreement being equated with an arbitral award had been a conceptual starting point of the project that led to the preparation of the draft Model Law. It was stated that a provision along the lines of variant D would be particularly apt to create the additional level of enforceability which the draft Model Law sought to establish beyond the contractual level described in variant B. In addition, it was pointed out that in certain countries, the text of variant D would be in line with existing legislation.

43. It was widely felt, however, that introducing a provision along the lines of variant D might result in considerable uncertainties and practical difficulties. In particular, the legal fiction that the settlement agreement should be treated as an arbitral award would not alter the fundamentally contractual nature of the settlement agreement. Difficulties might therefore arise from the interplay of the two legal regimes that might be applicable, namely the general law of contracts and the legal regime governing arbitral awards. For example, as to the reasons that might be invoked for challenging the binding and enforceable character of a settlement agreement, it was stated that the grounds listed in article V of the New York Convention and in article 36 of the UNCITRAL Model Law on International Commercial Arbitration for refusing enforcement, as well as the grounds listed under article 34 of that Model Law for setting aside an arbitral award, might be insufficient or inappropriate to deal with circumstances such as fraud, mistake, duress or any other grounds on which the validity of a contract might be challenged. As to recognition and enforcement, it was observed that settlement agreements might greatly benefit from the application of the New York Convention. However, the widely shared view was that strong doubts would exist in many countries as to whether and to what extent the New York Convention could govern settlement agreements. Furthermore, it was stated that a provision based on variant D would require a criterion distinguishing between settlements reached during or as a result of conciliation proceedings and those

settlements which might have been discussed during conciliation proceedings but were concluded outside the context of such proceedings. It was considered that drawing such distinctions could be difficult given the flexible nature of conciliation proceedings.

Variant A

44. Divergent views were expressed in respect of variant A. The variant was objected to on the grounds that stating that the settlement agreement was “binding and enforceable” did not create any certainty as to the level of enforceability of the agreement. It was stated that in many countries given that settlement agreements were readily recognized as contracts, this variant would not add to the substance of existing law. In addition, variant A was objected to on the grounds that it did not create uniformity since it failed to provide a unified solution as to how such settlement agreements might become “enforceable” but rather left the matter to the law of each enacting State.

45. The prevailing view however was that a provision along the lines of variant A should be introduced into the draft Model Law since it allowed a certain level of flexibility and might even constitute a useful step towards establishing greater uniformity if the guide to enactment were to facilitate the sharing of information on existing requirements for enforcement, for example through an illustrative listing of such requirements. It was generally agreed that express reference should be made in the text of variant A to the contractual nature of the settlement agreement. It was also agreed that, the words “and the conciliator or the panel of conciliators have signed the settlement agreement” should be deleted so as not to suggest any implication as to the liability of the conciliator or the panel of conciliators, or to create any of the obligations that might stem from becoming a witness of the agreement. Further, many conciliators might wish to avoid the appearance of favouring a particular result.

46. Various suggestions were made as to how the text of variant A could be used as a basis for establishing a legal regime through which settlement agreements would be granted greater enforceability than an ordinary contract. One suggestion was that the draft Model Law should provide that a settlement agreement, as a contract, should have authority as *res judicata*. It was pointed out that such an approach would be in line with the existing law of conciliation in a number of countries and that, more generally, the notion of *res judicata* was known in some form to numerous legal systems. Accordingly, it was suggested that a reference to that notion should be inserted in a redraft of variant A. A related suggestion, made with a view to enhancing the acceptability of the provision, was that such direct reference to *res judicata* as a term of art should be replaced by a description of the contents of the notion. Another suggestion was that the text of variant A should be redrafted along the following lines: “If the parties reach agreement on a settlement of a dispute, such agreement is deemed to be binding and enforceable. Enforcement of the settlement may be refused only at the request of a party against whom it is invoked if that party furnishes evidence to the competent court where recognition or enforcement is sought that the settlement is null and void.”

47. A further suggestion was that, in order to ensure that a settlement that was sought to be enforced was actually the result of a conciliation and also to guard against parties being caught by surprise by enforcement provisions, draft article 17 should require the settlement agreement to state expressly that parties agreed that it arose as a result of a conciliation proceeding and that the parties intended that it would be enforceable under legislation enacting the draft Model Law. It was pointed out that the inclusion of such a requirement would be consistent with party autonomy as the underlying principle in conciliation. Concern was expressed, however, that such additional requirements might be suitable only to cases where conciliation was administered by a conciliation institution or authority but might be too cumbersome for conciliation carried out on an ad hoc basis. The unintended effect of imposing such requirements might be that a number of settlement agreements would not benefit from enforceability as recognized by the draft Model Law if they did not contain the required statements.

48. The Working Group did not come to a final conclusion as to the contents of draft article 17 during the initial discussion. It was agreed that the discussion should be resumed after the Working Group had completed its review of the draft articles. The resumed discussion should be based on a revised version of variant A, taking into account the comments made and examples of solutions in national laws that provided for expedited enforcement of settlement agreements.

New article on interpretation of the Model Law

49. A suggestion was made, and the Working Group agreed, to include in the draft Model Law a provision along the lines of article 3 of the UNCITRAL Model Law on Electronic Commerce, article 8 of the UNCITRAL Model Law on Cross-Border Insolvency and article 4 of the UNCITRAL Model Law on Electronic Signatures. Such a provision, based on article 7 of the United Nations Convention on Contracts for the International Sale of Goods, would provide guidance for interpretation of the draft Model Law, with due regard being given to its international origin. Taking as a model the provisions referred to in the three UNCITRAL Model Laws, the Working Group agreed on the following wording of a new draft article:

“1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

“2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.”

Article 4. Variation by agreement

50. The text of draft article 4 as considered by the Working Group was as follows:

“Except as otherwise provided in these model legislative provisions, the parties may agree to exclude or vary any of these provisions.”

51. It was suggested that the words “Except as otherwise provided” were unnecessary, since no provision of the draft Model Law appeared to provide otherwise. Concern was expressed that, if the effect of draft article 4 was to allow parties to exclude or vary any or all the provisions in the draft Model Law, this could result in unintended results, for example, if parties decided to exclude all the provisions of the draft Model Law except for those relating to enforcement, or if the parties could agree that paragraph 3 of article 8, which provided guidelines for the conduct of the conciliator, would not apply to a particular conciliation. It was widely felt that a provision such as paragraph 3 of article 8, if it were retained in the draft Model Law, should not be subject to the discretion of the parties. The Working Group agreed that the general rule underlying the draft Model Law ought to be party autonomy and that mandatory rules should be expressly identified. The Working Group, at this stage of its discussion, did not reach a final decision regarding the opening words of draft article 4. It was agreed that the matter should be reopened after the Working Group had completed its review of the substantive provisions of the draft Model Law, with a view to identifying those mandatory provisions of the draft Model Law, if any, that might need to be listed in draft article 4.

Article 5. Commencement of conciliation proceedings

52. The text of draft article 5 as considered by the Working Group was as follows:

“1. The conciliation proceedings in respect of a particular dispute commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.

“2. If a party that invited another party to conciliate does not receive a reply within [fourteen] days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.”

Paragraph 1

53. The Working Group decided to defer consideration of draft article 5, paragraph 1, until a decision had been made as to whether a provision dealing with the limitation period (which was currently set forth in draft article 12) would be included in the draft Model Law. It was suggested that, if it was decided not to include a provision on the limitation period, paragraph 1 could be considered to be unnecessary.

Paragraph 2

54. Several suggestions were made in respect of paragraph 2. One suggestion was that the rule that the party inviting the other party to conciliation could elect to treat a failure to receive a reply within 14 days as a rejection of

the invitation to conciliation, was too rigid. It was considered that, in certain circumstances, a reply to an invitation to conciliate could be delayed through no fault of the party sending that reply. To avoid that situation, a suggestion was made that the following words should be added at the end of paragraph 2: "on the condition that the party gives notice to the other party or parties to the dispute that it has elected to treat the failure to respond to the invitation as a rejection of the invitation to conciliate." Another suggestion was that, instead of stating that the party inviting the other party to conciliate should "receive" a reply within fourteen days, paragraph 2 should state that the reply should be "sent" within 14 days. In response, it was recalled that such an approach had been rejected at an earlier session of the Working Group. Little support was expressed in favour of the suggestions. However, with a view to alleviating the concern that the rule established in paragraph 2 might be too rigid, it was agreed that the time period during which a reply to an invitation to conciliate should be made should be extended from 14 to 30 days.

55. The view was expressed that, as currently drafted, paragraph 2 did not make it clear whether or not acceptance or rejection of the invitation to conciliate was confidential information. It was agreed that this question might need to be considered in the context of draft article 13, which dealt with admissibility of evidence in other proceedings.

56. Subject to the extension of the time period to 30 days, the Working Group adopted the substance of draft paragraph 2 and referred it to the drafting group.

Article 6. Number of conciliators

57. The text of draft article 6 as considered by the Working Group was as follows:

"There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators."

58. The Working Group adopted the substance of draft article 6 and referred it to the drafting group.

Article 7. Appointment of conciliators

59. The text of draft article 7 as considered by the Working Group was as follows:

"1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

"2. In conciliation proceedings with two conciliators, each party appoints one conciliator.

"3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

"4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

"(a) a party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

"(b) the parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

"5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties."

60. A concern was expressed that, as currently drafted, draft article 7 did not contemplate the possibility that, in court-initiated arbitrations, the situation might arise that a court rather than the parties appointed a conciliator. In response it was suggested that, even in court-initiated conciliations, in some States the parties in dispute were still generally responsible for appointing the conciliator or panel of conciliators.

61. The view was expressed that in paragraphs 2 and 3 of draft article 7, the appointment provisions should only represent a fall-back provision when the parties were unable to reach a mutual agreement on the appointment of a conciliator or panel of conciliators. It was suggested that paragraphs 1, 2 and 3 should establish as a general requirement that, in all cases, parties that contemplated conciliation should endeavour to reach a mutual agreement on a conciliator or panel of conciliators. The suggestion was objected to on the grounds that such a general requirement, which might require the inclusion of a time limit within which such endeavours should be made, would introduce an unnecessary complication that could further delay the commencement and progress of conciliation proceedings.

62. Another suggestion was that paragraphs 1, 2 and 3 should be redrafted to take account of multiparty conciliations. In cases where there were more than two parties, it would be impracticable for each party to appoint one conciliator. In such cases, it would be appropriate for the parties to refer the matter to an arbitral institution or an independent third person. On that basis, it was suggested that the following text should replace the current paragraphs 1, 2 and 3:

"1. The parties shall endeavor to reach agreement on the name of the sole conciliator, or the names of the members of the panel of conciliators, to be appointed.

"2. In conciliation proceedings involving one conciliator, if the parties are unable to reach agreement on the name of the sole conciliator, the conciliator shall be appointed by [name of appropriate institution or description of appropriate person].

“3. In conciliation proceedings involving a panel of conciliators, if the parties are unable to reach agreement on the name of any member of the panel, that member of the panel shall be appointed by [name of appropriate institution or description of appropriate person].”

63. A further suggestion was that paragraphs 1, 2 and 3 should be redrafted to the effect that, where the parties intended to appoint an even number of conciliators, each party should appoint an equal number of conciliators. Where parties intended to appoint an odd number of conciliators, an additional stage would need to be considered, where parties should endeavour to reach agreement on the name of the remaining conciliator. In response to that suggestion, it was pointed out that, in practice, the maximum number of conciliators was usually three.

64. While limited support was expressed in favour of each of the above suggestions, the prevailing view was that the text of draft article 7 should remain unchanged. It was agreed that the draft guide to enactment might need to point out the advantages of the parties first endeavouring to mutually agree on a conciliator or panel of conciliators. The text of draft article 7 was referred to the drafting group.

65. In the context of the discussion of draft article 7, a proposal was made that a conciliator should be required to disclose any circumstances that were likely to raise justifiable doubts as to his or her impartiality or independence. It was suggested that text should be included along the lines set out in article 12, paragraph 1, of the UNCITRAL Model Law on International Commercial Arbitration. General support was expressed in favour of that proposal. The Working Group also discussed whether, in the event that such a requirement of disclosure was included, the provision should also set out the consequences that might result from failure to make such a disclosure. One view was that the Model Law should state expressly that failure to make such disclosure should not result in the nullification of the conciliation process. The prevailing view was that the consequences of failure to disclose such information should be left to the law of the enacting State.

66. After discussion, it was decided that a provision along the following lines should be added to the draft Model Law: “When a person is approached in connection with his or her possible appointment as a conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.” The matter was referred to the drafting group.

Article 8. Conduct of conciliation

67. The text of draft article 8 as considered by the Working Group was as follows:

“1. The parties are free to agree, by reference to a set of rules or otherwise, upon the manner in which the conciliation is to be conducted.

“2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any [views] [expectations] [intentions] [wishes] that the parties may express, and the need for a speedy settlement of the dispute.

“3. The conciliator shall be guided by principles of [objectivity, fairness and justice][objectivity, impartiality and independence] and seek to maintain fairness in treatment as between the parties.

“4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.”

Paragraph 1

68. The substance of paragraph 1 was found generally acceptable.

Paragraph 2

69. The view was expressed that paragraph 2 should be deleted, since the provision did not reflect the current practice of conciliation, which demonstrated that parties were unlikely to agree on rules of procedure that would be imposed by the conciliator. The widely prevailing view, however, was that the policy underlying the provision was appropriate, and that the substance of paragraph 2 was generally acceptable. With respect to the alternative words between square brackets, general preference was expressed for the word “wishes” (or “wishes expressed”), for reasons of consistency with article 7, paragraph 3, of the UNCITRAL Conciliation Rules.

Paragraph 3

70. The view was expressed that paragraph 3 should be deleted. The concern (expressed at the thirty-fourth session of the Working Group) was reiterated that, by providing courts with a yardstick against which to measure the conduct of conciliators, paragraph 3 could have the unintended effect of inviting parties to seek annulment of the settlement agreement through court review of the conciliation process. It was thus suggested that the statement of principles should be located in the draft guide to enactment (A/CN.9/487, para. 124). Another view was that the scope of paragraph 3 should be limited to establishing the principles to be applied by the conciliator in the conduct of the process, without interfering with the terms of the settlement agreement. However, the prevailing view was that the guiding principles should be retained in the body of the legislative provisions to the effect of providing guidance regarding conciliation, particularly for less experienced conciliators.

71. As to the alternative wordings between square brackets, it was recalled that the first variant reflected a decision made by the Working Group that “objectivity, fairness and

justice” should be retained as one option (A/CN.9/487, para. 125). The view was expressed that the first variant was to be preferred for the reason that it mirrored the language of article 7, paragraph 2, of the UNCITRAL Conciliation Rules. The second variant reflected the view that “impartiality and independence” were to be preferred over words such as “fairness and justice” on the basis that the latter terms connoted the role of a decision maker (such as a judge or an arbitrator) rather than the role of a conciliator, and that using the English word “fairness” might cause difficulties in certain other languages, particularly if it were to be translated in the grammatical form of a substantive.

72. It was widely felt that both variants should be interpreted as establishing a standard of conduct that might vary considerably with the circumstances of the case. The view was expressed that failure to comply with paragraph 3 should not be regarded in itself as sufficient grounds for annulment of the settlement agreement. After discussion, it was agreed that the educative function, as well as the abstract and relative nature of the standard of conduct expressed in paragraph 3, might be better expressed through the deletion of both variants. The Working Group decided that paragraph 3 should be redrafted along the following lines: “In conducting the proceedings, the conciliator or the panel of conciliators shall seek to maintain fairness in treatment as between the parties and, in so doing, shall take into account the circumstances of the case.” The matter was referred to the drafting group.

73. At the close of the discussion, the Working Group agreed that, while other provisions of draft article 8 might be subject to contrary agreement between the parties, paragraph 3 should be regarded as setting a minimum standard. Thus, parties should not be allowed to agree on a different standard of conduct to be followed by conciliators. It was decided that an exception to the general application of draft article 4 should be made with respect to paragraph 3 of draft article 8.

Paragraph 4

74. The view was expressed that paragraph 4 should be deleted. It was stated that enacting States should remain free to decide whether conciliators were entitled to make proposals for settlement. The widely prevailing view, however, was that the substance of paragraph 4 was generally acceptable.

Article 9. Communication between conciliator and parties

75. The text of draft article 9 as considered by the Working Group was as follows:

“Unless otherwise agreed by the parties, the conciliator or the panel of conciliators may meet or communicate with the parties together or with each of them separately.”

76. It was generally felt that the text of draft article 9 might need to be revised to make it clear that any member of a panel of conciliators should be free to meet with the

parties. The following text was proposed as a possible paragraph 2 to be inserted after the current draft provision: “Where there is more than one conciliator, each party-appointed conciliator shall be at liberty to meet with, discuss and communicate with the party who appointed that conciliator and, subject to any constraints placed upon the conciliator by the appointing party, the conciliator will be at liberty to disclose all or any of the content of what may have been discussed to the other conciliator or conciliators.” While some support was expressed in favour of the proposed text, it was generally felt that the effect of such a provision might be to institutionalize partiality on the part of the conciliator appointed by one party. With a view to avoiding the creation of any particular relationship between a conciliator and a party, it was agreed that the text of draft article 9 should be reworded along the following lines: “Unless otherwise agreed by the parties, the conciliator, a member of the panel of conciliators or the panel of conciliators may meet or communicate with the parties together or with each of them separately.” The matter was referred to the drafting group.

Article 10. Disclosure of information

77. The text of draft article 10 as considered by the Working Group was as follows:

“When the conciliator or the panel of conciliators receives information concerning the dispute from a party, the conciliator or the panel of conciliators may disclose the substance of that information to the other party. However, the conciliator or the panel of conciliators shall not disclose information received from a party, when the party gives the information to the conciliator or the panel of conciliators subject to a specific condition that it be kept confidential.”

78. The policy underlying draft article 10 was challenged, in line with a view expressed at the thirty-fourth session of the Working Group. It was stated that, in the absence of agreement to the contrary, requiring the conciliator to maintain strict confidentiality of the information communicated by a party was the only way of ensuring frankness and openness of communications in the conciliation process. Such confidentiality was reported to be consistent with conciliation practice in certain countries (A/CN.9/487, para. 131). It was proposed that draft article 10 should be amended to read as follows: “When the conciliator or the panel of conciliators receives information concerning the dispute from a party, the conciliator or the panel of conciliators shall not disclose that information to any other party unless the party giving the information expressly consents to such disclosure.”

79. In response, the Working Group reiterated its preference for the view that had prevailed widely at its thirty-fourth session, according to which draft article 10 should ensure circulation of information between the various participants in the conciliation process. It was pointed out that requiring consent by the party which gave the information before any communication of that information to the other party by the conciliator would be overly formalistic, inconsistent with established practice in many countries as

reflected in article 10 of the UNCITRAL Conciliation Rules and likely to inhibit the entire conciliation process (A/CN.9/487, para. 132).

80. It was pointed out that draft article 10 focused on disclosure of information as between the parties. With a view to expressing that focus more clearly, it was suggested that the current title of draft article 10 should be replaced by the words “disclosure of information between the parties”. Along the same lines, it was suggested that the reference to information being “disclosed” should be reformulated to indicate unequivocally information being “disclosed to the other party”. Those suggestions were accepted by the Working Group. With respect to disclosure of information to third parties, however, it was widely agreed that the draft Model Law should establish a strict rule on confidentiality.

81. As a matter of drafting, it was suggested that the words “the substance of that information” should be replaced by the words “that information”. It was pointed out in response that the current text, along the lines of article 10 of the UNCITRAL Conciliation Rules, was preferable to avoid burdening the conciliator with an obligation to communicate the literal content of any information received from the parties. Another suggestion was that the text should be brought in line with the revised text of draft article 9, through appropriate reference to “any member of the panel of conciliators”. That suggestion was widely supported.

82. After discussion, the Working Group agreed that draft article 10 should be redrafted along the following lines: “When the conciliator, a member of the panel of conciliators or the panel of conciliators receives information concerning the dispute from a party, the conciliator, the member of the panel of conciliators or the panel of conciliators may disclose the substance of that information to the other party. However, the conciliator, the member of the panel of conciliators or the panel of conciliators shall not disclose to the other party information received from a party, when that party gives the information to the conciliator, the member of the panel of conciliators or the panel of conciliators subject to a specific condition that it be kept confidential.” The text was referred to the drafting group.

General provision on confidentiality

83. Support was expressed for the inclusion of a general rule of confidentiality applying to the conciliator and, possibly, to the parties. A proposal, developed on the basis of article 14 of the UNCITRAL Conciliation Rules, was made along the following lines: “The conciliator and the parties must keep confidential all matters relating to the conciliation proceedings and the settlement agreement, except where disclosure is necessary for the purposes of implementation, enforcement or setting aside.” Various concerns were expressed with respect to that proposal. One concern was that it might be inappropriate to impose upon the parties a rule that would not be subject to party autonomy and could be very difficult, if not impossible, to enforce. In response, it was suggested that the obligation to respect confidentiality could be made subject to the parties’

contrary agreement. Another concern was that the proposal failed to provide for exceptions, for example in circumstances where an obligation to disclose was established by law, such as an obligation to disclose evidence of a criminal offence. A more general concern was expressed that the scope of a provision on confidentiality should be broad enough to cover not only information disclosed during the conciliation proceedings but also to cover the substance and the result of these proceedings as well as matters relating to a conciliation that occurred before the agreement to conciliate was reached including, for example, discussions concerning the desirability of conciliation, the terms of an agreement to conciliate, the choice of conciliators, an invitation to conciliate and the acceptance or rejection of such an invitation.

84. With a view to alleviating those concerns, the following alternative text was proposed: “The conciliator and the parties must keep confidential all matters relating to the conciliation proceedings and the settlement agreement. This does not apply to information which is (a) necessary for the purposes of implementation, enforcement or the setting aside of the settlement agreement; (b) authorized for disclosure by the party that originally divulged the information; (c) in any event, in the public domain (d) required by law to be disclosed; or (e) necessary for a party to disclose to its professional advisers, to whom this provision would also apply.” As a matter of drafting, it was pointed out by its proponents that the language set out in paragraph (b) of the proposed text might need to be finessed to cover the person with whom the information first originated. Whilst the first sentence of that proposal was found generally acceptable in substance, concern was expressed as to the exceptions set out in the second sentence. It was stated that the term “professional advisers” was unclear, for example as to whether the proposed text was intended to refer only to licensed practitioners or was also intended to cover unlicensed practitioners and whether independent auditors were considered advisers in all legal systems. Although a widely shared view emerged that the exceptions set forth in that proposal were relevant and appropriate in substance, it was strongly felt that listing exceptions in the text of the draft Model Law might raise difficult questions of interpretation, in particular as to whether the list should be regarded as exhaustive. After discussion, the Working Group agreed that an illustrative and non-exhaustive list of possible exceptions to the general rule on confidentiality would more appropriately be provided in the draft guide to enactment.

85. Yet another proposal was made that sought to respect party autonomy and avoid the use of any list (whether exhaustive or non-exhaustive) of exceptions. That proposal read along the following lines: “Unless otherwise agreed by the parties, and except to the extent necessary by law or to protect a legal right, matters relating to the conciliation proceedings shall be confidential.” Concern was expressed that the phrase “legal right” was ambiguous. Wording elaborating on the text of article 14 of the UNCITRAL Conciliation Rules was proposed as an alternative so that the words “to protect a legal right” would be replaced by “for purposes of implementation, enforcement or the setting aside of the settlement agreement”. While support was expressed in favour of that wording, it was pointed out

that the reference to “setting aside” the settlement agreement might be inappropriate. It was stated that emphasizing the possibility of “setting aside” a settlement agreement might be inconsistent with the overall policy of the draft Model Law to provide additional enforceability for a settlement agreement, in particular under draft article 17. In addition, although article 34 of the UNCITRAL Model Law on International Commercial Arbitration enumerated grounds for setting aside an arbitral award, no similar provision had been envisaged under the draft Model Law. After discussion, it was agreed that no reference should be made to “setting aside” of the settlement agreement. As a matter of drafting a concern was raised that the words “conciliation proceedings” could be interpreted too narrowly as not covering the settlement agreement. To avoid that ambiguity, it was suggested that language such as “matters relating to the conciliation proceedings and the settlement agreement” should be used. Another suggestion was that words such as “matters relating to the conciliation proceedings, including the substance of the proceedings” would ensure a broader application for this rule. Ultimately, the phrase “all matters relating to the conciliation proceedings” was proposed and met with strong support not least because it reflected a tried and tested formula set out in article 14 of the UNCITRAL Conciliation Rules. It was agreed that the draft guide to enactment should provide the explanations necessary to avoid a narrow interpretation of the words “conciliation proceedings” and to make it clear that the exceptions to the general rule on confidentiality should cover not only the settlement agreement but also the conciliation proceedings to ensure that, for example in annulment proceedings, the right of a party to go to court (where such a right existed) would be protected.

86. In keeping with article 14 of the UNCITRAL Conciliation Rules, it was generally agreed that a provision should be included in the draft Model Law along the following lines: “Unless otherwise agreed by the parties, except where disclosure is required under the law or necessary for the purposes of implementation or enforcement of a settlement agreement, all matters relating to the conciliation proceedings shall be confidential.” The matter was referred to the drafting group. The view was expressed that it would be advisable to specify the parties to whom the principle of confidentiality would apply given the reference in the provision to “the law”.

Article 11. Termination of conciliation

87. The text of draft article 11 as considered by the Working Group was as follows:

“The conciliation proceedings are terminated:

“(a) by the conclusion of the settlement agreement by the parties, on the date of the agreement;

“(b) by a written declaration of the conciliator or the panel of conciliators, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

“(c) by a written declaration of the parties addressed to the conciliator to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

“(d) by a written declaration of a party to the other party and the conciliator, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.”

88. General support was expressed for the substance of draft article 11. Various issues were raised with respect to the wording of the draft article. It was recalled that, with a view to better accommodating the use of electronic commerce, the Working Group, at its previous session, had agreed to replace the words “the signing” with “the conclusion” of the settlement agreement. In keeping with the policy of supporting electronic means of communication, a question was raised as to whether the reference to “written declaration” in subparagraph (b) should be amended to simply refer to “declaration”. It was suggested that, given that the intention of the article was to ensure that there was some evidence of termination via a declaration, words such as “or other means of communication” could be inserted in subparagraphs (b), (c) and (d) after the term “written declaration” to accommodate electronic means of communication. An alternative view was that the term “record” would be a more appropriate term to capture the need for the declaration to terminate to be retrievable. The Working Group agreed that article 6 of the UNCITRAL Model Law on Electronic Commerce provided a workable model that might be used in drafting a definition of “writing” that would accommodate electronic means of communication. It was suggested that a footnote in the draft Model Law or in its guide to enactment could provide that any enacting state that had not enacted the UNCITRAL Model Law on Electronic Commerce should consider inclusion of a provision along the lines of article 6 of that instrument when enacting the draft Model Law. It was suggested that, if it were considered necessary to elaborate upon the reference to “writing” in draft article 11, enacting States might need to consider similar developments with respect to other provisions of the draft Model Law, such as, for example, the notion “signed” in draft article 17. It was generally agreed that the issues of electronic commerce did not require specific provisions to be inserted in the draft Model Law, but should be addressed in the draft guide to enactment.

89. It was observed that the present draft addressed the situation where only one or more of the members of the panel of conciliators terminated conciliation proceedings. The current drafting of subparagraph (b) left open the question of whether, where there was more than one conciliator, all members of the panel should act jointly and the declaration should originate from the entire panel of conciliators. In that connection it was noted that subparagraph (c) referred to a written declaration “addressed to the conciliator” and subparagraph (d) referred to a written declaration “of a party to the other party and the conciliator”. It was suggested that both these paragraphs should be amended to cover conciliations involving more than one conciliator. That proposal received general acceptance.

90. A question was raised as to the “the date of the declaration” in subparagraphs (b), (c) and (d). It was stated that, as currently drafted, subparagraph (d) afforded a party to a conciliation not only the means of unilaterally terminating the conciliation proceedings, but also the possibility of making a unilateral decision as to the date upon which

those proceedings would be terminated. A concern was raised that subparagraph (d) could lend itself to abuse by a party that backdated the declaration with the effect that certain disclosures made during the conciliation would not be covered by articles such as draft article 10, which dealt with disclosure of information. Accordingly, a proposal was made that the words “the date of the declaration” in subparagraphs (b), (c) and (d) should be replaced by the words “the date when the declaration was received by the other party.” However a contrary view was that, even if a conciliation was terminated, draft articles 10 and 13 would still govern disclosures made whilst the conciliation was still on foot.

91. After discussion, it was agreed that, with the exception of amendments needed to cover conciliations involving a panel of conciliators, the text of draft article 11 should remain unchanged, with the possible inclusion in the draft guide to enactment of an explanation regarding such terms as “written”, “in writing” and “signed”, when used in the context of electronic commerce. The draft article was referred to the drafting group.

Article 12. Limitation period

92. The text of draft article 12 as considered by the Working Group was as follows:

“[1. When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

“2. Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.]”

93. Strong opposition was expressed to the retention of draft article 12, principally on the basis that the issue of the limitation period raised complex technical issues and would be difficult to incorporate into national procedural regimes, which took different approaches to the issue. Moreover, it was suggested that the provision was unnecessary since other avenues were available to the parties to protect their rights (for example, by agreeing to extend the limitation period or by commencing arbitral or court proceedings for the purpose of interrupting the running of the limitation period). An equally strong argument was presented in favour of inclusion of draft article 12 on the basis that preserving the parties’ rights during a conciliation would enhance the attractiveness of conciliation. It was said that an agreed extension of the limitation period was not possible in some legal systems and providing a straightforward and efficient means to protect the rights of the parties was preferable to leaving the parties with the option of commencing arbitral or court proceedings. Some of those opposed to the inclusion of the article considered that the point of commencement of a conciliation proceeding (that is, agreement of the parties to engage in conciliation proceedings as provided for in draft article 5) was not precise enough and that draft article 12 might be more acceptable if that point was established with greater precision. In line with that thinking, it was suggested that paragraph 1 should

be redrafted along the following lines: “The running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended on the date on which the person or persons asked by the person to act as conciliator or conciliators agree to act in such capacity.” It was suggested that that wording was an improvement on the current text as it tied the suspension of the limitation period to a more objective event than the agreement to engage in conciliation proceedings. However, the suggestion was opposed because it took control of suspension of the limitation period out of the hands of the parties and gave such control to conciliators. It was said that the claimant needed the protection of the interruption of the limitation period from the moment that it agreed to conciliate with the other party and that an interruption that was linked to the acceptance of a person to act as a conciliator might come too late to provide such protection. It was suggested that, if greater clarity was being sought, the better date would be the date on which an acceptance of an invitation to conciliate was received by the party inviting another party or parties to conciliation.

94. After discussion, it was decided that draft article 12 should be based on the idea that it was the agreement of the parties that suspended the limitation period and that the provision should be placed in a footnote to draft article 5 for optional use by States that wished to enact it.

Article 5, paragraph 1. Commencement of conciliation proceedings

95. Having concluded its discussion of draft article 12, the Working Group reverted to draft article 5, paragraph 1, in accordance with its earlier agreement that the discussion of the article should be deferred until after the Working Group had considered draft article 12.

96. A suggestion that a reference to a “written agreement” for the parties to agree to conciliate (as required for arbitration agreements) was not supported because of the informality of the conciliation process and because there was no need to impose such a formal requirement upon parties wishing to resolve their dispute by conciliation.

97. It was observed that a provision on the commencement of conciliation proceedings could not be precise given that parties used different methods to agree to engage in conciliation proceedings. It was suggested that these methods could be spelt out in the guide to enactment. It was considered that, ultimately, the question of when the parties reached agreement to commence proceedings was a question of evidence. The view was expressed that defining commencement of conciliation would mainly be a problem for those States that chose to enact a provision for suspension of the limitation period along the lines of draft article 12 since parties would need to be certain of the date of such suspension. In order to make the rule more precise, a suggestion was made to include text based on article 5 of the UNCITRAL Conciliation Rules in the following terms: “Unless otherwise agreed by the parties, a conciliation will commence if a written invitation to conciliate is made by one party and received by the other party.” However that suggestion was criticized because it reflected only one way

in which agreement to conciliate might be reached. A further criticism was that where a court pursuant to its prerogatives ordered the parties to conciliate, it was inappropriate to assume that it was up to one party to invite the other party to conciliate and for the other party to accept such an invitation. The possibility that a party's invitation was not forthcoming on the basis of a court order might imply that the parties were allowed to disregard the court order. Therefore, it was suggested that the date of the court order should be taken as the date when the conciliation proceedings commenced. Nevertheless the Working Group adopted the view that it was not the court order per se that triggered conciliation proceedings, but it was rather the moment when the parties implemented that order by taking steps to set the process in motion. That moment should therefore be defined in terms of the parties' initiation of conciliation proceedings. Any failure of the parties to follow the court order would give rise to consequences that fell outside the scope of the draft Model Law.

98. There was a concern that the drafting of the provision did not make a clear distinction between cases where the parties agreed to conciliate any future disputes that might arise between them and cases where the parties, after a dispute had arisen, agreed to request a third person to act as a conciliator in respect of that dispute. Draft article 5 referred only to the latter case, that is, when the parties agreed to engage in conciliation after a dispute had arisen.

99. It was proposed that to address this the following text could be included: "1A. For the purposes of paragraph 1, a term contained in a contract entered into before the difference or dispute arose that provides for differences or disputes arising under the contract to be resolved by conciliation does not constitute a formal agreement to engage in conciliation proceedings. 1B. For the purposes of paragraph 1, a formal agreement to engage in conciliation proceedings may be constituted by an invitation to conciliate coupled with an acceptance of such invitation." While that particular wording was not supported, the policy underlying it received some support. An alternative text proposed was along the following lines: "Unless otherwise agreed by the parties, the conciliation proceedings in respect of a particular dispute that has arisen commence on the date on which a written invitation to commence proceedings made pursuant to an order of a competent authority, a prior agreement to conciliate or at the initiative of a party is accepted by the other party." However, the proposal was criticized on the basis that, as argued earlier (see para. 97 above), the provision was not appropriate for cases where a court ordered the proceedings and for cases where the parties agreed to conciliate without exchanging an invitation and its acceptance.

100. There was general agreement that a provision regarding commencement of conciliation proceedings should be retained. The view emerged that the current text was appropriate because it was general enough, provided it was amended to make it clearer that it dealt with agreements to conciliate made after a dispute arose. It was agreed that text along the following lines should be included: "1. Unless otherwise agreed, the conciliation proceedings in respect of a particular dispute that has arisen commence on the day on which the parties to the dispute agree to engage in

conciliation proceedings. 2. If the party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate." It was agreed that the text could replace the existing text of draft article 5, paragraph 1. The substance of the provision was adopted and referred to the drafting group.

Article 13. Admissibility of evidence in other proceedings

101. The text of draft article 13 as considered by the Working Group was as follows:

"1. [Unless otherwise agreed by the parties,] a party who participated in the conciliation proceedings or a third person shall not rely on, or introduce as evidence, in arbitral or judicial proceedings, whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings:

"(a) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;

"(b) Statements or admissions made by a party in the course of the conciliation proceedings;

"(c) Proposals made by the conciliator;

"(d) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator.

"2. Paragraph 1 of this article applies irrespective of [the form of the information or evidence referred to therein] [whether the information or evidence referred to therein is in oral or written form].

"3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by the arbitral tribunal or the court [whether or not the arbitral or judicial proceedings relate to the dispute that is the subject of the conciliation proceedings] unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings.

"4. Where evidence has been offered in contravention of paragraph 1 of this article, the arbitral tribunal or the court shall treat such evidence as inadmissible.

"5. Evidence that is admissible in arbitral or court proceedings does not become inadmissible as a consequence of being used in a conciliation."

Paragraph 1

Opening words

102. With respect to the words "[Unless otherwise agreed by the parties]", the view was expressed that the general principle stated in paragraph 1 should not be subject to party autonomy. Accordingly, it was suggested that the

mandatory nature of paragraph 1 should be expressed in draft article 4. Some support was expressed in favour of that suggestion, which was aimed at preserving the autonomous and confidential character of conciliation. However, the prevailing view was that the public interest that might be attached to the prohibition established under paragraph 1 was not strong enough to justify deviation from party autonomy as one of the main principles underpinning the draft Model Law. After discussion, it was decided that paragraph 1 should remain subject to contrary agreement by the parties. As to how the non-mandatory nature of the provision should be expressed, the view was expressed that the words “[Unless otherwise agreed by the parties]” were superfluous in view of the general rule contained in draft article 4. However, the prevailing view was that maintaining those words would better reflect the function of the rule stated in paragraph 1 as a default rule of conduct for the parties.

Subparagraphs (a) to (d)

103. While general support was expressed in favour of subparagraphs (a) to (d), a suggestion was made for inclusion of two additional subparagraphs along the following lines and in the order indicated: “(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings” and “(f) A document prepared solely for purposes of the conciliation proceedings.” That suggestion was met with general approval.

104. A question was raised regarding the interplay between paragraph 1 of draft article 13 and draft article 12. It was said that to the extent that the commencement of the proceedings could suspend the limitation period under draft article 12, it was not clear how a party could provide evidence of such suspension if paragraph 1 of draft article 13 prohibited such evidence being introduced. In response, it was stated that, when it referred to “an invitation” to engage in conciliation and an expression of “willingness” to participate in conciliation proceedings, new subparagraph (a) was intended to preserve the confidentiality of the conciliation proceedings but not to deal with the agreement to conciliate. Thus, paragraph 1 did not prevent evidence of the existence of an agreement to conciliate being introduced as a cause for suspension of the limitation period. It was observed that appropriate clarification in that respect might need to be given in the draft guide to enactment.

Paragraph 2

105. The substance of paragraph 2 was found generally acceptable. With respect to the alternative wordings between square brackets, it was generally felt that the words “the form of the information or evidence referred to therein” should be preferred, as they did not refer to any specific form of the information and thus avoided questions of interpretation that might arise, for example, as to whether information on an electronic medium should be regarded as written or oral. The matter was referred to the drafting group.

Paragraph 3

Reference to “The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by the arbitral tribunal or the court . . .”

106. General support was expressed for the basic rule established by paragraph 3 with respect to arbitral tribunals and courts. The discussion focused on the exceptions that should be made to the general prohibition of disclosure of information binding the parties under paragraph 1 and the courts and tribunals under paragraph 3 (see paras. 108 to 114 below).

Reference to “[whether or not the arbitral or judicial proceedings relate to the dispute that is the subject of the conciliation proceedings]”

107. While there was general agreement that the words between square brackets should be retained, it was felt that they should apply equally to paragraphs 1, 2 and 3. To that effect, it was agreed that the words should be relocated in a separate paragraph, which should read along the following lines: “The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.” The matter was referred to the drafting group.

Reference to “unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings.”

108. Various views were expressed regarding possible exceptions to the general rule expressed earlier in paragraph 3. One view was that all mention of such possible exceptions should be deleted. It was pointed out that parties engaging in conciliation proceedings should feel confident that the confidentiality of the process would be protected by law and that they would not become obliged to divulge information relating to conciliation proceedings in the context of a later judicial or arbitral procedure. The prevailing view, however, was that the Model Law should establish expressly the power of courts and arbitral tribunals to order disclosure of information in specific circumstances.

109. As to the formulation of the exceptions to the general rule expressed at the beginning of paragraph 3, a suggestion was made that the wording of paragraph 3 should closely follow the wording adopted for the general provision on confidentiality (see para. 86 above), along the following lines: “except where disclosure is required under the law or necessary for the purposes of implementation or enforcement of a settlement agreement.” That suggestion was widely supported. In the context of the suggested reformulation, it was pointed out that the words “is permitted under the law” contained in the current draft should be deleted. Referring to disclosure being “permitted” under the law would result in an overly broad exception to the general principle of non-disclosure, since the law could generally be interpreted as “permitting” the use of information as evidence.

110. In the context of that discussion, the view was expressed that exceptions to the prohibition of disclosure of information should apply equally to the parties under paragraph 1 and courts or arbitral tribunals under paragraph 3. It was stated that exceptions under paragraph 1 were needed, for example to cover a situation where a party would legitimately wish to challenge the validity of the settlement agreement because that party's consent to the settlement was the result of wrongdoing on the part of the other party or the conciliator. It was stated in response that no exception to paragraph 1 was needed, provided that exceptions were offered under paragraph 3. Under that view, a party should not be allowed to make a determination as to whether information referred to in paragraph 1 should be disclosed. Instead, where a party considered that the production of information referred to in paragraph 1 was required under the law or necessary to preserve its rights, for example in cases of alleged fraud, that party should apply to a court to obtain a decision in that respect. It was stated that allowing a party to deviate from the general rule contained in paragraph 1 would undermine the right of the other party to confidentiality of the conciliation process.

111. With a view to reconciling the various views expressed regarding the exceptions to be provided to the general rules expressed in paragraphs 1 and 3, it was suggested that the issue might be dealt with under paragraph 4.

Paragraph 4

112. A suggestion was made that the word "shall" should be replaced by "may". While support was expressed for the suggestion, the prevailing view was that the suggested amendment would give excessive discretion to the courts and encourage parties to ignore the general prohibition regarding disclosure of information. The prevailing view was that language inspired from the general provision on confidentiality (see para. 86 above), along the lines retained for paragraph 3 ("except where disclosure is required under the law or necessary for the purposes of implementation or enforcement of a settlement agreement"), would adequately cover the interests of a party in case of alleged fraud.

113. As a matter of drafting, it was agreed that, if the same language inspired from the general provision on confidentiality was to be inserted in paragraphs 3 and 4, the two paragraphs should be merged into a single provision.

114. After discussion, it was agreed that paragraphs 3 and 4 should be reformulated as a single paragraph 3 along the following lines: "3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement."

Paragraph 5

115. General agreement was expressed with the substance of paragraph 5. It was proposed that the provision should be prefaced by the words "Subject to the limitations in paragraph 1" and the word "otherwise" should be added before the word "admissible". That proposal was found generally acceptable. The text was referred to the drafting group.

Article 14. Role of conciliator in other proceedings

116. The text of draft article 14 as considered by the Working Group was as follows:

"1. Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that was or is the subject of the conciliation proceedings.

"2. Evidence given by the conciliator regarding the matters referred to in paragraph 1 of article 13 or regarding the conduct of either party during the conciliation proceedings, is not admissible in any arbitral or judicial proceedings [whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings] [in respect of a dispute that was or is the subject of the conciliation proceedings].

"3. [Paragraph 1 applies] [Paragraphs 1 and 2 apply] also in respect of another dispute that has arisen from the same contract [or any related contract]."

Paragraph 1

117. It was argued that the question of whether a conciliator should be able to act as a representative or counsel of either party should not be left to party autonomy. To give effect to that proposal, it was suggested that the words "or as a representative or counsel of a party" should be omitted from paragraph 1 or alternatively that the opening words of that paragraph "Unless otherwise agreed by the parties" should be deleted, with appropriate changes being introduced in draft article 4 to indicate the mandatory nature of paragraph 1. It was suggested that, in some jurisdictions, even if the parties agreed to the conciliator acting as a representative or as a counsel of any party, such an agreement would contravene ethical guidelines to be followed by conciliators and could also be perceived as undermining the integrity of conciliation as a method for dispute settlement. The proposal was objected to on the basis that it undermined the principle of party autonomy and failed to recognize that, in jurisdictions where ethical rules required a conciliator not to act as representative or counsel, the conciliator would always be free to refuse to act in that capacity. It was suggested that paragraph 1 should be amended so that it would simply remain silent on the question of whether a conciliator could act as the representative or counsel of any of the parties. To that effect, it was proposed that the words "or as a representative or counsel of a party" should be deleted from paragraph 1. It was pointed

out that, at least in countries where no ethical prohibition was established against it, the effect of such an amendment would be to allow a conciliator to act as the counsel or representative of any party without any other party's consent. Notwithstanding that view, the Working Group agreed to the deletion of the words "or as a representative or counsel of a party in any arbitral or judicial proceedings". It was also agreed that an explanation should be given in the draft guide to enactment to clarify that, in some jurisdictions, ethical guidelines prohibited a conciliator from acting as a representative or counsel whereas in other jurisdictions this was permitted.

118. As to the form of the agreement by the parties that a conciliator might act as an arbitrator, the view was expressed that paragraph 1 might be confusing in practice. It was suggested that the text might need to indicate more clearly whether the agreement by the parties would need to be express and also possibly written. That suggestion did not receive support.

Paragraph 2

119. As a matter of drafting, it was suggested that the use of the term "evidence" might raise difficulties of interpretation in certain languages or legal systems when used as a substitute for "testimony" in relation to the conciliator. It was explained that paragraph 2 might be difficult to understand if it could be read as suggesting that evidence would be brought by the conciliator when it would normally be expected that such evidence would be brought by the parties. On that basis, it was suggested that the term "testimony" should be preferred to the word "evidence". It was stated in response that the concept of "testimony" was not broad enough to cover certain essential elements such as, for example, written notes taken by the conciliators in the context of the proceedings.

120. It was also suggested that the term "matters" should be replaced either by the term "facts" or by "information", in line with the language used in draft article 13. A proposal was made to delete the words "or regarding the conduct of either party during the conciliation proceedings" on the basis that it contradicted the idea that conciliation should involve frank and candid discussions. That proposal was opposed on the basis that evidence as to the conduct of parties by a conciliator could be highly prejudicial and undermine the confidence of parties in conciliation proceedings. However, it was considered that the words were unnecessary since testimony about the conduct of a party was inadmissible because it was covered by one of the subparagraphs of draft article 13, paragraph 1. As to the alternative wordings between square brackets, the Working Group expressed a preference for the retention of the first set of words ("whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings").

121. A proposal was made that, for purposes of clarity, paragraph 2 should be redrafted along the following lines "The conciliator shall not give evidence regarding the matters referred to in paragraph 1 of article 13 or regarding the conduct of either party during the conciliation

proceedings." It was proposed that this sentence should be followed by a new sentence modifying the existing text to read as follows: "Such evidence is not admissible in any arbitral or judicial proceedings whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation." That proposal received some support.

122. An alternative proposal to overcome concerns expressed about the term "evidence" and to better align the status of the conciliator with that of any other "third person" under draft article 13, was to amend draft article 13, paragraph 1, to encompass evidence or testimony given by a conciliator. To achieve this it was proposed that paragraph 2 of draft article 14 should be deleted and that the opening words of paragraph 1 of draft article 13 should be amended to read as follows: "Unless otherwise agreed by the parties, a party who participated in the conciliation proceedings, or a third person, including the conciliator, shall not give testimony or evidence on, or introduce as evidence, in arbitral, judicial or similar proceedings". After discussion, that proposal was accepted by the Working Group and referred to the drafting group. It was also agreed that the guide to enactment should reflect the fact that, in some jurisdictions, even the parties to a conciliation could not waive the prohibition on calling a conciliator as a witness unless a specific exception applied, such as obligation under law.

Paragraph 3

123. It was recalled that this provision was intended to extend the coverage of both paragraphs 1 and 2 to cover disputes arising from the same or a related contract, irrespective of whether or not a conciliation clause applied to all of the disputes. It was agreed that paragraph 3 should be deleted and that its substance should be added at the end of paragraph 1 as follows: "in respect of a dispute that was or is the subject of the conciliation proceedings, as well as any dispute that has arisen from the same contract or any related contract." The matter was referred to the drafting group.

Article 15. Resort to arbitral or judicial proceedings

124. The text of draft article 15 as considered by the Working Group was as follows:

"1. During conciliation proceedings the parties shall not initiate any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, and a court or arbitral tribunal shall give effect to this obligation. Either party may nevertheless initiate arbitral or judicial proceedings where, in its opinion, such proceedings are necessary for preserving its rights. Initiation of such proceedings is not of itself to be regarded as termination of the conciliation proceedings.

"2. [To the extent that the parties have expressly undertaken not to initiate [during a certain time or until an event has occurred] arbitral or judicial proceedings with respect to a present or future dispute, such an

undertaking shall be given effect by the court or the arbitral tribunal [until the terms of the agreement have been complied with]].

“[3. The provisions of paragraphs 1 and 2 of this article do not prevent a party from approaching an appointing authority requesting it to appoint an arbitrator.]”

125. The discussion focused on the implications of the second sentence of paragraph 1. It was recalled that, as currently drafted, it left each party with very broad discretion to determine whether initiating arbitral or judicial proceedings was “necessary for preserving its rights”. For example, any application for interim measures of protection could easily be described as “necessary for preserving the rights” of the applicant. The probability that the second sentence might be used to defeat the first sentence of paragraph 1 thus seemed very high (A/CN.9/WG.II/WP.115, para. 42).

126. Concern was expressed that the use of the phrase “in its opinion” might not be appropriate in a model law and that further efforts should be made to find a more objective statement protecting a party’s right to resort to arbitral or judicial proceedings. Subject to the possible outcome of such efforts, general support was expressed in favour of the policy underlying the second sentence of paragraph 1. It was widely felt that the rule contained in the first sentence of paragraph 1, which prohibited the initiation of any judicial or arbitral proceedings during conciliation proceedings, should be deleted, since it was too broadly stated to be acceptable as the basic rule underlying the relationship between conciliation and arbitral or judicial proceedings. A view was also expressed that this rule should be deleted because it was too narrow, applying only after conciliation proceedings had begun, and because it remained unclear how the obligation arising from it would be enforced in some legal systems. It was agreed that the first sentence should be replaced by paragraph 2, which focused more appropriately on the case where a specific agreement of the parties prohibited the initiation of competing arbitral or judicial proceedings in cases where the parties had agreed to resort to conciliation. It was pointed out that such a redraft of article 15 should result in increased confidence in conciliation as a dispute settlement method if parties were reassured that resorting to conciliation would not undermine their legal rights. In that connection, general support was expressed in favour of the third sentence of paragraph 1, which made it clear that the initiation of judicial or arbitral proceedings during conciliation proceedings was not to be regarded in itself as termination of the conciliation proceedings.

127. With respect to the formulation of paragraph 2, general support was expressed for the current wording including the various sets of words between square brackets. However, a concern was expressed that it might allow parties to set an unreasonably long period of time during which arbitral or judicial proceedings could not be undertaken. A related concern was that paragraph 2 as currently drafted required a court or arbitral tribunal to give effect to a contractual obligation irrespective of whether or not the contractual formalities of the law outside the draft Model Law had been complied with. This could cause

problems in some jurisdictions, where courts would have the discretion to refuse contractual obligations that were not drafted with sufficient certainty. In that respect, a number of delegations acknowledged that it was always open to a court to examine a contract, including a contractual provision relating to delaying court or arbitral proceedings, to determine its validity. It was suggested that the draft guide to enactment should reflect the fact that paragraph 2 would be integrated with the requirements of existing procedural and substantive law.

128. It was agreed that paragraph 3 could be deleted since it had become unnecessary in light of the accepted changes in draft article 15.

129. After discussion, it was agreed that draft article 15 should read along the lines of: “Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a certain time or until an event has occurred arbitral or judicial proceedings with respect to a present or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with. Either party may nevertheless initiate arbitral or judicial proceedings where, in its opinion, such proceedings are necessary for preserving its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.” The text was referred to the drafting group.

Article 16. Arbitrator acting as conciliator

130. The text of draft article 16 as considered by the Working Group was as follows:

“[It is not incompatible with the function of an arbitrator if the arbitrator raises the question of a possible conciliation and, to the extent agreed to by the parties, participates in efforts to reach an agreed settlement.]”

131. It was recalled that, at the thirty-fourth session of the Working Group, the view was expressed that draft article 16 should be deleted because its focus was on actions that could be taken during arbitral proceedings rather than actions taken during conciliation proceedings. Therefore, if that provision was needed at all, its proper place was legislation that dealt with arbitration (A/CN.9/WG.II/WP.115, para. 44). Moreover, it was recalled that, in the context of draft article 1, the Working Group had decided to exclude from the scope of the draft model legislative provisions those situations where an arbitrator would conduct a conciliation pursuant to his or her procedural prerogatives or discretion (A/CN.9/487, para. 103).

132. Two contrary views emerged on the issue of whether or not to include draft article 16. One view was that its inclusion would be useful, particularly for countries with little experience in the field of conciliation. It was pointed out that the Working Group had generally accepted the principle that an arbitrator could propose and participate in conciliation. It was also pointed out that there would be no inconsistency between excluding cases where conciliation was conducted by a judge or an arbitrator from the scope of the draft Model Law and expressing in that same draft

Model Law the principle that judges and conciliators were allowed to conduct such conciliation. Expressing that principle in the draft Model Law might be even more necessary in view of the fact that the UNCITRAL Model Law on International Commercial Arbitration did not deal with the issue at all. The prevailing view, however, was that, since draft article 16 dealt with the functions and the competence of an arbitrator, it would be inappropriate and confusing to include such a provision in a model law on conciliation. After discussion, it was agreed that draft article 16 should be deleted but that an appropriate explanation should be included in the draft guide to enactment to make it clear that the draft Model Law was not intended to indicate whether or not an arbitrator could act or participate in a conciliation relating to the dispute, a matter that was up to the discretion of the parties acting within the context of applicable law. It was agreed that, in preparing such explanations, the Secretariat should bear in mind the text of paragraph 47 of the UNCITRAL Notes on Organizing Arbitral Proceedings.

Draft article 17

133. The Working Group resumed its consideration of draft article 17 (for previous discussion, see paras. 38-48 above). Various proposals were made as to how Variant A could be used as a basis for establishing a legal regime through which settlement agreements would be granted greater enforceability than an ordinary contract. One suggestion was that draft article 17 should be redrafted as follows:

“1. If the parties reach agreement on a settlement of the dispute and the parties have signed the settlement agreement, that agreement is binding and enforceable as a contract.

“2. After signature of the agreement, any party is barred from challenging the terms of the settlement unless it proves that the agreement is null and void [or otherwise ineffective] [under applicable law] [*the enacting State may insert further provisions specifying provisions for the enforceability of such agreements*].”

134. While the substance of paragraph 1 was found to reflect a common denominator acceptable to the Working Group, it was widely felt that the text of proposed paragraph 2 was too restrictive since the draft Model Law might need to cover grounds for challenging a settlement agreement other than that agreement being null and void. The example was given of a settlement agreement that might be challenged on the grounds that it did not accurately reflect the terms agreed between the parties. Doubts were expressed as to whether challenging a settlement agreement on such grounds should be permitted under the draft Model Law.

135. With a view to providing a more generic description of expedited procedures for the enforcement of settlement agreements, another proposal for a revised text of draft article 17 was made as follows:

“If the parties reach agreement on a settlement of the dispute, that agreement is binding, and enforceable

by the same procedures as a settlement agreement of a commercial dispute is enforceable in this State. [The enacting State may insert a description or reference to such procedures. In addition, the enacting State may insert: ‘If the parties include in the settlement agreement that it was reached in a conciliation and that they agree that it is enforceable in the same way as an arbitral award in an international commercial dispute is enforceable in this State, it shall be enforceable by such procedures and subject to such defences and means of recourse as apply in this State with respect to international commercial arbitral awards.’]”

136. While some support was expressed in favour of that proposal, it was widely felt that simply referring in the text to the existence of procedures for the enforcement of a settlement agreement of a commercial dispute under the law of the enacting State resulted in merely restating the obvious and failed to provide the minimum level of harmonization that could be expected from a text of uniform law prepared by UNCITRAL. As a matter of drafting, doubts were expressed as to whether using the words “the same procedures” adequately reflected the need to refer to both procedural and substantive law. It was also pointed out that, in view of the multiplicity of procedures that might be available in any country regarding the enforcement of a settlement agreement, the suggested text would be of little assistance to its users.

137. Regarding the possibility that parties would agree that the settlement agreement was “enforceable in the same way as an arbitral award”, divergent views were expressed as to whether the effect of that proposal would be to render a settlement agreement enforceable under the New York Convention (see para. 43 above). Strong reservations were expressed as to the feasibility of equating a settlement agreement that was fundamentally a contract with an arbitral award. It was stated that, in some countries, objections of a constitutional nature would oppose the establishment of such a fiction.

138. A widely shared view was that more work and additional research was needed as to how the enforceable character of a settlement agreement might be expressed in the draft Model Law. Additional suggestions were made as to how the draft Model Law might achieve a step towards harmonizing the various laws and establishing an expedited enforcement mechanism. One suggestion was that the draft Model Law should establish as a minimum uniform rule that, in challenging the binding and enforceable character of a settlement agreement, the claimant would bear the burden of proof. Another suggestion was that additional work should concentrate on the grounds for refusing enforcement of a settlement agreement, with article V of the New York Convention and articles 34 and 36 of the UNCITRAL Model Law on International Commercial Arbitration being used as a source of inspiration. Yet another suggestion was that the legal regime of notarized acts in certain countries might constitute a useful model. It was pointed out, however, that such a model might require the establishment of form requirement for settlement agreements, thus introducing a level of formalism that might contradict existing conciliation practice.

139. After discussion, the Working Group decided that the text of draft article 17 should be redrafted along the following lines: “If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and enforceable ... [*the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement.*]” It was pointed out that the text was aimed at reflecting the lowest common denominator between the various legal systems. It was recognized that the text was ambiguous, since it might be read in different languages and different legal systems either as creating a high degree of enforceability or as merely referring to the obvious fact that a settlement agreement could be made enforceable through appropriate procedures. It was noted that, in preparation for the thirty-fifth session of the Commission, States would be invited to submit official comments on the draft text and that the Secretariat would hold informal consultations regarding the feasibility of improving on that text.

Draft article 4

140. Pursuant to its earlier agreement, the Working Group proceeded to consider provisions in the draft Model Law that might need to be regarded as mandatory and thus not subject to variation by agreement as permitted by draft article 4. It was recalled that any such provisions would need to be listed in draft article 4.

141. It was recalled that paragraph 3 of draft article 8, which set out guiding principles of conduct for the conciliator, had been agreed as a mandatory provision that was not subject to party autonomy. In addition, it was agreed that the new article regarding interpretation of the draft Model Law was not intended to apply to the relationships between the parties. That new article should therefore be considered as mandatory and not be subject to party autonomy.

142. A suggestion was made that draft article 17 should be mandatory. A number of delegations expressed concern with that suggestion on the basis that the draft text was ambiguous. In response, it was stated that, although greater clarity in draft article 17 could be sought through informal consultations or the provision of comments by Governments, draft article 17 should be mandatory as a provision on enforcement, regardless of its final drafting. It was generally agreed that, to the extent the draft Model Law would contain a provision on enforcement, that provision should not be subject to party autonomy. However, it was also felt that the uncertainty regarding draft article 17 as currently drafted was such that it should not be listed among the mandatory provisions of the draft Model Law. An alternative proposal was made that a footnote to draft article 17 could be included in the text along the following lines: “When implementing the procedure for enforcement of settlement agreements, an enacting State may consider the possibility for such a procedure to be mandatory.” After discussion, that proposal was adopted by the Working Group.

143. A question was raised as to whether draft article 1 also needed to be listed among the mandatory provisions.

It was suggested that, in its future deliberations, the Commission might need to consider the extent to which certain provisions regarding the sphere of application of the Model Law would need to be included in the list of mandatory provisions contained in draft article 4. The Working Group took note of that suggestion.

144. After discussion, it was agreed that draft article 17 should be listed as a mandatory provision in draft article 4. However, it was also agreed that the Secretariat would continue to hold informal consultations on the drafting of article 17.

III. DRAFT GUIDE TO ENACTMENT OF THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

145. The Working Group proceeded to consider the draft guide to enactment of the UNCITRAL Model Law on International Commercial Conciliation set out in A/CN.9/WG.II/WP.116.

Title and general comments

146. It was suggested that the title of the draft guide should be changed to “Draft guide to enactment and use of the UNCITRAL Model Law on International Commercial Conciliation” to better reflect that the guide was intended not only for legislators but also for other users of the text, including judges, practitioners and academics. The Working Group accepted that proposal.

147. A question was raised as to whether the draft guide was intended for adoption by the Commission or simply for publication under the responsibility of the Secretariat. While guides to enactment published with earlier UNCITRAL model laws had been expressly adopted by the Commission, it was noted that the two options were open. It was agreed that whatever course was taken, the draft guide should reflect the decision of the Commission in its opening statement under the section entitled “Purpose of this guide”.

Paragraph 4

148. It was suggested that, in the light of the changes made to paragraph 3 of article 8 of the Model Law, which omitted references to the words “independent and impartial”, it would be appropriate to amend references to these terms in the first sentence of paragraph 4 of the draft guide. It was also suggested that, in the penultimate sentence of paragraph 4, it might be appropriate to provide a clearer distinction between conciliation and arbitration such as, for example, by including a reference to the non-adjudicatory nature of the conciliation process. Alternatively, it was proposed that the language in that sentence could be amended by replacing the phrase “involves independent and impartial third person assistance” with the phrase “involves third person assistance in an independent and impartial manner”.

Paragraph 7

149. It was suggested that draft paragraph 7 should be amended to better reflect the policy expressed in the Working Group that the draft Model Law should seek to improve the possibilities of making settlement agreements binding and enforceable. As presently drafted, the draft paragraph might be read as indicating that conciliation could never be binding.

Scope

150. In respect of section D entitled “Scope”, it was suggested that paragraph 12 should be amended to reflect the discussion in the Working Group that some provisions were intended to be mandatory.

Structure of the Model Law

151. The view was expressed that the use of the term “rules” in paragraph 19 and earlier in paragraph 16, was confusing. It was suggested that, where appropriate, the draft guide should refer to the term “rules” when speaking of conciliation rules but should use the term “provisions” when referring to provisions of the text of the draft Model Law.

Article-by-article remarks

152. A suggestion was made that draft paragraph 23 should reflect that the reference to “commercial” was based on a definition set out in the UNCITRAL Model Law on International Commercial Arbitration. Another suggestion was that the reference to “commercial” should also include a reference to “electronic commerce”. It was recalled that the notion of “electronic commerce” did not apply only to the commercial sphere, as observed in the context of work by the Commission in the field of electronic commerce. However, it was agreed that appropriate explanations would be included in the draft guide to indicate that the draft Model Law was intended to accommodate the needs of electronic commerce and online dispute settlement.

153. It was also suggested that the indication in paragraph 23 that defining “commercial” “may be particularly useful for those countries where a discrete body of commercial law does not exist” was too narrow. It was suggested that the footnote could also be useful in countries where a discrete body of commercial law existed, because such law might differ from country to country and the footnote could play a harmonizing role in that respect.

Article 6. Number of conciliators

154. It was suggested that paragraph 41 should be amended to indicate that the default rule referred to therein was inspired by the rule as set out in the UNCITRAL Model Law on International Commercial Arbitration. However, a number of private international arbitration rules provided a default rule of one arbitrator.

Article 7. Appointment of conciliators

155. It was suggested that a general reference should be included in paragraph 42 that, in the case of conciliation, it was possible to have an even number of conciliators on the basis that the conciliators were not required to render a decision or to vote.

Article 8. Conduct of conciliation

156. It was suggested that the commentary regarding draft article 9 in paragraphs 44 to 46 inclusive should express the policy agreed to in the Working Group that the references to “fair treatment of the parties” in the draft Model Law was intended to govern the conciliation process and not the settlement agreement.

Article 9. Communication between conciliator and the parties

157. It was suggested that in paragraph 48 the words “shall use his or her best efforts” or the words “shall act so as to” should be included after the words “The conciliator” to better reflect changes made during the discussion regarding draft article 8.

Article 10. Disclosure of information

158. It was suggested that the final words in paragraph 49, namely “unlike in arbitration, where the duty of disclosure is absolute” should be deleted as that could be considered to be an overstatement and also was not appropriate to include in a guide relating to conciliation.

Article 16. Arbitrator acting as a conciliator

159. Although the Working Group acknowledged that draft article 16 had been omitted, there was agreement that the draft guide should reflect, in an appropriate place, the fact that, in a number of jurisdictions, arbitrators were permitted to act as conciliators, although that practice was prohibited in other jurisdictions.

Article 17. Enforceability of settlement

160. It was agreed that States would provide the Secretariat with examples of national legislation and practices relating to enforcement of settlement agreements, for possible reflection in the draft guide to enactment.

161. The Secretariat was requested to prepare a revised version of the draft guide to enactment and use of the draft Model Law on International Commercial Conciliation, taking into account the deliberations of the Working Group regarding the draft articles and the above suggestions.

ANNEX

DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

(as approved by the UNCITRAL Working Group on Arbitration at its thirty-fifth session, held at Vienna from 19 to 30 November 2001)

Article 1. Scope of application and definitions

1. This Law applies to international¹ commercial² conciliation.
2. For the purposes of this Law, "conciliation" means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator or the panel of conciliators does not have the authority to impose upon the parties a solution to the dispute.
3. A conciliation is international if:
 - (a) The parties to an agreement to conciliate have, at the time of the conclusion of that agreement, their places of business in different States; or
 - (b) The State in which the parties have their places of business is different from either:
 - (i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or
 - (ii) The State with which the subject matter of the dispute is most closely connected.
4. For the purposes of this article:
 - (a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;
 - (b) If a party does not have a place of business, reference is to be made to the party's habitual residence.
5. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.
6. The parties are free to agree to exclude the applicability of this Law.
7. Subject to the provisions of paragraph 8 of this article, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.

¹States wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text: [...]

²The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.

8. This Law does not apply to:

- (a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and
- (b) [...].

Article 2. Interpretation

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.
2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

Article 3. Variation by agreement

Except for the provisions of article 2 and article 7, paragraph 3, the parties may agree to exclude or vary any of the provisions of this Law.

Article 4. Commencement of conciliation proceedings³

1. Unless otherwise agreed by the parties, the conciliation proceedings in respect of a particular dispute that has arisen commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.
2. If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

Article 5. Number of conciliators

There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators.

Article 6. Appointment of conciliators

1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

³The following text is suggested for States that might wish to adopt a provision on the suspension of the limitation period:

Article X. Suspension of limitation period

- (1) When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.
- (2) Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.

2. In conciliation proceedings with two conciliators, each party appoints one conciliator.

3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

(a) A party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

6. When a person is approached in connection with his or her possible appointment as a conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.

Article 7. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, on the manner in which the conciliation is to be conducted.

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any wishes that the parties may express and the need for a speedy settlement of the dispute.

3. In any case, in conducting the proceedings, the conciliator or the panel of conciliators shall seek to maintain fair treatment of the parties and, in so doing, shall take into account the circumstances of the case.

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

Article 8. Communication between conciliator and parties

Unless otherwise agreed by the parties, the conciliator, the panel of conciliators or a member of the panel may meet or communicate with the parties together or with each of them separately.

Article 9. Disclosure of information between the parties

When the conciliator, the panel of conciliators or a member of the panel receives information concerning the dispute from a

party, the conciliator, the panel of conciliators or a member of the panel may disclose the substance of that information to the other party. However, when a party gives any information to the conciliator, the panel of conciliators or a member of the panel subject to a specific condition that it be kept confidential, that information shall not be disclosed to the other party.

Article 10. Duty of confidentiality

Unless otherwise agreed by the parties, all information relating to the conciliation proceedings shall be kept confidential, except where disclosure is required under the law or for the purposes of implementation or enforcement of a settlement agreement.

Article 11. Admissibility of evidence in other proceedings

1. Unless otherwise agreed by the parties, a party that participated in the conciliation proceedings or a third person, including a conciliator, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding, any of the following:

(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;

(b) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;

(c) Statements or admissions made by a party in the course of the conciliation proceedings;

(d) Proposals made by the conciliator;

(e) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator;

(f) A document prepared solely for purposes of the conciliation proceedings.

2. Paragraph 1 of this article applies irrespective of the form of the information or evidence referred to therein.

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement.

4. The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.

5. Subject to the limitations of paragraph 1 of this article, evidence that is otherwise admissible in arbitral or court proceedings does not become inadmissible as a consequence of having been used in a conciliation.

Article 12. Termination of conciliation

The conciliation proceedings are terminated:

(a) By the conclusion of a settlement agreement by the parties, on the date of the agreement;

(b) By a written declaration of the conciliator or the panel of conciliators, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

(c) By a written declaration of the parties addressed to the conciliator or the panel of conciliators to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

(d) By a written declaration of a party to the other party and the conciliator or the panel of conciliators, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

Article 13. Conciliator acting as arbitrator

Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator in respect of a dispute that was or is the subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or any related contract.

Article 14. Resort to arbitral or judicial proceedings

1. Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specified period of

time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with.

2. A party may nevertheless initiate arbitral or judicial proceedings where, in its sole discretion, it considers such proceedings necessary to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.

Article 15. Enforceability of settlement agreement⁴

If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and enforceable ... *[the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement]*.

⁴When implementing the procedure for enforcement of settlement agreements, an enacting State may consider the possibility of such a procedure being mandatory.

B. Note by the Secretariat on the settlement of commercial disputes: model legislative provisions on international commercial conciliation, working paper submitted to the Working Group on Arbitration at its thirty-fifth session

(A/CN.9/WG.II/WP.115) [Original: English]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (*k*)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (*g*)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (*c*)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (*i*)); and the power of the arbitral tribunal to award interest (para. 107 (*j*)). It was noted with approval that, with respect

to "online" arbitrations (that is, arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (*m*)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group had considered articles 1-16 of the draft model legislative provisions (A/CN.9/WG.II/WP.113/Add.1 and Corr.1). It was generally felt that work on the provisions could be expected to be completed by the Working Group at its subsequent session. The Commission requested the Working Group to proceed with the examination of the provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.⁷

6. At the close of its thirty-fourth session, the Working Group requested the Secretariat to prepare revised drafts of the articles, based on the discussion in the Working Group, for consideration at its subsequent session (see A/CN.9/487, para. 20). The present note contains a revised draft of the model legislative provisions on conciliation.

II. REVISED ARTICLES OF MODEL LEGISLATIVE PROVISIONS ON INTERNATIONAL COMMERCIAL CONCILIATION

Article 1. Scope of application

1.^[1] These model legislative provisions apply to international commercial* conciliation, as defined in articles 2 and 3,

(a) If the place of conciliation, as agreed upon by the parties or, in the absence of such agreement, as determined with the assistance of the conciliator or panel of conciliators, is in this State; or^[2]

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), para. 315.

(b) If the place of conciliation has not been agreed or otherwise determined as provided for in subparagraph (a),^[3] the place of conciliation is deemed to be in this State if any of the following places is in this State: the place of the institution that administered the conciliation proceedings; the place of residence of the conciliator; or the place of business of both parties if that place is in the same country.

2. These model legislative provisions also apply to a commercial conciliation that is not international in the sense of article 3 if the parties have [expressly] agreed that the model legislative provisions are applicable to the conciliation.^[4]

Remarks

1. At its thirty-fourth session, the Working Group expressed the view that the territorial factor should be listed as the first factor to be taken into account when determining the applicability of the draft legislative provisions. Such a restructuring was intended to make it clear that the territorial factor was to be the default rule triggering application of the provisions in the absence of other elements listed under paragraph 1, such as the international nature of conciliation or the agreement of the parties to opt in to the model legislative provisions (see A/CN.9/487, para. 91).

2. To increase certainty as to when the model legislative provisions would apply, the Working Group agreed to include a provision in paragraph 1 to the effect that the parties would be free to agree upon the place of conciliation and, failing that agreement, it would be for the conciliator or the panel of conciliators to determine that place (see A/CN.9/487, para. 92 and A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 2). The new paragraph follows draft wording proposed at the thirty-fourth session of the Working Group.

3. The Working Group agreed that article 1 should address cases where the place of conciliation had not been agreed upon or determined and where, for other reasons, it was not possible to establish the place of conciliation. Possible criteria suggested for the applicability of the model legislative provisions might be, for example, the place of the institution that administered the conciliation proceedings, the place of residence of the conciliator or the place of business of both parties if that place was in the same country (see A/CN.9/487, para. 93).

4. The question of the possibility for the parties to opt into the model legislative provisions was discussed by the Working Group at its thirty-fourth session in the context of draft article 3 (see A/CN.9/487, paras. 107-109). It was agreed that the provision should be worded along the lines of "the parties have [expressly] agreed that these model legislative provisions are applicable". It is submitted that draft article 1, which defines the scope of the model legislative provisions, is a more appropriate place for such a provision than draft article 3.

3. Articles . . . apply also if the place of conciliation is not in this State.^[5]

4. These model legislative provisions apply irrespective of whether a conciliation is carried out on the initiative of one party after a dispute has arisen, in compliance with a mutual agreement of the parties made before the dispute arose, or pursuant to a direction or [request] [invitation] of a court or competent governmental entity.^[6]

Remarks

5. Paragraph 3 is intended to indicate whether certain provisions (such as those on the admissibility of evidence in other proceedings, the role of the conciliator in other proceedings or the limitation period) should produce effects in the enacting State even if the conciliation proceedings took place in another country and would thus not generally be covered by the law of the enacting State (see A/CN.9/485 and Corr.1, paras. 120 and 134, and A/CN.9/487, para. 94). The Working Group agreed to consider the issues dealt with in paragraph 3 further in the light of decisions yet to be made with respect to draft articles 12-15.

6. Paragraph 4 has been redrafted to take into account the consensual nature of conciliation. The initiative of a party would not be sufficient to carry out a consensual process, since the other party would at least have to agree with that initiative (see A/CN.9/487, para. 95). Although it noted that, it was inconceivable in some countries that a conciliation could result from a "direction" of the court, the Working Group nonetheless agreed that the model legislative provisions should apply to such instances of mandatory conciliation, given that in some other countries, conciliation was regarded by legislation as a necessary step to be taken before litigation could be initiated (see A/CN.9/487, para. 96). The paragraph has been redrafted to cover three possible situations, namely (a) where an agreement to conciliate pre-existed the dispute (for example, where a general provision had been made in a contract that possible future disputes would be settled through conciliation); (b) where an agreement to conciliate was made by the parties after the dispute arose; and (c) where conciliation was imposed on or suggested to the parties by a court, an arbitral tribunal or an administrative entity.

5. These model legislative provisions do not apply to:

(a) Cases where a judge or an arbitrator, in the course of adjudicating a particular dispute, conducts a conciliatory process; and

(b) [. . .].^[7]

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

Remark

7. The inclusion of a provision allowing enacting States to exclude certain situations from the sphere of application of the model legislative provisions was found to be generally acceptable by the Working Group (see A/CN.9/487, para. 98), which agreed that the guide to enactment should provide illustrations and explanations as to the situations that were likely to be regarded by enacting legislators as exceptional cases where the provisions should not apply. With a view to avoiding undue interference with existing procedural law, subparagraph (a) has been added to exclude from the scope of the model legislative provisions situations where the judge or arbitrator, in the course of adjudicating a particular dispute, conducts a conciliatory process, either at the request of the disputing parties or exercising his or her prerogative or discretion (see A/CN.9/487, para. 103). Other areas of exclusion to be specified by enacting States might include collective bargaining relationships between employers and employees (see A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 5).

References to previous UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 111-116
 A/CN.9/487, paras. 88-99
 A/CN.9/WG.II/WP.110, paras. 87, 88 and 90
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 5.

Article 2. Conciliation^[8]

For the purposes of these model legislative provisions, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import,^[9] whereby parties request a third person, or a panel of persons, to assist them [in an independent and impartial manner]^[10] [and without the authority to impose a binding decision on the parties]^[11] in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contract or other legal relationship.

Remarks

8. At its thirty-fourth session, the Working Group recalled that draft article 2 was aimed at setting out the elements for the definition of conciliation, taking account of the agreement of the parties, the existence of a dispute, the intention of the parties to reach an amicable settlement and the participation of an impartial and independent third person or persons to assist the parties in an attempt to reach an amicable settlement. Those elements, it was recalled, distinguished conciliation from arbitration on the one hand and mere negotiations (either between the parties or between representatives of the parties) on the other (see A/CN.9/487, para. 101).

9. Support was expressed in the Working Group for retention of the words “whether referred to by the expression conciliation, mediation or an expression of similar import”. The Working Group noted that different procedural styles and techniques might be used in practice to facilitate dispute settlement and that different expressions might be used to refer to those styles and techniques. It was agreed that the model legislative provisions should encompass all styles and techniques (see A/CN.9/487, para. 104).

10. The Working Group decided that a decision as to whether the words “in an independent and impartial manner” were necessary for the definition of conciliation would be made at its thirty-fifth session. A suggestion was made that the words should be deleted as they could be understood as introducing a subjective element to the definition of conciliation and could also be understood as establishing a legal requirement whose violation would have consequences beyond the model legislative provisions and might even be understood as an element for determining their applicability. A contrary view was that the phrase ought to be retained on the basis that it emphasized the nature of conciliation. The Working Group agreed to place the words in square brackets (see A/CN.9/487, para. 102).

11. The words “and without the authority to impose a binding decision on the parties” in square brackets are intended to reflect the suggestion made at the thirty-fourth session of the Working Group that draft article 2 should clarify that the conciliator was a person who did not have authority to impose a binding decision on the parties (see A/CN.9/487, para. 103).

References to previous UNCITRAL documents

A/CN.9/460, paras. 8-10
 A/CN.9/485 and Corr.1, paras. 108 and 109

A/CN.9/487, paras. 100-104
 A/CN.9/WG.II/WP.108, para. 11
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 7 and 8

Article 3. International conciliation^[12]

1. A conciliation is international if:

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

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

- (i) The place of conciliation; or
- (ii) Any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject matter of the dispute is most closely connected;^[13]

Remarks

12. At its thirty-fourth session, the Working Group agreed that the acceptability of the model legislative provisions might be greater if no attempt was made to interfere with domestic conciliation and thus agreed that, subject to any agreement by the parties to opt into the legal regime set forth in the model legislative provisions, the instrument should be limited in scope to international conciliation (see A/CN.9/487, para. 106).

13. A widely shared view in the Working Group was that the previous draft of paragraph 1(c) reading “or parties have [expressly] agreed that the subject matter of the agreement to conciliate relates to more than one country”, should be revised on the basis that it was inappropriate to combine in a single paragraph objective criteria such as the place of conciliation and a subjective test such as the agreement of the parties to opt into the legal regime set forth in the model legislative provisions. It was considered that, if the parties wished to opt into the model legislative provisions, they should be permitted to do so directly by the effect of an appropriate statement to be included in article 1, rather than by a fiction regarding the location of the subject matter of the dispute. An opposite view was that such an opt-in provision could be included in the definition of “international” as was done in the UNCITRAL Model Law on International Commercial Arbitration. After discussion, the prevailing view was that the provision should be reworded along the lines of “the parties have [expressly] agreed that these model legislative provisions are applicable”. The Secretariat was requested to prepare a revised draft containing those words and to place it at an appropriate location in the draft model legislative provisions (see A/CN.9/487, paras. 107-109). The provision currently appears as paragraph 2 of draft article 1.

2. For the purposes of this article:

(a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

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

References to previous UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 117-120
 A/CN.9/487, paras. 105-109

A/CN.9/WG.II/WP.110, para. 89
A/CN.9/WG.II/WP.113/Add.1 and Corr.1

Article 4. Variation by agreement

Except as otherwise provided in these model legislative provisions, the parties may agree to exclude or vary any of these provisions.^[14]

Remark

14. The text of draft article 4 was previously contained in the last paragraph of draft article 1 (see A/CN.9/487, para. 99). With a view to emphasizing the prominent role given by the model legislative provisions to the principle of party autonomy, that provision has been isolated in a separate article. This type of drafting is also intended to bring the model legislative provisions more closely in line with other UNCITRAL instruments (such as article 6 of the United Nations Convention on Contracts for the International Sale of Goods, article 4 of the UNCITRAL Model Law on Electronic Commerce and article 5 of the UNCITRAL Model Law on Electronic Signatures). A formulation even closer to that of those existing texts would be along the following lines "The provisions of this Law may be derogated from or their effect may be varied by agreement, unless that agreement would not be valid or effective under applicable law." Expressing the principle of party autonomy in a separate article may further reduce the desirability of repeating that principle in the context of a number of specific provisions of the draft legislative provisions, as considered by the Working Group.

References to previous UNCITRAL documents

A/CN.9/485 and Corr.1, para. 112
A/CN.9/487, para. 99
A/CN.9/WG.II/WP.110, para. 87
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 6

Article 5. Commencement of conciliation proceedings

1. The conciliation proceedings in respect of a particular dispute commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.^[15]

2. If a party that invited another party to conciliate does not receive a reply within [fourteen] days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.^{[16] [17]}

Remarks

15. At its thirty-fourth session, the Working Group agreed that paragraph 1 of this article should be harmonized with paragraph 3 of draft article 1 to accommodate the fact that a conciliation might be carried out as a consequence of a direction or request by a dispute settlement body such as a court or arbitral tribunal (see A/CN.9/487, para. 111). The general reference to the "day on which the parties to the dispute agree to engage in conciliation proceedings" would seem to cover the different methods by which parties may agree to engage in conciliation proceedings. Such methods may include, for example, the acceptance by one party of an invitation to conciliate made by the other party, or the

acceptance by both parties of a direction or suggestion to conciliate made by a court. Those examples may need to be spelled out in the guide to enactment.

16. A suggestion that time should start to run from the day on which the invitation to conciliate was received was rejected by the Working Group on the basis that the provision was modelled on paragraph 4 of article 2 of the UNCITRAL Conciliation Rules and that it was desirable to maintain harmony between the two texts (see A/CN.9/487, para. 112). However, it was agreed that, in view of the increased use of modern means of communication, the time period of thirty days might be shortened to two weeks (see A/CN.9/487, paras. 112 and 113). The Working Group noted that, since paragraph 2 did not deal with the commencement of conciliation proceedings, it could be included elsewhere in the draft model legislative provision (see A/CN.9/487, para. 115). The Working Group also noted that a final decision as to the need for maintaining the draft article and as to its precise contents should be made after the Working Group had considered in particular draft article 12 and possibly draft article 11 (see A/CN.9/487, para. 115).

17. It was suggested to the Working Group that draft article 5 should address the situation where an invitation to conciliate was withdrawn after it had been made (see A/CN.9/487, para. 114). No specific provision to that effect (such as a provision specifying that the party initiating the conciliation is free to withdraw the invitation to conciliate until that invitation has been accepted) has been added to the text of draft article 5 in view of the need to avoid interfering with the law of contract formation by introducing new rules as to the conditions under which an offer or an acceptance to conciliate might be withdrawn. It is submitted that a specific provision regarding the withdrawal of an invitation to conciliate is probably superfluous in view of the possibility offered to both parties to terminate conciliation proceedings at any time under subparagraph (d) of draft article 11.

References to previous UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 127-132
A/CN.9/487, paras. 110-115
A/CN.9/WG.II/WP.110, paras. 95 and 96
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 11 and 12.

Article 6. Number of conciliators

There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators.^[18]

Remark

18. At its thirty-fourth session, the Working Group agreed with the substance of draft article 6 (see A/CN.9/487, para. 117).

References to previous UNCITRAL documents

A/CN.9/487, paras. 116 and 117
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 13

Article 7. Appointment of conciliators

1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

2. In conciliation proceedings with two conciliators, each party appoints one conciliator.^[19]

3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

(a) a party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

(b) the parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

Remark

19. Although a suggestion was made at the thirty-fourth session of the Working Group that the appointment of each conciliator should be agreed to by both parties, the prevailing view was that the solution in the present draft was more practical, allowed for speedy commencement of the conciliation process and might actually foster settlement in the sense that the two party-appointed conciliators, while acting independently and impartially, would be in a better position to clarify the positions of the parties and thereby enhance the likelihood of settlement (see A/CN.9/487, para. 119).

References to previous UNCITRAL documents

A/CN.9/487, paras. 118 and 119

A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 14

Article 8. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, upon the manner in which the conciliation is to be conducted.^[20]

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any [views] [expectations] [intentions] [wishes] that the parties may express, and the need for a speedy settlement of the dispute.^[21]

Remarks

20. At the thirty-fourth session of the Working Group, there was broad agreement for casting paragraph 1 along the lines of article 19 of the UNCITRAL Model Law on International Commercial Arbitration and to stress that the parties were free to agree on the manner in which the conciliation was to be conducted. The words

“by reference to a standard set of rules or otherwise,” in square brackets were approved, subject to the deletion of the term “standard”. A suggestion that paragraph 1 should be deleted and that paragraph 2 should provide that the conciliator should be able to decide on the manner in which the conciliation proceedings should be conducted, did not receive support (see A/CN.9/487, para. 121).

21. The Working Group agreed that the term “wishes” was unusual for inclusion in legal provisions but noted that, if a more appropriate term could not be found, then it could be retained in light of the fact that it was used in the UNCITRAL Conciliation Rules (see A/CN.9/487, para. 122). With a view to providing more objective wording, the terms “views”, “expectations” and “intentions” are offered as possible alternatives.

3. The conciliator shall be guided by principles of [objectivity, fairness and justice][objectivity, impartiality and independence] and seek to maintain fairness in treatment as between the parties.^[22]

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.^[23]

Remarks

22. Some concern was expressed in the Working Group regarding the inclusion of a general statement of principles in the model legislative provisions. It was stated that, by providing courts with a yardstick against which to measure the conduct of conciliators, the first sentence of paragraph 3 could have the unintended effect of inviting parties to seek annulment of the settlement agreement through court review of the conciliation process. It was thus suggested that the statement of principles should be located in the guide to enactment. However, the prevailing view was to retain the guiding principles in the body of the legislative provisions to provide guidance regarding conciliation, including for less experienced conciliators. Paragraph 3 offers two variants. The first variant reflects the decision made by the Working Group that “objectivity, fairness and justice” should be retained as one option (see A/CN.9/487, para. 125). The second variant reflects the view that “impartiality and independence” were to be preferred over words such as “fairness and justice” on the basis that the latter terms connoted the role of a decision maker (such as a judge or an arbitrator) rather than the role of a conciliator, and that using the English word “fairness” might cause difficulties in translation. The draft also reflects the principle that both parties should receive equal treatment from the conciliator (see A/CN.9/129, para. 129). The Working Group decided that the second sentence in the previous draft of paragraph 3 (“Unless otherwise agreed by the parties, the conciliator may give consideration to, among other things, the rights and obligations of the parties, the usages of the trade concerned and the circumstances surrounding the dispute, including any previous business practices between the parties”), to the extent that it dealt with elements to be taken into account in the substance of the settlement agreement, would be more appropriately reflected in the guide to enactment (see A/CN.9/487, para. 126).

23. Despite some expressions of doubt as to the usefulness of this paragraph, the Working Group agreed that paragraph 4 should be retained (see A/CN.9/129, para. 127).

References to previous UNCITRAL documents

A/CN.9/468, paras. 56-59

A/CN.9/485 and Corr.1, paras. 121-125

A/CN.9/487, paras. 120-127
 A/CN.9/WG.II/WP.108, paras. 61 and 62
 A/CN.9/WG.II/WP.110, paras. 91 and 92
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 15-18

Article 9. Communication between conciliator and parties

Unless otherwise agreed by the parties, the conciliator or the panel of conciliators may meet or communicate with the parties together or with each of them separately.^[24]

Remark

24. The Working Group agreed to the substance of draft article 9. While agreement was expressed for the idea that the model legislative provisions should reflect the principle that both parties should receive equal treatment from the conciliator, the Working Group decided against inclusion of such a formal rule in draft article 8 (see A/CN.9/487, para. 129). The general idea that both parties should receive equal treatment is reflected in draft article 8.

References to previous UNCITRAL documents

A/CN.9/468, paras. 54 and 55
 A/CN.9/485 and Corr.1, para. 126
 A/CN.9/487, paras. 128 and 129
 A/CN.9/WG.II/WP.108, paras. 56 and 57
 A/CN.9/WG.II/WP.110, para. 93
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 19

Article 10. Disclosure of information

When the conciliator or the panel of conciliators receives information concerning the dispute from a party, the conciliator or the panel of conciliators may disclose the substance of that information to the other party. However, the conciliator or the panel of conciliators shall not disclose information received from a party, when the party gives the information to the conciliator or the panel of conciliators subject to a specific condition that it be kept confidential.^[25]

Remark

25. Of the two alternatives considered at the previous session (A/CN.9/487, para. 130), alternative 1 was preferred as the better option to ensure circulation of information between the various participants in the conciliation process. It was agreed that the confidentiality provision should apply in all cases, even without a specific agreement of the parties. On that basis, the words "the parties are free to agree otherwise, including that" have been deleted (see A/CN.9/487, para. 132). A suggestion that the term "factual information" should be used instead of "information" was rejected on the basis that the latter term was preferable as it covered all relevant information and avoided difficulties that might arise in interpreting what was meant by "factual" information. The guide to enactment to article 10 should make it clear that the notion of "information" should be understood as covering also communications that took place before the actual commencement of the conciliation.

References to previous UNCITRAL documents

A/CN.9/468, paras. 54 and 55
 A/CN.9/487, paras. 130-134
 A/CN.9/WG.II/WP.108, paras. 58-60
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 20 and 21

Article 11. Termination of conciliation

The conciliation proceedings are terminated:

- (a) By the conclusion^[26] of the settlement agreement by the parties, on the date of the agreement;
- (b) By a written declaration of the conciliator or the panel of conciliators,^[27] after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;
- (c) By a written declaration of the parties addressed to the conciliator to the effect that the conciliation proceedings are terminated, on the date of the declaration; or
- (d) By a written declaration of a party to the other party and the conciliator, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

Remarks

26. At its thirty-fourth session, the Working Group agreed to replace the words "the signing" with the words "the conclusion" to better accommodate the use of electronic commerce (see A/CN.9/487, para. 136 and A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 23).

27. The view was expressed that subparagraph (b) might need to address the situation where the conciliation proceedings were conducted by a panel of conciliators but the proceedings were declared as terminated by only one or more of its members (see A/CN.9/487, para. 136). The Working Group might wish to decide whether the model legislative provisions should provide that, where there is more than one conciliator, all members of the panel should act jointly and the declaration should originate from the entire panel of conciliators. In that respect, it may be recalled that article 3 of the UNCITRAL Conciliation Rules stipulates that "Where there is more than one conciliator, they ought, as a general rule, to act jointly." That provision is clearly worded in terms of a recommendation and not an obligation. Another reason for which the model legislative provisions might not seek to impose that conciliators should act jointly, is the variety in the procedural situations in which the conciliators might intervene to terminate the proceedings. Depending on the procedural style adopted by the parties and the panel, the decision might be made by consensus of all members of the panel, but also by the presiding conciliator or through delegation by the panel to one of its members. The Working Group may wish to decide whether it would be appropriate for model legislative provisions to enter into that level of procedural detail.

References to previous UNCITRAL documents

A/CN.9/485 and Corr.1, para. 133
 A/CN.9/487, paras. 135 and 136
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 22 and 23

Article 12. Limitation period

[1. When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

2. Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.]^[28]

Remark

28. Despite strong opposition to the retention of draft article 12 (see A/CN.9/487, para. 138), the Working Group agreed at its thirty-fourth session to retain the draft article on a provisional basis for continuation of the discussion at a later stage. A question was raised as to whether the effect of the draft article was to interrupt or merely to suspend the running of the limitation period. In that context, it may be recalled that, at its thirty-third session, the Working Group noted that there were essentially three ways in which conciliation proceedings might affect the running of the limitation period. One possibility was that after the limitation period was interrupted by the commencement of the conciliation proceedings it would start to run anew. Another possibility was that, if the conciliation ended without a settlement, the limitation period would be deemed to have continued to run as if there had been no conciliation. In such a case there might be a need for an additional grace period if, in the meantime, the limitation period had expired or had run close to expiry. That approach was reflected in a draft provision before the Working Group that was modelled on article 17 of the Convention on the Limitation Period in the International Sale of Goods (New York, 1974). A third option was that, during the conciliation period, the limitation period would not run and would resume running from the time the conciliation ended unsuccessfully. Of the three, that last option (also referred to as the “chess clock” solution or, in some legal systems, as “suspension”) received considerable support (see A/CN.9/485 and Corr.1, para. 138).

References to previous UNCITRAL documents

A/CN.9/468, paras. 50-53
A/CN.9/485 and Corr.1, paras. 133-138
A/CN.9/487, paras. 137 and 138
A/CN.9/WG.II/WP.108, paras. 53-55
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 24

Article 13. Admissibility of evidence in other proceedings^[29]

1. [Unless otherwise agreed by the parties,] a party who participated in the conciliation proceedings or a third person^[30] shall not rely on, or introduce as evidence, in arbitral or judicial proceedings, whether or not such arbitral or judicial proceedings relate to the dispute that is or was^[31] the subject of the conciliation proceedings:^[32]

(a) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;^[33]

(b) Statements or admissions^[34] made by a party in the course of the conciliation proceedings;

Remarks

29. At its thirty-fourth session, the Working Group expressed general support for the policy underlying draft article 13, namely, that it was designed to encourage frank and candid discussions in conciliation by prohibiting the use of information listed in paragraph 1 in any later proceedings (see A/CN.9/487, para. 140).

30. Broad support was expressed for retaining the words “or a third person” as necessary to ensure that persons other than the party (for example, witnesses or experts) who participated in the conciliation proceedings were also bound by paragraph 1. However, doubt was expressed whether it was appropriate for a third person to be bound by paragraph 1, in particular if the parties to the conciliation controlled the extent to which those third persons were so bound (by virtue of the words “unless otherwise agreed by the parties”) (see A/CN.9/487, para. 140). The Working Group may wish to make a final decision regarding that issue. It should be noted that the words “or a third person” would seem to cover also the conciliator. The Working Group may wish to discuss whether draft article 13 should be made subject to draft article 14 (see below at remark 39).

31. The Working Group noted that conciliation proceedings might still be continuing at the time when paragraph 1 became applicable (see A/CN.9/487, para. 140). To cover that situation, the paragraph has been redrafted to refer to a “dispute that is or was” the subject of conciliation proceedings.

32. There was support in the Working Group for a suggestion that, where information of the type covered by paragraph 1 had been generated before and in anticipation of conciliation proceedings, such information should also be covered by the draft article (see A/CN.9/487, para. 140). The Working Group may wish to discuss further the implications of that suggestion. In particular, attention might be given to the ways in which “information generated before and in anticipation of conciliation proceedings” might be defined to avoid creating an overly broad and unspecific exception to well-established procedural rules.

33. It was suggested that the appropriate balance for distinguishing between evidence that was to be covered by the provision and evidence that remained outside of it would be achieved by deleting the words “matters in dispute” and replacing the word “admissions” with the words “statements or admissions” and maintaining the substance of paragraph 4 (see A/CN.9/487, para. 141).

34. See previous remark.

(c) Proposals made by the conciliator;

(d) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator.

2. Paragraph 1 of this article applies irrespective of [the form of the information or evidence referred to therein] [whether the information or evidence referred to therein is in oral or written form].^[35]

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by the arbitral tribunal or the court [whether or not the arbitral or judicial proceedings relate to the dispute that is the subject of the conciliation proceedings unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings].

4. Where evidence has been offered in contravention of paragraph 1 of this article, the arbitral tribunal or the court shall treat such evidence as inadmissible.

5. Evidence that is admissible in arbitral or court proceedings does not become inadmissible as a consequence of being used in a conciliation.

Remark

35. Paragraph 2 has been introduced with a view to reflecting the agreement reached by the Working Group that, if there was any doubt that the provision covered oral as well as written evidence, it should be made clear in the provision that the draft article covered any information or evidence, regardless of its form (see A/CN.9/487, para. 141).

References to previous UNCITRAL documents

A/CN.9/460, paras. 11-13
A/CN.9/468, paras. 22-30
A/CN.9/485 and Corr.1, paras. 139-146
A/CN.9/487, paras. 139-141
A/CN.9/WG.II/WP.108, paras. 18-28
A/CN.9/WG.II/WP.110, paras. 99 and 100
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 25-32

Article 14. Role of conciliator in other proceedings

1. Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that was or is the subject of the conciliation proceedings.

2. Evidence given by the conciliator^[36] regarding the matters^[37] referred to in paragraph 1 of article 12 or regarding the conduct of either party during the conciliation proceedings,^[38] is not admissible in any arbitral or judicial proceedings [whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings] [in respect of a dispute that was or is the subject of the conciliation proceedings].^[39]

Remarks

36. At the thirty-fourth session of the Working Group, a view was taken that the term “testimony of the conciliator” used in the previous draft was too narrow in the context of paragraph 2 and that words such as “evidence given by the conciliator” should be preferred (see A/CN.9/487, para. 143).

37. The Working Group expressed support for replacing the word “facts” with a word such as “matters” or “information” (see A/CN.9/487, para. 143).

38. Support was expressed in the Working Group for broadening the scope of the prohibition provided in paragraph 2 to include testimony by a conciliator that a party acted in bad faith during the conciliation (see A/CN.9/487, para. 143).

39. The Working Group noted that paragraph 1 of draft article 13 applied in arbitral or judicial proceedings whether or not

those proceedings related to the dispute that was the subject of the conciliation proceedings, whereas the scope of paragraph 2 of draft article 14 was narrower, in that it referred to arbitral or judicial proceedings in respect of a dispute that was the subject of conciliation proceedings (see A/CN.9/487, para. 143). It is suggested that the text of paragraph 2 of draft article 14 should be in line with that of paragraph 1 of draft article 13. The first optional wording between square brackets aligns the situation of the conciliator under paragraph 2 of draft article 14 with that of a “third person” under paragraph 1 of draft article 13. It could be argued that the “third person” in draft article 13 does not cover the conciliator because of the specific provision contained in draft article 14. Even in that case, however, the policy in draft articles 13 and 14 may need to be aligned to ensure that certain information regarding the conciliation is kept confidential. As a matter of general policy, the Working Group may wish to determine whether it is desirable to establish a general prohibition for the conciliator to give evidence in any conceivable arbitral or judicial proceedings regarding the broad range of information listed under subparagraphs (a)-(d) of paragraph 1 of draft article 13. The second optional wording between square brackets is the wording considered by the Working Group at its thirty-fourth session. Should that wording be maintained, it would conflict with paragraph 1 of draft article 13, particularly if the reference to “a third person” in draft article 13 is to be understood as covering also the conciliator and not only such third persons as experts and witnesses (see above, remark 30). The Working Group might therefore need to reconsider the policy embodied in paragraph 1 of draft article 13.

3. [Paragraph 1 applies] [Paragraphs 1 and 2 apply]^[40] also in respect of another dispute that has arisen from the same contract [or any related contract].^[41]

Remarks

40. Depending on the decision made by the Working Group regarding the bracketed language in paragraph 2, it may be superfluous to refer to evidence given by the conciliator regarding “another dispute” under paragraph 3.

41. Of the three formulations before the Working Group (see A/CN.9/487, para. 142) support was expressed for the broadest possible formulation offered. However, it was observed that the word “related” and some terms that might be used to express that concept in other language versions were complex and had given rise to difficulties of interpretation (see A/CN.9/487, para. 144).

References to previous UNCITRAL documents

A/CN.9/460, paras. 14 and 15
A/CN.9/468, paras. 31-37
A/CN.9/485 and Corr.1, paras. 147-153
A/CN.9/487, paras. 142-145
A/CN.9/WG.II/WP.108, paras. 29-33
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 33-35

Article 15. Resort to arbitral or judicial proceedings

1. During conciliation proceedings the parties shall not initiate any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, and a court or arbitral tribunal shall give effect to this obligation. Either party may nevertheless initiate arbitral or judicial proceedings where, in its opinion, such proceedings are necessary for preserving its rights. Initiation of such proceedings is not of itself to be regarded as termination of the conciliation proceedings.^[42]

Remark

42. At its thirty-fourth session, the Working Group expressed support for the substance of paragraph 1. It was noted that paragraph 1 would serve a function even if draft article 11, which dealt with the effect of conciliation on the limitation period, were to be retained, since the claimant might want to initiate arbitral or judicial proceedings for a purpose other than suspending the running of the limitation period (see A/CN.9/487, para. 147). The Working Group may wish to discuss further the implications of the second sentence of paragraph 1. As currently drafted, it leaves each party with very broad discretion to determine whether initiating arbitral or judicial proceedings is “necessary for preserving its rights”. For example, any application for interim measures of protection could easily be described as “necessary for preserving the rights” of the applicant. The probability that the second sentence might be used to defeat the first sentence of paragraph 1 thus seems very high.

2. [To the extent that the parties have expressly undertaken not to initiate [during a certain time or until an event has occurred] arbitral or judicial proceedings with respect to a present or future dispute, such an undertaking shall be given effect by the court or the arbitral tribunal [until the terms of the agreement have been complied with]].^[43]

[3. The provisions of paragraphs 1 and 2 of this article do not prevent a party from approaching an appointing authority requesting it to appoint an arbitrator.]

Remark

43. Support was expressed for the substance of paragraph 2, including the words placed between square brackets within the paragraph. It was considered that agreements to conciliate should be binding on the parties, in particular where the parties had expressly agreed not to initiate adversary proceedings until they had tried to settle their disputes by conciliation. It was pointed out that paragraph 1, which allowed initiation of arbitral or judicial proceedings in certain circumstances, and paragraph 2, which did not permit initiation of arbitral or judicial proceedings before the parties complied with their commitment to conciliate, sought to achieve possibly conflicting results and that the operation of the two provisions should be coordinated and clarified (see A/CN.9/487, paras. 148 and 149). Subject to any redrafting of the second sentence of paragraph 1, the Working Group may wish to determine whether the matter would be sufficiently clarified by making paragraph 2 “subject to paragraph 1 of this article” or whether the second sentence of paragraph 1 would need to be reproduced within the text of paragraph 2. Alternatively, the Working Group may wish to discuss whether the guide to enactment should clarify why paragraph 2 should not reproduce the type of exception embodied in the second sentence of paragraph 1. For example, it might be explained that paragraph 1 applies once the conciliation proceedings have started and the exception in the second sentence may become necessary if the conciliation proceedings last over a long period of time. However, paragraph 2 deals with a presumably short period commencing after the dispute has arisen. Typically, the parties would agree not to initiate adversary proceedings in order to facilitate negotiations or conciliation and there might be no compelling reason to provide an exception to override an express and deliberate agreement of the parties.

References to previous UNCITRAL documents

A/CN.9/468, paras. 45-49
A/CN.9/485 and Corr.1, paras. 154-158

A/CN.9/WG.II/WP.108, paras. 49-52

A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 36 and 37

Article 16. Arbitrator acting as conciliator

[It is not incompatible with the function of an arbitrator if the arbitrator raises the question of a possible conciliation and, to the extent agreed to by the parties, participates in efforts to reach an agreed settlement.]^[44]

Remark

44. At the thirty-fourth session of the Working Group, the view was expressed that draft article 16 should be deleted because its focus was on actions that could be taken during arbitral proceedings rather than actions taken during conciliation proceedings. Therefore, if that provision was needed at all, its proper place was legislation that dealt with arbitration. Moreover, it was recalled that during the discussion of draft article 1, paragraph 4, the Working Group discussed the possibility of excluding from the scope of the draft model legislative provisions those situations where an arbitrator would conduct a conciliation pursuant to his or her procedural prerogatives or discretion (see A/CN.9/487, para. 103; and above, remark 7). If that were to be the case, the draft article might be deleted. However, if the draft model legislative provisions would also cover situations where an arbitrator, in the course of arbitral proceedings, undertook to act as a conciliator, the substance of draft article 16 would remain useful. In such a case, it was suggested to express the idea of draft article 16 in draft article 1. The Secretariat was requested to prepare a draft on the basis of those discussions, possibly preparing alternative solutions (see A/CN.9/487, para. 152). If the model legislative provisions should deal with a conciliation process conducted by an arbitrator, this might need to be clarified in draft article 1 by a provision along the lines of “These model legislative provisions apply also where an arbitrator, to the extent agreed to by the parties, acts as a conciliator”.

References to previous UNCITRAL documents

A/CN.9/468, paras. 41-44
A/CN.9/485 and Corr.1, para. 159
A/CN.9/487, paras. 151 and 152
A/CN.9/WG.II/WP.108, paras. 44-48
A/CN.9/WG.II/WP.110, para. 104
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 38

Article 17. Enforceability of settlement^[45]

Variant A

If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable [*the enacting State inserts provisions specifying provisions for the enforceability of such agreements*].^[46]

Remarks

45. At its thirty-fourth session, the Working Group noted that legislative solutions regarding the enforceability of settlements

reached in conciliation proceedings differed widely. Some States had no special provisions on the enforceability of such settlements, with the result that they would be enforceable as any contract between the parties. This understanding that conciliation settlements were enforceable as contracts had been restated in some laws on conciliation. It was also noted that several laws contained provisions to the effect that a written settlement agreement was to be treated as an award rendered by an arbitral tribunal and was to produce the same effect as a final award in arbitration, provided that the result of the conciliation process was reduced to writing and signed by the conciliator or conciliators and the parties or their representatives. According to another approach found in one national law, the settlement agreement was deemed to be an enforceable title, and the rights, debts and obligations that were certain, express and capable of being enforced and that were recorded in the settlement agreement, were enforceable pursuant to the provisions established for the enforcement of court decisions. It was pointed out, however, that that approach was used with respect to conciliation administered by approved institutions where the conciliators were selected from a list maintained by an official organ. In yet other laws, it was provided that conciliation settlements were treated as arbitral awards, but that such settlements “might, by leave of the court” be enforced in the same manner as a judgement, this wording appearing to leave a degree of discretion to the court in enforcing the settlement. The view was expressed that the draft model legislative provisions might give recognition to a situation where the parties appointed an arbitral tribunal with the specific purpose of issuing an award based on the terms settled upon by the parties. Such an award, envisaged in article 30 of the UNCITRAL Model Law on International Commercial Arbitration, would be capable of enforcement as any arbitral award. Other settlements, according to that view, were to be regarded as contracts and to be enforced as such. Under that view, the model legislative provisions should merely state the principle that the settlement agreement was to be enforced, without attempting to provide a unified solution as to how such settlement agreements might become “enforceable”, a matter that should be left to the law of each enacting State. According to other views, however, it would be useful, in order to increase the attractiveness of conciliation, to endow settlements reached during conciliation with the possibility of enforcement. Accordingly, it was considered desirable to prepare a harmonized statutory provision for States that might wish to enact it. After discussion, the Secretariat was requested to prepare a revised version of draft article 16, with possible variants to reflect the various views that had been expressed and the legislative approaches that had been discussed (see A/CN.9/487, paras. 154-159).

46. Variant A is the text considered by the Working Group at its thirty-fourth session. It purports to reflect the view that the model legislative provisions should merely state the principle that the settlement agreement is enforceable, without attempting to provide a unified solution as to how such settlement agreements might become “enforceable”, a matter that should be left to the law of each enacting State. Examples of solutions provided under national laws may be given in the guide to enactment.

Variant B

If the parties reach agreement on a settlement of the dispute, that agreement is binding and enforceable as a contract.^[47]

Variant C

If the parties reach agreement on a settlement of the dispute, they may appoint an arbitral tribunal, including by appointing the conciliator or a member of the panel of conciliators, and request the arbitral tribunal to record the settlement in the form of an arbitral award on agreed terms.^[48]

Variant D

If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable as an arbitral award.^[49]

Remarks

47. Variant B reflects the widely shared view that, in determining its enforceability, a settlement agreement should be dealt with as a contract. Under that variant, the settlement agreement is not requested to be signed by the parties and the conciliator or the panel of conciliators in order not to interfere with existing contract law through the imposition of specific form requirements for the formation of that contract.

48. Variant C is based on article 30 of the UNCITRAL Model Law on International Commercial Arbitration. It offers a basic procedural framework as to how a settlement agreement may become expressed in the form of an arbitral award.

49. Variant D reflects the view that, in determining its enforceability, a settlement agreement should be dealt with as an arbitral award. That variant offers no indication as to the procedure through which such an arbitral award is produced. The guide to enactment may need to provide guidance regarding the meaning of the words “enforceable as an arbitral award”, for example by reference to the more detailed provisions of articles 30, 35 and 36 of the UNCITRAL Model Law on International Commercial Arbitration.

References to previous UNCITRAL documents

A/CN.9/460, paras. 16-18
 A/CN.9/468, paras. 38-40
 A/CN.9/485 and Corr.1, para. 159
 A/CN.9/487, paras. 153-159
 A/CN.9/WG.II/WP.108, paras. 34-42
 A/CN.9/WG.II/WP.110, paras. 105-112
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 39

**C. Note by the Secretariat on the settlement of commercial disputes:
draft guide to enactment of the UNCITRAL [Model Law on International
Commercial Conciliation], working paper submitted to the
Working Group on Arbitration at its thirty-fifth session
(A/CN.9/WG.II/WP.116) [Original: English]**

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in

arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (i)); and the power of the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to "online" arbitrations (that is, arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group had considered articles 1-16 of the draft model legislative provisions (A/CN.9/WG.II/WP.113/Add.1 and Corr.1). It was generally felt that work on the provisions could be expected to be completed by the Working Group at its subsequent session. The Commission requested the Working Group to proceed with the examination of the provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.⁷

6. At the close of its thirty-fourth session, the Working Group requested the Secretariat to prepare revised drafts of the articles, based on the discussion in the Working Group, for consideration at its subsequent session (see A/CN.9/487, para. 20). The present note contains the first draft of the related guide to enactment.

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), para. 315.

ANNEX

GUIDE TO ENACTMENT OF THE UNCITRAL [MODEL LAW
ON INTERNATIONAL COMMERCIAL CONCILIATION]

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I. PURPOSE OF THE GUIDE

1. In preparing and adopting model legislative provisions on international commercial conciliation, the United Nations Commission on International Trade Law (UNCITRAL) was mindful that such provisions would be a more effective tool for States modernizing their legislation if accompanied by background and explanatory information. The Commission was also aware of the likelihood that the model provisions would be used in a number of States with limited familiarity with conciliation as a method of dispute settlement. Primarily directed to executive branches of Governments and legislators preparing the necessary legislative revisions, the information provided in the present Guide to Enactment should also provide useful insight to other users of the text, including judges, practitioners and academics.

2. Much of this Guide is drawn from the *travaux préparatoires* of the Model Law. The Guide explains why the provisions in the

Model Law have been included as essential basic features of a statutory device designed to achieve the objectives of the Model Law. When it drafted the model provisions, the Commission assumed that explanatory material would accompany the text of the Model Law. For example, some issues are not settled in the Model Law but are addressed in the Guide, which is designed to provide an additional source of inspiration to States enacting the Model Law. It might also assist States in considering which provisions of the Model Law, if any, might have to be varied to accommodate particular national circumstances.

3. This Guide to Enactment has been prepared by the Secretariat pursuant to a request made by UNCITRAL. It reflects the Commission's deliberations and decisions at the session where the Model Law was adopted and the considerations of UNCITRAL's Working Group on Arbitration, which conducted the preparatory work.

II. INTRODUCTION TO THE MODEL LAW

A. Notion of conciliation and purpose of the Model Law

4. The term “conciliation” is used in the Model Law as a broad notion referring to proceedings in which a person or a panel of persons assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. There are critical differences among the dispute resolution processes of negotiation, conciliation and arbitration. Once a dispute arises, the parties typically seek to resolve their dispute by negotiating without involving anyone outside the dispute. In arbitration, the parties entrust the dispute resolution process and the outcome of the dispute to the arbitral tribunal, which imposes a binding decision on the parties. At the centre of the dispute resolution continuum lies conciliation. Conciliation differs from party negotiations in that conciliation involves independent and impartial third-person assistance to settle the dispute. It differs from arbitration because in conciliation the parties retain full control over the process and the outcome.

5. Conciliation proceedings in the above sense are envisaged and dealt with in a number of rules of arbitral institutions and institutions specializing in the administration of various forms of alternative methods of dispute resolution, as well as in the UNCITRAL Conciliation Rules, which the Commission adopted in 1980. Those Rules are widely used and have served as a model for rules of many institutions.

6. Conciliation proceedings in which parties in dispute agree to be assisted in their attempt to reach a settlement may differ in procedural details depending on what is considered the best method to foster a settlement between the parties. The provisions governing such proceedings, as contained in the Model Law, are designed to accommodate such differences and leave the parties and conciliators free to carry out the conciliatory process as they consider appropriate.

7. In practice, proceedings in which the parties are assisted by a third person to settle a dispute are referred to by expressions such as conciliation, mediation or similar terms. The notion of “alternative dispute resolution” is also used to refer collectively to various techniques and adaptations of procedures for solving disputes by conciliatory methods rather than by a binding method such as arbitration. The Model Law uses the term “conciliation” as synonymous to all those procedures. To the extent that such “alternative dispute resolution” procedures are characterized by features mentioned above, they are covered by the Model Law.

8. Conciliation is being increasingly used in dispute-settlement practice in various parts of the world, including regions where until a decade or two ago it was not commonly used. This trend is reflected, for example, in the establishment of a number of private and public bodies offering services to interested parties designed to foster the amicable settlement of disputes. This trend, a growing desire in various regions of the world to promote conciliation as a method of dispute settlement and experience with national legislation on conciliation, have given rise to discussions calling for internationally harmonized legal solutions designed to facilitate conciliation.

B. The Model Law as a tool for harmonizing legislation

9. A model law is a legislative text that is recommended to States for incorporation into their national law. Unlike an international convention, model legislation does not require the State enacting it to notify the United Nations or other States that may have also enacted it. States are strongly encouraged, however, to

inform the UNCITRAL secretariat of any enactment of the new Model Law (or any other model law resulting from the work of UNCITRAL).

10. In incorporating the text of the model legislation into its legal system, a State may modify or leave out some of its provisions. In the case of a convention, the possibility of changes being made to the uniform text by the States parties (normally referred to as “reservations”) is much more restricted; in particular, trade law conventions usually either totally prohibit reservations or allow only very few, specified ones. The flexibility inherent in model legislation is particularly desirable in those cases where it is likely that the State would wish to make various modifications to the uniform text before it would be ready to enact it as national law. Some modifications may be expected in particular when the uniform text is closely related to the national court and procedural system. This, however, also means that the degree of, and certainty about, harmonization achieved through model legislation is likely to be lower than in the case of a convention. Because of the flexibility inherent in a model law, the number of States enacting model legislation is likely to be higher than the number of States adhering to a convention. In order to achieve a satisfactory degree of harmonization and certainty, States should consider making as few changes as possible in incorporating the new Model Law into their legal systems, but, if changes are made, they should remain within the basic principles of the Model Law. A significant reason for adhering as much as possible to the uniform text is to make the national law as transparent and familiar as possible for foreign parties, advisers and conciliators who participate in conciliations in the enacting State.

C. Background and history

11. International trade and commerce have grown rapidly, with cross-border transactions no longer being limited to the largest corporate powers or nations as the contracting parties. With electronic commerce expanding exponentially, where business is frequently conducted across national boundaries, the need for effective and efficient dispute resolution systems has become paramount. UNCITRAL has drafted the Model Law to assist States in designing dispute resolution processes that are intended to reduce costs of dispute settlement, foster maintaining a cooperative atmosphere between trading parties, prevent further disputes and inject certainty into international trade. By adopting the Model Law, and by educating parties engaged in international commerce about its purposes, the parties will be encouraged to seek non-adjudicative dispute settlement methods, which will increase stability in the marketplace.

12. Certain issues, such as the admissibility of certain evidence in subsequent judicial or arbitral proceedings or the role of conciliators in subsequent proceedings, might be solved by reference to such rules as the UNCITRAL Conciliation Rules. There are many cases, however, where the parties have not agreed to any conciliation rules. The conciliation process might thus benefit from the establishment of non-mandatory legislative conciliation provisions for parties who mutually desire to conciliate but have not agreed on a set of rules for the conciliation process and procedure.

13. Moreover, in many countries where agreements as to the admissibility of certain kinds of evidence are of uncertain effect or might not address all concerns of the parties, uniform legislation provides a useful clarification. The level of predictability and certainty required to foster conciliation are best achieved through legislation.

14. The objectives of the Model Law, which include encouraging the use of conciliation and providing greater predictability and

certainty in its use, are essential for fostering economy and efficiency in international trade. The prevailing view that emerged in the Commission was that it would be worthwhile to explore the possibility of preparing uniform legislative rules to support the increased use of conciliation.

[*Note by the Secretariat: history of the Model Law to be completed*]

Reference to UNCITRAL documents

A/CN.9/WG.II/WP.108, paras. 11-17
A/54/17, para. 342

D. Scope

15. In preparing the Model Law and addressing the subject matter before it, the Commission had in mind a broad notion of conciliation, which could also be referred to as “mediation”, “alternative dispute resolution” and “neutral evaluation”. The Commission’s intent is that the Model Law should be applicable to the broadest range of commercial disputes. The Commission agreed that the title of the Model Law should refer to international commercial conciliation. While a definition of “conciliation” is provided in article 2, the definitions of “commercial” and “international” are contained in a footnote to article 1 and in article 3, respectively. While the Model Law is restricted to international and commercial cases, the State enacting the Model Law may consider extending it to domestic commercial disputes and some non-commercial ones.

16. The Model Law should be regarded as a balanced and discrete set of rules and could be enacted as a single statute or as a part of a law on dispute settlement.

E. Structure of the Model Law

17. The Model Law contains definitions, procedures and guidelines on related issues based upon the importance of party control over the process and outcome.

18. Articles 1 through 3 provide background and define conciliation generally and its international application specifically. These are the types of provisions that would generally be found in legislation to determine the range of matters the Model Law is intended to cover.

19. The rules in articles 4 through 9 are intended to cover procedural aspects of the conciliation. These procedural rules will have particular application to the circumstances where the parties have not adopted rules governing dispute resolution processes, and thus are designed to be in the nature of default provisions. They are also intended to assist parties in dispute that may have defined dispute resolution processes in their agreement, in this context acting as a supplement to their agreement.

20. The remainder of the Model Law addresses post-conciliation issues to avoid uncertainty resulting from an absence of statutory provisions governing these issues.

F. Assistance from the UNCITRAL secretariat

21. In line with its training and assistance activities, the UNCITRAL secretariat may provide technical consultations for Governments preparing legislation based on the Model Law. UNCITRAL provides technical consultation for Governments considering legislation based on other UNCITRAL model laws,

or considering adhesion to one of the international trade law conventions prepared by UNCITRAL.

22. Further information concerning the Model Law as well as the Guide and other model laws and conventions developed by UNCITRAL, may be obtained from the secretariat at the address below. The secretariat welcomes comments concerning the Model Law and the Guide, as well as information concerning enactment of legislation based on the Model Law.

UNCITRAL secretariat
United Nations Vienna International Centre
P.O. Box 500
1400 Vienna, Austria

Telephone: + (43) (1) 26060-4060 or 4061
Telefax: + (43) (1) 26060-5813
Electronic mail: uncitral@uncitral.org
Internet home page: www.uncitral.org

III. ARTICLE-BY-ARTICLE REMARKS

Article 1. Scope of application

1. These model legislative provisions apply to international commercial* conciliation, as defined in articles 2 and 3,

(a) if the place of conciliation, as agreed upon by the parties or, in the absence of such agreement, as determined with the assistance of the conciliator or panel of conciliators, is in this State; or

(b) if the place of conciliation has not been agreed or otherwise determined as provided for in subparagraph (a), the place of conciliation is deemed to be in this State if any of the following places is in this State: the place of the institution that administered the conciliation proceedings, the place of residence of the conciliator or the place of business of both parties if that place is in the same country.

2. These model legislative provisions also apply to a commercial conciliation that is not international in the sense of article 3 if the parties have [expressly] agreed that the model legislative provisions are applicable to the conciliation.

3. Articles . . . apply also if the place of conciliation is not in this State.

4. These model legislative provisions apply irrespective of whether a conciliation is carried out on the initiative of one party after a dispute has arisen, in compliance with a mutual agreement of the parties made before the dispute arose, or pursuant to a direction or [request] [invitation] of a court or competent governmental entity.

5. These model legislative provisions do not apply to:

(a) cases where a judge or an arbitrator, in the course of adjudicating a particular dispute, conducts a conciliatory process; and

(b) [. . .].

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

23. The purpose of article 1, which is to be read in conjunction with the definition of “conciliation” in article 2 and the definition of “international” in article 3, is to delineate the scope of application of the Model Law. In preparing the Model Law, the Working Group generally agreed that the application of the uniform rules should be restricted to commercial matters. The term “commercial” is defined in the footnote to article 1, paragraph 1. The purpose of the footnote is to be inclusive and broad and to overcome any technical difficulties that may arise in national law as to which transactions are commercial. No strict definition of “commercial” was provided, the intention being that the term should be interpreted broadly so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. The footnote to article 1 provides an illustrative list of relationships that are to be considered commercial, thus emphasizing the breadth of the suggested interpretation and indicating that the test is not based on what the national law may regard as “commercial”. This may be particularly useful for those countries where a discrete body of commercial law does not exist. In certain countries, the use of footnotes in a statutory text might not be regarded as acceptable legislative practice. National authorities enacting the Model Law might thus consider the possible inclusion of the text of the footnote in the body of the enacting legislation itself.

24. The Model Law would apply if the place of conciliation is in the enacting State. The Working Group, during the course of preparing the Model Law, expressed the view that the territorial factor should be listed as the first factor to be taken into account when determining the applicability of the Model Law. The territorial factor set out in subparagraph (a) provides that the Model Law applies (assuming other elements, particularly that the conciliation is international and commercial, are satisfied) if the place of conciliation is in the enacting State. It may be noted that, while article 1, paragraph 2, enables the parties to agree to extend the application of the Model Law to a non-international conciliation, it does not provide for such an extension if a conciliation does not meet the test of “commercial” as defined in the footnote to article 1.

25. Subparagraph (a) is designed to increase certainty as to when the Model Law will apply by allowing the parties the freedom to agree upon the place of conciliation in the first instance. Failing that agreement, it is for the conciliator or the panel of conciliators to assist the parties in determining that place. To avoid conflict and to promote certainty, the parties should be encouraged to agree on the place of conciliation in their agreements.

26. Subparagraph (b) aims to address circumstances where the place of conciliation has not been agreed upon or determined or where, for other reasons, it may not be possible to establish the place of conciliation. In this situation, this paragraph provides that the Model Law will apply if any of the following is in the enacting State: the institution administering the conciliation, the residence of the conciliator, or the parties’ places of business, if those places are in the same country.

27. Paragraph 2 allows the parties to agree to the application of the Model Law (that is, to opt into the Model Law) even if the conciliation is not international as defined in the Model Law.

28. Nothing in the Model Law should prevent an enacting State from extending the scope of the Model Law to cover conciliation outside the commercial sphere [or to allow the parties to agree that the Model Law applies in respect of a non-commercial conciliation].

29. In principle, the Model Law only applies to international conciliation as defined in article 3. An enacting State may in the

implementing legislation, however, extend the applicability of the Model Law to both domestic and international conciliation.

30. Paragraph 3 enumerates the provisions which should produce effects in the enacting State even if the conciliation proceedings took place in another country and would thus not generally be covered by the law of the enacting State. [Those provisions are . . .].

31. Paragraph 4, while recognizing that conciliation is a voluntary process based on the agreement of the parties, also recognizes that some countries have taken measures to promote conciliation, for example by requiring the parties in certain situations to conciliate or by allowing judges to suggest to parties or to require that parties conciliate before they continue with litigation. In order to remove any doubt about the application of the Model Law in all these situations, paragraph 4 provides that the Model Law applies irrespective of whether a conciliation is carried out on the initiative of a party or pursuant to a legal requirement or request by a court. It is suggested that, even if the enacting State does not require parties to conciliate, the provision should nevertheless be enacted because parties in the enacting State may commence conciliation proceedings pursuant to a request by a foreign court, in which case the Model Law should also apply.

32. Paragraph 5 allows enacting States to exclude certain situations from the sphere of application of the Model Law. Subparagraph (a) expressly excludes from the application of the Model Law any case where either a judge or arbitrator, in the course of adjudicating a dispute, undertakes a conciliatory process. This process may be either at the request of the parties that are in dispute or in the exercise of the judge’s prerogatives or discretion. This exclusion was considered necessary to avoid undue interference with existing procedural law. Another area of exclusion might be conciliations relating to collective bargaining relationships between employers and employees given that a number of countries may have established conciliation systems in the collective bargaining system which may be subject to particular policy considerations that might differ from those underlying the Model Law. A further exclusion could relate to a conciliation that is conducted by a judicial officer. Given that such judicially conducted conciliation mechanisms are conducted under court rules, it may be appropriate to also exclude these from the scope of the Model Law.

References to UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 111-116

A/CN.9/487, paras. 88-99

A/CN.9/WG.II/WP.110, paras. 87, 88 and 90.

A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 1-6

Article 2. Conciliation

For the purposes of these model legislative provisions, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them [in an independent and impartial manner][and without the authority to impose a binding decision on the parties] in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contract or other legal relationship.

33. Article 2 sets out the elements for the definition of conciliation. The definition thus takes into account the agreement of the parties, the existence of a dispute, the intention of the parties to reach an amicable settlement and the participation of an impartial

and independent third person that assists the parties in an attempt to reach an amicable settlement. The intent is to distinguish conciliation on the one hand from binding arbitration and on the other hand from negotiations between the parties or their representatives.

34. [The words “in an independent and impartial manner” are not intended to establish a legal requirement in the sense of providing an element necessary for determining whether the law applies. Though in that sense the words are unnecessary for defining conciliation, they have been included to emphasize its nature. The words “and without the authority to impose a binding decision on the parties” are intended to distinguish conciliation from a process such as arbitration.]

35. Inclusion of the words “whether referred to by the expression conciliation, mediation or an expression of similar import” is intended to reflect that the Model Law applies irrespective of the name given to the process. The Commission intends that the word “conciliation” would express a broad notion of a voluntary process controlled by the parties and conducted with the assistance of a neutral third person. Different procedural styles and techniques might be used in practice to achieve settlement of a dispute and different expressions might be used to refer to those styles and techniques. In drafting the Model Law, the Commission intended that it should encompass all the styles and techniques that fall within the context of article 2.

References to UNCITRAL documents

A/CN.9/460 paras. 8-10
A/CN.9/485 and Corr.1, paras. 108-109
A/CN.9/487, paras. 100-104
A/CN.9/WG.II/WP.108, para. 11
A/CN.9/WG.II/WP.110, paras. 83-85
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 7 and 8
A/CN.9/WG.II/WP.115, paras. 8-11

Article 3. International conciliation

1. A conciliation is international if:

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

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

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

2. For the purposes of this article:

(a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;

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

36. In principle, the Model Law only applies to international conciliation. Article 3 establishes a test for distinguishing international cases from domestic ones. The Commission, in adopting the Model Law, agreed that the acceptability of the Model Law would be enhanced if no attempt was made to interfere with

domestic conciliation. However, the Model Law contains no provision that would, in principle, be unsuitable for domestic cases. In line with this thinking, the parties are allowed to opt into the Model Law as provided for in article 1, paragraph 2. It should be noted that in some jurisdictions, particularly in federal States, considerable difficulties might arise in distinguishing international trade from domestic trade. The Model Law should not be interpreted as encouraging enacting States to limit its applicability to international cases.

References to UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 117-120
A/CN.9/487, paras. 105-109
A/CN.9/WG.II/WP.110, para. 89
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 9 and 10

Article 4. Variation by agreement

Except as otherwise provided in these model legislative provisions, the parties may agree to exclude or vary any of these provisions.

37. With a view to emphasizing the prominent role given by the Model Law to the principle of party autonomy, this provision has been isolated in a separate article. This type of drafting is also intended to bring the Model Law more closely in line with other UNCITRAL instruments (such as article 6 of the United Nations Convention on Contracts for the International Sale of Goods, article 4 of the UNCITRAL Model Law on Electronic Commerce and article 5 of the UNCITRAL Model Law on Electronic Signatures). A formulation even closer to that of those existing texts would be along the following lines “The provisions of this Law may be derogated from or their effect may be varied by agreement, unless that agreement would not be valid or effective under applicable law.” Expressing the principle of party autonomy in a separate article may further reduce the desirability of repeating that principle in the context of a number of specific provisions of the Model Law.

References to UNCITRAL documents

A/CN.9/485 and Corr.1, para. 112
A/CN.9/487, para. 99
A/CN.9/WG.II/110, para. 87
A/CN.9/WG.II/113/Add.1 and Corr.1, footnote 6

Article 5. Commencement of conciliation proceedings

1. The conciliation proceedings in respect of a particular dispute commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.

2. If a party that invited another party to conciliate does not receive a reply within [fourteen] days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

38. The Commission, in adopting the Model Law, agreed that paragraph 1 of this article should be harmonized with paragraph 4 of article 1. This was done to accommodate the fact that a conciliation might be carried out as a consequence of a direction or request by a dispute settlement body such as a court or arbitral tribunal. The general reference to the “day on which the parties to

the dispute agree to engage in conciliation proceedings” would seem to cover the different methods by which parties may agree to engage in conciliation proceedings. Such methods may include, for example, the acceptance by one party of an invitation to conciliate made by the other party, or the acceptance by both parties of a direction or suggestion to conciliate made by a court.

39. By referring in the provision only to “agree[ment] to engage in conciliation proceedings”, the Model Law leaves the determination of when exactly this agreement is concluded to laws outside the law on conciliation. In view of the increased use of modern means of communication, the time period to reply to an invitation to conciliate has been set for 14 days, instead of 30 days as provided for in the UNCITRAL Conciliation Rules.

40. Article 5 does not address the situation where an invitation to conciliate is withdrawn after it has been made. No specific provision to that effect (such as a provision specifying that the party initiating the conciliation is free to withdraw the invitation to conciliate until that invitation has been accepted) was added to the text to avoid interfering with the law of contract formation by introducing new rules as to the conditions under which an offer or an acceptance to conciliate might be withdrawn. Although a proposal was made during the preparation of the Model Law to include a specific provision regarding the withdrawal of an invitation to conciliate, such a provision would probably be superfluous in view of the possibility offered to both parties to terminate conciliation proceedings at any time under subparagraph (d) of article 11.

References to UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 127-132
A/CN.9/487, paras. 110-115
A/CN.9/WG.II/WP.110, paras. 95 and 96
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 11 and 12

Article 6. Number of conciliators

There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators.

41. Unlike in arbitration where the default rule is three arbitrators, conciliation practice shows that parties usually wish to have the dispute handled by one conciliator. For that reason, the default rule in article 6 is one conciliator.

References to UNCITRAL documents

A/CN.9/487, paras. 116 and 117
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 13

Article 7. Appointment of conciliators

1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

2. In conciliation proceedings with two conciliators, each party appoints one conciliator.

3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

(a) A party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

42. The intent here is to encourage the parties to agree on the selection of a conciliator. Although a suggestion was made while preparing the Model Law that the appointment of each conciliator should be agreed to by both parties, which would thereby avoid the perception of partisanship, the prevailing view was that the solution allowing each party to appoint a conciliator was the more practical approach. This approach allows for speedy commencement of the conciliation process and might foster settlement in the sense that the two party-appointed conciliators, while acting independently and impartially, would be in a better position to clarify the positions of the parties and thereby enhance the likelihood of settlement. When three or more conciliators are to be appointed, the conciliator other than the two party-appointed conciliators should in principle be appointed by agreement of the parties. This should foster greater confidence in the conciliation process.

43. When no agreement can be reached on a conciliator, reference is to be had to an institution or a third person. Subparagraphs (a) and (b) provide that that institution or person may simply provide names of recommended conciliators or, by agreement of the parties, directly appoint conciliators. Paragraph 5 sets out some guidelines for that person or institution to follow in making recommendations or appointments. These guidelines seek to foster the independence and impartiality of the conciliator.

References to UNCITRAL documents

A/CN.9/487, paras. 118 and 119
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 14

Article 8. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, upon the manner in which the conciliation is to be conducted.

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any [views] [expectations] [intentions] [wishes] that the parties may express and the need for a speedy settlement of the dispute.

3. The conciliator shall be guided by principles of [objectivity, fairness and justice] [objectivity, impartiality and independence] and seek to maintain fairness in treatment as between the parties.

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

44. Paragraph 1 of this article stresses that the parties are free to agree on the manner in which the conciliation is to be conducted. It was derived from article 19 of the UNCITRAL Model Law on International Commercial Arbitration.

45. Paragraph 2 recognizes the role of the conciliator who, while observing the will of the parties, may shape the process as he or she considers appropriate.

46. Paragraph 4 clarifies that a conciliator may, at any stage, make a proposal for settlement. Whether, to what extent and at which stage the conciliator may make any such proposal will depend on many factors including the wishes of the parties and the techniques the conciliator considers to be most conducive to a settlement.

Reference to UNCITRAL document

A/CN.9.WG.II/WP.110, paras. 91 and 92

Article 9. Communication between conciliator and the parties

Unless otherwise agreed by the parties, the conciliator or the panel of conciliators may meet or communicate with the parties together or with each of them separately.

47. Separate meetings between the conciliator and the parties are, in practice, so usual that a conciliator is presumed to be free to use this technique, save for any express restriction agreed to by the parties. The purpose of this provision is to put this issue beyond doubt.

48. The conciliator should afford the parties equal treatment, which, however, is not intended to mean that equal time should be devoted for separate meetings with each party. The conciliator may explain to the parties in advance that there may be time discrepancies, both real and imagined, which should not be construed as other than the fact that the conciliator is taking time to explore all issues, interests and possibilities for settlement.

Reference to UNCITRAL document

A/CN.9/468, paras. 54 and 55

Article 10. Disclosure of information

When the conciliator or the panel of conciliators receives information concerning the dispute from a party, the conciliator or the panel of conciliators may disclose the substance of that information to the other party. However, the conciliator or the panel of conciliators shall not disclose information received from a party, when the party gives the information to the conciliator or the panel of conciliators subject to a specific condition that it be kept confidential.

49. Article 10 expresses the principle that, whatever information that a party gives to a conciliator, that information may be disclosed to the other party. Such disclosure fosters the confidence of both parties in the conciliation. However, the principle of disclosure is not absolute, in that the conciliator has the freedom but not the duty to disclose such information to the other party. As

well, the conciliator has the duty not to disclose a particular piece of information when the party that gave the information to the conciliator made it subject to a specific condition that it be kept confidential. This approach is justified because the conciliator imposes no binding decision on the parties, unlike in arbitration where the duty of disclosure is absolute.

50. The intent is to foster open and frank communication of information between parties and, at the same time, to preserve the parties' rights to maintain confidentiality. The role of the conciliator is to cultivate a candid exchange of information regarding the dispute.

51. A broad notion of "information" is preferred in the context of this statutory rule. It is intended to cover all relevant information communicated by a party to the conciliator. The notion of "information", as used in this article, should be understood as covering communications that took place before the actual commencement of the conciliation.

References to UNCITRAL documents

A/CN.9/468, paragraphs 54 and 55

A/CN.9/487, paras. 130-134

A/CN.9/WG.II/WP.108, paras. 58-60

Article 11. Termination of conciliation

The conciliation proceedings are terminated:

(a) By the conclusion of the settlement agreement by the parties, on the date of the agreement;

(b) By a written declaration of the conciliator or the panel of conciliators, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

(c) By a written declaration of the parties addressed to the conciliator to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

(d) by a written declaration of a party to the other party and the conciliator, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

52. The provision enumerates various circumstances in which there is no point for continuing proceedings and the conciliation ends. In subparagraph (a) the provision uses the expression "conclusion" instead of "signing" in order better to reflect the possibility of entering into a settlement by electronic communication.

References to UNCITRAL documents

A/CN.9/487, para. 136

cf article 15 of the UNCITRAL Conciliation Rules

Article 12. Limitation period

1. [When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.]

2. Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.]

**Article 13. Admissibility of evidence
in other proceedings**

1. [Unless otherwise agreed by the parties,] a party who participated in the conciliation proceedings or a third person shall not rely on, or introduce as evidence, in arbitral or judicial proceedings, whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings:

(a) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;

(b) Statements or admissions made by a party in the course of the conciliation proceedings;

(c) Proposals made by the conciliator;

(d) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator.

2. Paragraph 1 of this article applies irrespective of [the form of the information or evidence referred to therein] [whether the information or evidence referred to therein is in oral or written form].

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by the arbitral tribunal or the court [whether or not the arbitral or judicial proceedings relate to the dispute that is the subject of the conciliation proceedings unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings].

4. Where evidence has been offered in contravention of paragraph 1 of this article, the arbitral tribunal or the court shall treat such evidence as inadmissible.

5. Evidence that is admissible in arbitral or court proceedings does not become inadmissible as a consequence of being used in a conciliation.

53. In conciliation proceedings, the parties may typically express suggestions and views regarding proposals for a possible settlement, make admissions, or indicate their willingness to settle. If, despite such efforts, the conciliation does not result in a settlement and a party initiates judicial or arbitral proceedings, those views, suggestions, admissions or indications of willingness to settle might be used to the detriment of the party who made them. This possibility of such a “spillover” of information may discourage parties from actively trying to reach a settlement during conciliation proceedings, which would reduce the usefulness of conciliation.

54. Thus, this article is designed to encourage frank and candid discussions in conciliation by prohibiting the use of information listed in paragraph 1 in any later proceedings. The words “or a third person” are used to clarify that persons other than the party (for example, witnesses or experts) who participated in the conciliation proceedings are also bound by paragraph 1.

55. The provision is needed in particular if the parties have not agreed on article 20 of the UNCITRAL Conciliation Rules which provides that the parties must not “rely on or introduce as evidence in arbitral or judicial proceedings . . . :

(a) Views expressed or suggestions made by the other party in respect of a possible settlement of the dispute;

(b) Admissions made by the other party in the course of the conciliation proceedings;

(c) Proposals made by the conciliator;

(d) The fact that the other party had indicated his willingness to accept a proposal for settlement made by the conciliator.”

However, even if the parties have agreed on a rule of that type, the legislative provision is useful because, at least under some legal systems, the court may not give full effect to agreements concerning the admissibility of evidence in court proceedings.

56. Confidentiality of party information disclosed during conciliation may become an issue in different contexts and should be safeguarded. The approach in this article is designed to eliminate any uncertainty as to whether the parties may agree not to use as evidence in arbitral or judicial proceedings certain facts that occurred during the conciliation.

57. The Model Law aims at preventing the use of certain information in subsequent judicial or arbitral proceedings regardless of whether the parties have agreed to a rule such as that contained in article 20 of the UNCITRAL Conciliation Rules. Where the parties have not agreed to such a rule, the Model Law intends to make it an implied term of an agreement to conciliate that the parties will not rely in any subsequent arbitral or judicial proceedings on evidence of the types specified in the model provisions. The specified evidence would then be inadmissible in evidence and the arbitral tribunal or the court could not order disclosure.

58. The prohibition in article 13 is intended to apply to the specified information regardless of whether it appears in a document.

59. In order to achieve the purpose of promoting candor between the parties engaged in a conciliation, they must be able to enter into the conciliation knowing the scope of the rule and that it will be applied. There may be situations, however, where evidence of certain facts would be inadmissible under article 13, but the inadmissibility would have to be overridden by an overwhelming need to accommodate compelling reasons of public policy. For example, the need to disclose threats made by a participant to inflict bodily harm or unlawful loss or damage; where a participant attempts to use the conciliation to plan or commit a crime; where evidence is needed to establish or disprove an allegation of professional misconduct based on the conduct occurring during a conciliation; where evidence is needed in a proceeding in which fraud or duress is in issue regarding the validity or enforceability of an agreement reached by the parties; or where statements made during a conciliation show a significant threat to public health or safety. Paragraph 3 of the article expresses such exceptions in a general manner.

60. Paragraph 3 provides that an arbitral tribunal or court shall not order the disclosure of information referred to in paragraph 1 unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings. This provision was considered necessary to properly clarify and reinforce paragraph 1.

61. In some legal systems a party may not be compelled to produce in court proceedings a document that enjoys a “privilege”, for example, a written communication between a client and its attorney. The privilege may, however, be deemed lost if a party has relied on the privileged document in a proceeding. Privileged documents may be presented in conciliation proceedings with a view to facilitating settlement. In order not to discourage the use of privileged documents in conciliation, the enacting State may wish to consider preparing a uniform provision stating that the use of a privileged document in conciliation proceedings does not constitute a waiver of the privilege.

References to UNCITRAL documents

A/CN.9/468, paras. 22-29
 A/CN.9/485 and Corr.1, paras. 139-146
 A/CN.9/487, paras. 139-141
 A/CN.9/WG.II/WP.108, paras. 18-28
 A/CN.9/WG.II/WP.110, paras. 98-100
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 25-32

Article 14. Role of conciliator in other proceedings

1. Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that was or is the subject of the conciliation proceedings.

2. Evidence given by the conciliator regarding the matters referred to in paragraph 1 of article 13 or regarding the conduct of either party during the conciliation proceedings, is not admissible in any arbitral or judicial proceedings [whether or not such arbitral or judicial proceedings relate to the dispute that is or was the subject of the conciliation proceedings] [in respect of a dispute that was or is the subject of the conciliation proceedings].

3. [Paragraph 1 applies] [Paragraphs 1 and 2 apply] also in respect of another dispute that has arisen from the same contract [or any related contract].

62. Article 14 reinforces the effect of article 13 by limiting the possibility of the conciliator acting as arbitrator and by restricting the possibility of the conciliator providing evidence in subsequent proceedings.

63. In some cases, the parties might regard prior knowledge on the part of the arbitrator as advantageous, particularly if the parties think that this knowledge would allow the arbitrator to conduct the case more efficiently. In these cases, the parties may actually prefer that the conciliator and not somebody else be appointed as an arbitrator in the subsequent arbitral proceedings. The provision poses no obstacle to the appointment of the former conciliator provided the parties depart from the rule by agreement, for example, by a joint appointment of the conciliator to serve as an arbitrator.

References to UNCITRAL documents

A/CN.9/468, paras. 31-37
 A/CN.9/485 and Corr.1, paras. 148-153
 A/CN.9/487, paras. 143-145
 A/CN.9/WG.II/WP.108, paras. 29-33
 A/CN.9/WG.II/WP.110, footnote 30

Article 15. Resort to arbitral proceedings

1. During conciliation proceedings the parties shall not initiate any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, and a court or arbitral tribunal shall give effect to this obligation. Either party may nevertheless initiate arbitral or judicial proceedings where, in its opinion, such proceedings are necessary for preserving its rights. Initiation of such proceedings is not of itself to be regarded as termination of the conciliation proceedings.

2. [To the extent that the parties have expressly undertaken not to initiate [during a certain time or until an event has occurred] arbitral or judicial proceedings with respect to a present or future dispute, such an undertaking shall be given effect by the court or the arbitral tribunal [until the terms of the agreement have been complied with].

3. [The provisions of paragraphs 1 and 2 of this article do not prevent a party from approaching an appointing authority requesting it to appoint an arbitrator.]

64. Paragraph 1 of article 15 deals with the issue of whether, and to what extent, the party may initiate court or arbitral proceedings during the course of conciliation proceedings. The idea behind this provision is to allow the parties to initiate arbitral or court proceedings only in circumstances where, in the opinion of the party initiating such proceedings, such action is "necessary for preserving its rights". Possible circumstances that may require initiation of arbitral or court proceedings may include the necessity to seek interim measures of protection or to avoid the expiration of the limitation period.

65. Paragraph 2 deals with the effect of the agreement of the parties to engage in conciliation. The consequence of that provision is that the court or arbitral tribunal will be obliged to bar litigation or an arbitration from proceeding if that would be in violation of the agreement of the parties. Paragraph 2 does not contain the exception that is contained in paragraph 1, namely that a party may initiate arbitral or judicial proceedings where such proceedings are necessary for preserving its rights. [The Working Group may wish to consider whether such an exception would also be needed in paragraph 2 of article 15.]

References to UNCITRAL documents

A/CN.9/468, paras. 45-49
 A/CN.9/485 and Corr.1, paras. 155-158

Article 16. Arbitrator acting as a conciliator

[It is not incompatible with the function of an arbitrator if the arbitrator raises the question of a possible conciliation and, to the extent agreed to by the parties, participates in efforts to reach an agreed settlement.]

References to UNCITRAL documents

A/49/17
 A/CN.9/468, paras. 41-44
 A/CN.9/487, para. 152
 A/CN.9/WG.II/WP.108, paras. 29-33
 A/CN.9/WG.II/WP.110, para. 104

Article 17. Enforceability of settlement**Variant A**

If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable [*the enacting State inserts provision specifying provisions for the enforceability of such agreements*].

Variant B

If the parties reach agreement on a settlement of the dispute, that agreement is binding and enforceable as a contract.

Variant C

If the parties reach agreement on a settlement of the dispute, they may appoint an arbitral tribunal, including by appointing the conciliator or a member of the panel of conciliators, and request the arbitral tribunal to record the settlement in the form of an arbitral award on agreed terms.

Variant D

If the parties reach agreement on a settlement of the dispute and the parties and the conciliator or the panel of conciliators have signed the settlement agreement, that agreement is binding and enforceable as an arbitral award.

66. Legislative solutions regarding the enforceability of settlements reached in conciliation proceedings differ widely. Many practitioners have put forward the view that the attractiveness of conciliation would be increased if a settlement reached during a conciliation would, for the purposes of enforcement, be treated as or similarly to an arbitral award. Reasons given for introducing expedited enforcement usually aim to foster the use of conciliation and to avoid situations where a court action to enforce a settlement might take months or years to reach judgement.

67. Variant A purports to reflect the view that the model legislative provisions should merely state the principle that the settlement agreement is enforceable, without attempting to provide a unified solution as to how such settlement agreements might become “enforceable”. Under this variation, enforceability is a matter that should be left to the law of each enacting State.

68. Some States have no special provisions on the enforceability of such settlements, with the result that they would be enforceable as any contract between the parties. This understanding that conciliation settlements are enforceable as contracts has been restated in some laws on conciliation. Variant B reflects this approach. Under that variant, the settlement agreement is not required to be signed by the parties and the conciliator or the panel of conciliators in order not to interfere with existing contract law through the imposition of specific form requirements for the formation of that contract.

69. In some national legislation, parties who had settled a dispute are empowered to appoint an arbitrator specifically to issue an award based on the agreement of the parties. Variant C is modelled on this approach. It is based on article 30 of the UNCITRAL Model Law on International Commercial Arbitration and offers a basic procedural framework as to how a settlement agreement may become expressed in the form of an arbitral award.

70. Variant D reflects the view that, in determining its enforceability, a settlement agreement should be dealt with as an arbitral award. By subjecting conciliation settlements to the enforcement rules governing arbitral awards, the enforcement of these settlements would be simplified and expedited. Typically this would mean that conciliation settlements would be enforced by the court without reopening factual or substantive legal questions (except for questions of public policy). This variant, however, offers no indication as to the procedure through which such an arbitral award is produced. For guidance about the meaning of the words “enforceable as an arbitral award”, see the more detailed provisions of articles 30, 35 and 36 of the UNCITRAL Model Law on International Commercial Arbitration.

71. Some legal systems provide for enforcement in a summary fashion if the parties and their attorneys signed the settlement agreement and it contained a statement that the parties may seek summary enforcement of the agreement. Also, settlements might be the subject of expedited enforcement if, for example, the settlement agreement was notarized or formalized by a judge or co-signed by the counsel of the parties. [Depending on the Working Group’s decision on article 17, it may be decided to include these examples in the guide to enactment for the benefit of those States that may wish to include such measures designed to facilitate enforcement of such settlements in their legislation].

References to UNCITRAL documents

A/CN.9/468, paras. 38-40
A/CN.9/487, paras. 154-159
A/CN.9/WG.II/WP.108, paras. 34-42
A/CN.9/WG.II/WP.110, paras. 105-112

D. Report of the Working Group on Arbitration on the work of its thirty-sixth session

(New York, 4-8 March 2002) (A/CN.9/508) [Original: English]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (i)); and the power of the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to "online" arbitrations (that is, arbitrations in which

significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group had considered articles 1-16 of the draft model legislative provisions (A/CN.9/WG.II/WP.113/Add.1 and Corr.1). It was generally felt that work on the provisions could be expected to be completed by the Working Group at its subsequent session. The Commission requested the Working Group to proceed with the examination of those provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.⁷ At its thirty-fifth session (Vienna, 19-30 November 2001), the Working Group approved the final version of the draft provisions in the form of a draft model law on international commercial conciliation. The report of that session is contained in document A/CN.9/506. The Working Group noted that the draft model law, together with the draft guide to enactment and use, would be circulated to member States and observers for comment and presented to the Commission for review and adoption at its thirty-fifth session.

6. With regard to the requirement of written form for the arbitration agreement, the Commission noted that the Working Group had considered the draft model legislative provision revising article 7, paragraph 2, of the UNCITRAL Model Law on International Commercial Arbitration (see A/CN.9/WG.II/WP.113, paras. 13 and 14) and a draft interpretative instrument regarding article II, paragraph 2, of the New York Convention (see A/CN.9/WG.II/WP.113, para. 16). Consistent with a view expressed at the thirty-fourth session of the Working Group (see A/CN.9/487, para. 30), concern was expressed as to whether a mere reference to arbitration terms and conditions or to a standard set of arbitration rules available in written form could satisfy the written form requirement. It was stated that such a reference should not be taken as satisfying the

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-fifth Session, Supplement No. 17 and corrigendum (A/55/17 and Corr.3), para. 315.

form requirement since the written text being referred to was not the actual agreement to arbitrate but rather a set of procedural rules for carrying out the arbitration (that is, a text that would most often exist prior to the agreement and result from the action of persons that were not parties to the actual agreement to arbitrate). It was pointed out that, in most practical circumstances, it was the agreement of the parties to arbitrate that should be required to be made in a form that was apt to facilitate subsequent evidence of the intent of the parties. In response to that concern, it was generally felt that, while the Working Group should not lose sight of the importance of providing certainty as to the intent of the parties to arbitrate, it was also important to work towards facilitating a more flexible interpretation of the strict form requirement contained in the New York Convention, so as not to frustrate the expectations of the parties when they agreed to arbitrate. In that respect, the Commission took note of the possibility that the Working Group would examine further the meaning and effect of the more-favourable-right provision of article VII of the New York Convention.

7. With regard to the issues related to interim measures of protection, the Commission noted that the Working Group had considered a draft text for a revision of article 17 of the UNCITRAL Model Law on International Commercial Arbitration and the text of paragraph 1 (a) (i) of a draft new article prepared by the Secretariat for addition to that Model Law (see A/CN.9/WG.II/WP.113, para. 18). The Working Group was requested to continue its work on the basis of revised draft provisions to be prepared by the Secretariat.

8. The Working Group on Arbitration is composed of all States members of the Commission. The session was attended by the following States members of the Working Group: Austria, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, Fiji, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Romania, Russian Federation, Singapore, Spain, Sweden, Thailand, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

9. The session was attended by observers from the following States: Argentina, Australia, Bangladesh, Belarus, Croatia, Cyprus, Czech Republic, Egypt, Finland, Iraq, Ireland, Malta, Nigeria, Peru, Philippines, Poland, Portugal, Republic of Korea, Slovakia, Switzerland, Turkey and Venezuela.

10. The session was attended by observers from the following international organizations: Central American Court of Justice, Chartered Institute of Arbitrators, Hague Conference on Private International Law, International Cotton Advisory Committee, North American Free Trade Agreement Advisory Committee on Private Commercial Disputes (NAFTA Article 2022 Committee), Permanent Court of Arbitration, American Bar Association, Latin American Banking Federation, Global Center for Dispute Resolution Research, Inter-American Commercial Arbitration Commission, International Chamber of Commerce, International Law Institute, International Maritime Committee, Lagos Regional Centre for International Commercial Arbitration, London Court of International Arbitration, Queen Mary

(University of London) School of International Arbitration, *Union Internationale des Avocats* and U.S.-Mexico Conflict Resolution Center.

11. The Working Group elected the following officers:

Chairman: Mr. José María ABASCAL ZAMORA (Mexico);

Rapporteur: Mr. Koichi MIKI (Japan).

12. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.II/WP.117);

(b) Note by the Secretariat on preparation of uniform provisions on written form for the arbitration agreement (A/CN.9/WG.II/WP.118); and

(c) Note by the Secretariat on preparation of uniform provisions on interim measures of protection (A/CN.9/WG.II/WP.119).

13. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of harmonized texts on written form for arbitration agreements and on interim measures of protection.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

14. The Working Group discussed agenda item 3 on the basis of the documents prepared by the Secretariat (A/CN.9/WG.II/WP.118 and A/CN.9/WG.II/WP.119). The deliberations and conclusions of the Working Group with respect to that item are reflected below in chapters III and IV. The Secretariat was requested to prepare revised draft provisions, based on the discussion in the Working Group, for continuation of the discussion at a later stage.

15. With regard to the requirement of written form for the arbitration agreement, the Working Group considered the draft model legislative provision revising article 7, paragraph 2, of the Model Law on Arbitration (see A/CN.9/WG.II/WP.118, para. 9). The Secretariat was requested to prepare a revised draft provision, based on the discussion in the Working Group, for consideration at a future session. The Working Group also discussed a draft interpretative instrument regarding article II, paragraph 2, of the New York Convention (see A/CN.9/WG.II/WP.118, paras. 25 and 26). The Working Group acknowledged that it could not, at the present stage, reach a consensus on whether to prepare an amending protocol or an interpretative instrument to the New York Convention and that both options should be kept open for consideration by the Working Group or the Commission at a later stage. In the meantime, the Working Group agreed that it would be useful to offer guidance on interpretation and application of the writing requirements in the New York Convention with a view to achieving a higher degree of uniformity. A valuable

contribution to that end could be made in the guide to enactment of the draft new article 7 of the UNCITRAL Model Law on Arbitration, which the Secretariat was requested to prepare for future consideration by the Working Group, by establishing a “friendly bridge” between the new provisions and the New York Convention, pending a final decision by the Working Group on how best to deal with the application of article II, paragraph 2, of the Convention.

16. With regard to the issues related to interim measures of protection, the Working Group considered a draft text for a revision of article 17 of the Model Law (see A/CN.9/WG.II/WP.119, para. 74). The Secretariat was requested to prepare revised draft provisions, based on the discussion in the Working Group, for consideration at a future session. Due to lack of time, a revised draft of a new article prepared by the Secretariat for addition to the Model Law regarding the issue of enforcement of interim measures of protection ordered by an arbitral tribunal (see A/CN.9/WG.II/WP.119, para. 83) was not considered by the Working Group.

17. It was noted that, subject to a decision to be made by the Commission at its forthcoming session, the thirty-fifth session of the Working Group was scheduled to be held from 7 to 11 October 2002 in Vienna.

III. REQUIREMENT OF WRITTEN FORM FOR THE ARBITRATION AGREEMENT

A. Model legislative provision on written form for the arbitration agreement

Article 7. Definition and form of arbitration agreement

18. The draft model provision was as follows:

“1. ‘Arbitration agreement’ is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

“2. The arbitration agreement shall be in writing. ‘Writing’ includes any form that provides a [tangible] record of the agreement or is [otherwise] accessible as a data message so as to be usable for subsequent reference.

“[3. ‘Data message’ means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange, electronic mail, telegram, telex or telecopy.]

“4. For the avoidance of doubt, the writing requirement in paragraph 2 is met if the arbitration clause or arbitration terms and conditions or any arbitration rules referred to by the arbitration agreement are in writing, notwithstanding that the contract or the separate

arbitration agreement has been concluded orally, by conduct or by other means not in writing.

“5. Furthermore, an arbitration agreement is in writing if it is contained in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by the other.

“6. The reference in a contract to a text containing an arbitration clause constitutes an arbitration agreement provided that the reference is such as to make that clause part of the contract.

“[7. For purposes of article 35, the written arbitration terms and conditions, together with any writing incorporating by reference or containing those terms and conditions, constitute the arbitration agreement.]”

Paragraph 1

19. It was pointed out that paragraph 1, which reproduced the unchanged text of paragraph 1 of the UNCITRAL Model Law on International Commercial Arbitration (the “Model Law on Arbitration”) encompassed, in its second sentence, two types of arbitration agreements: an agreement in the form of an arbitration clause in a contract, or a separate agreement. The provision itself was not felt to create controversy. Nevertheless, it was suggested that the Working Group might need to review and, if required, revise the current formulation of the second sentence so as to align it with the substance of paragraph 4. It was said, in particular, that paragraph 4 implicitly made a distinction between an arbitration agreement on the one hand and the terms and conditions of the arbitration or its governing rules on the other. Paragraph 4 thus appeared to cover situations that did not fall strictly under either of the types of arbitration agreement mentioned in paragraph 1.

20. The Working Group approved the substance of paragraph 1 and, having taken note of the comments made thereon, decided to revert to them after it had considered paragraph 4.

Paragraph 2

21. The Working Group considered various comments and proposals, of both substance and form, in connection with paragraph 2. The substantive comments raised by the provision were essentially concerned with the relationship between the notions of “record” and “data message” and the interplay among paragraphs 2, 3 and 4. Drafting comments were essentially concerned with refining the provision to make it unambiguously clear that arbitration agreements could be validly concluded by means other than in the form of paper-based documents, for example, by electronic communications.

22. The Working Group noted that the notion of “record”, as used in article 7, paragraph 2 of the Model Law on Arbitration, was not specifically concerned with facilitating the use of electronic means of communication. The text of draft paragraph 2 had therefore been drafted on the basis of

provisions of two more recent UNCITRAL texts: article 7, paragraph 2, of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, which provided that “[a]n undertaking may be issued in any form which preserves a complete record of the text of the undertaking [...]”; and article 6, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce, which provided that “[w]here the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”

23. The Working Group then considered at length the conceptual distinction between “record” and “data message” and the desirability of combining them in a single provision. The Working Group agreed that the notion of “record” as used in article 7, paragraph 2, of the Model Law on Arbitration should be retained without being limited to “tangible” records. Some of the speakers were of the view that the term “record” alone might suffice, since it was broad enough to cover “data messages”, particularly if it was linked with the definition of a form which “is otherwise accessible so as to be usable for subsequent reference.” Other speakers, however, expressed the view that the term “record” might raise issues of translation in the various official languages and create difficulties in those legal systems where such notions as “record” or “business record” were not heavily relied upon in commercial law. The prevailing view was that it was important to combine the traditional notion of “record” with the more innovative notion of “data message” so as to make it clear that records other than traditional paper documents were included among the acceptable forms of recording an arbitration agreement.

24. The qualifying phrase “accessible so as to be usable for subsequent reference”, was felt by some speakers to be unnecessary. The prevailing view was that it was essential in the context of paragraph 2, since it set forth the conditions whereby any message, including data messages, might meet writing requirements established by the law.

25. Having agreed to the need for making reference in paragraph 2 to both “record” and “data messages”, the Working Group proceeded to consider various drafting proposals. One proposal was that the second sentence of paragraph 2 should be redrafted along the following lines: “‘writing’ or ‘in writing’ includes any form being recorded by any means [, so as to be usable for subsequent reference].” The Working Group eventually agreed to reformulate the second sentence of paragraph 2 along the following lines: “‘Writing’ means any form, including without limitation a data message, that provides a record of the agreement or is otherwise accessible so as to be usable for subsequent reference.”

Paragraph 3

26. The Working Group considered that a definition of “data message” was needed since that expression was used in paragraph 2 and decided to retain the provision without the square brackets.

Paragraphs 4 and 6

27. There was general agreement that one of the main purposes of a revision of article 7 of the Model Law on Arbitration should be to recognize the formal validity of arbitration agreements that have come into existence in certain factual situations as to which courts or commentators have differing views on whether the form requirement set forth in the current text of article 7, paragraph 2, of the Model Law has been met. Among such factual situations, the Working Group focused its attention on the following:

(a) The case where a maritime salvage contract is concluded orally by radio with a reference to a pre-existing standard contract form containing an arbitration clause, such as the Lloyd’s Open Form;

(b) Contracts concluded by performance or by conduct (for example a sale of goods under article 18 of the United Nations Convention on Contracts for the International Sale of Goods), with reference to a standard form containing an arbitration clause, such as documents established by the Grain and Feed Trade Association;

(c) Contracts concluded orally but subsequently confirmed in writing or otherwise linked to a written document containing an arbitration clause, such as the general sale or purchase conditions established unilaterally by a party and communicated to the other;

(d) Purely oral contracts.

As a matter of general policy, it was widely agreed that in cases (a) to (c) the reference or other link to a written contractual document containing an arbitration clause should be sufficient to establish the formal validity of the arbitration agreement. It was also agreed that a purely oral arbitration agreement should not be regarded as formally valid under the Model Law. In that context, it was observed by a number of delegations that the mere reference in an oral contract to a set of arbitration rules should not be regarded as sufficient to meet the written form requirement, since a set of procedural rules should not be regarded, in and of itself, as equivalent to a contractual document containing an arbitration clause. However, some delegations expressed the view that such a reference in an oral contract to a set of arbitration rules should be accepted as expressing sufficiently the existence and contents of the arbitration agreement, particularly when the set of rules includes a model arbitration clause.

28. Doubts were expressed as to whether draft paragraph 4 adequately expressed the above-mentioned general policy. It was pointed out that stating that “the writing requirement [...] is met if the arbitration clause [...] [is] in writing” was tautological. In addition, a concern was expressed that the reference to “the arbitration terms and conditions” was unclear and created the risk of an inconsistency between draft paragraph 4 and draft paragraph 1. As to the reference to “any arbitration rules referred to by the arbitration agreement”, a further concern was that it did not take into account the need for the arbitration agreement to be sufficiently manifest to minimize the risk that a party would be drawn into arbitration against its will. Doubts were also expressed as to whether paragraph 4 could reasonably be read as consistent with the provisions of the New York Convention.

29. With a view to alleviating the above-mentioned concerns, a proposal was made that paragraph 4 should be redrafted along the following lines: "For the avoidance of doubt, the writing requirement in paragraph 2 is met if (a) the arbitration agreement, taken per se, is made in writing; or (b) a valid contract has been concluded between the parties and such contract includes within its contents, whether directly or by reference, a clause in writing providing for arbitration." Another proposal was that paragraph 4 should be redrafted as follows: "For the avoidance of doubt, the writing requirement in paragraph 2 is met if the arbitration clause is in writing, notwithstanding that the contract has been concluded orally, by conduct or by other means not in writing."

30. However, it was generally felt that, instead of draft paragraph 4, draft paragraph 6 should be used to support the above-mentioned policy. A note of caution was struck about revising the text of draft paragraph 6, which was already contained in article 7 of the Model Law, and was generally interpreted as covering the situation where the underlying contract did not mention arbitration but incorporated by reference another document, such as a standard form, which contained an arbitration clause. It was stated that the last sentence of paragraph 2 of article 7 of the Model Law on Arbitration, on which paragraph 6 was based, was generally not interpreted as interfering with the writing requirement established in respect of the arbitration agreement.

31. After discussion, the Working Group agreed that paragraph 4 should be deleted and paragraph 6 should be redrafted along the following lines: "For the avoidance of doubt, the reference in a contract or a separate arbitration agreement to a writing containing an arbitration clause constitutes an arbitration agreement in writing provided that the reference is such as to make that clause part of the contract or the separate arbitration agreement, notwithstanding that the contract or the separate arbitration agreement has been concluded orally, by conduct or by other means not in writing." It was also agreed that the guide to enactment of the model legislative provision should contain detailed explanations regarding the meaning and recommended interpretation of the revised text of paragraph 6.

Paragraph 5

32. The suggestion was made that the draft paragraph should be deleted for a number of reasons. Firstly, the reference to an "exchange of statements of claim and defence" was seen to be vague and potentially misleading since, for example, reference to the existence of an arbitration agreement was often made at an earlier stage of arbitral proceedings, such as in a notice of arbitration within the meaning of article 3 of the UNCITRAL Arbitration Rules. Secondly, the subject matter addressed in the draft paragraph was said to be already covered by articles 4 and 16, paragraph 2, of the Model Law on Arbitration, so that no further provision was needed. Lastly, it was suggested that the draft paragraph was excessively narrow in that it dealt only with the case where a party specifically alleged the existence of an arbitration agreement and did not cover frequent situations where the party merely stated its claim to the

arbitral tribunal without an express allegation that an arbitration agreement existed.

33. In support of the deletion of the draft paragraph it was also stated that the subject matter covered therein was essentially concerned with the waiver of a party's right to object to the jurisdiction of the arbitral tribunal, rather than with the formation of the arbitration agreement itself. As such, the substance of the draft paragraph was not appropriately placed in draft article 7. In any event, if the provision was to be retained, it was suggested that it should at least be amended along the following lines: "It is deemed that the parties have concluded a valid arbitration agreement if no objection to the jurisdiction of the arbitral tribunal is raised in due time."

34. The prevailing view, however, was in favour of retaining the draft paragraph. It was said that article 4 of the Model Law on Arbitration dealt with a different situation from the one contemplated in the draft paragraph, which was said to constitute a useful addition to the Model Law. Article 4 of the Model Law did not deal with the existence of the arbitration agreement, but only with the waiver of a party's right to raise objections based on alleged non-compliance with provisions of the Law from which the parties may derogate or with any requirement under the arbitration agreement, if that party had proceeded with the arbitration without stating its objection to such non-compliance without undue delay, or, if a time limit was provided therefor, within such period of time. Draft paragraph 5 was needed, since the narrow scope of article 4 of the Model Law did not allow it to be construed as a positive presumption of the existence of an arbitration agreement, in the absence of material evidence thereof, by virtue of the exchange of statements of claim and defence.

35. It was also pointed out that the draft paragraph had a precedent in the application of article 25 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("the Washington Convention"), which, in practice, had been construed to the effect that the notice of arbitration submitted by a foreign investor to the International Centre for Settlement of Investment Disputes under certain circumstances dispensed with the need for a special arbitration agreement.

Paragraph 7

36. It was recalled that paragraph 7 had been placed between square brackets until further discussion had taken place as to whether the substance of the provision should be included in article 7 or in an amendment to article 35. It was also recalled that article 35, paragraph 2, of the Model Law mirrored article IV of the New York Convention. Any deviation from the existing text of article 35 would therefore require additional work towards amending the New York Convention or providing means to secure a uniform yet innovative interpretation of article IV of the New York Convention.

37. The view was expressed that the issue dealt with under draft paragraph 7 would more appropriately be addressed under a revised version of both article 35 of the

Model Law and article IV of the New York Convention. It was stated that the governing principle regarding that issue was that the party seeking enforcement of an award should bear the burden of proof regarding the existence and contents of the arbitration agreement. That principle would remain unchanged even if the formal requirement regarding the submission of the arbitration agreement as a written original document was abandoned. It was thus suggested that in paragraph 2 of article 35 every reference to the arbitration agreement should be deleted. Article IV of the New York Convention should be modified accordingly.

38. Support was expressed in favour of the above-mentioned principle. In addition, it was pointed out that the suggested redraft of article 35 would present the advantage of avoiding the need for the party seeking enforcement to produce the “arbitration terms and conditions”, or any other document that might encourage courts to discuss the existence of the arbitration agreement in the absence of a challenge to the tribunal’s findings, which could needlessly delay enforcement.

39. However, the proposed redraft of article 35 was objected to on the grounds that amending that article could result in the need to revise article IV of the New York Convention, thereby pre-empting the result of the future discussion regarding the advisability of entering into the preparation of a protocol to the New York Convention (see below, paras. 42-50). As an alternative to the above-suggested redraft of article 35 of the Model Law, it was proposed that paragraph 7 should be deleted and a sentence should be added at the end of paragraph 6 along the following lines: “In such a case, the writing containing the arbitration clause constitutes the arbitration agreement for purposes of article 35.” It was stated by its proponents that such a sentence was consistent with the New York Convention. After discussion, that proposal was adopted by the Working Group.

B. Interpretative instrument regarding article II, paragraph 2, of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards

40. It was recalled that the Working Group at its thirty-fourth session discussed a preliminary draft interpretative instrument relating to article II, paragraph 2, of the New York Convention and requested the Secretariat to prepare a revised draft of the instrument, taking into account the discussion in the Working Group, for consideration at a future session (A/CN.9/487, para. 18).

41. At the current session, the Working Group proceeded with its consideration of the matter on the basis of the text of the draft declaration, as adopted by the Working Group at its thirty-fourth session (see A/CN.9/487, para. 63). That text was as follows:

“Declaration regarding interpretation of article II, paragraph 2, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, 10 June 1958

“The United Nations Commission on International Trade Law,

“1. *Recalling* resolution 2205 (XXI) of the General Assembly of 17 December 1966, which established the United Nations Commission on International Trade Law with the object of promoting the progressive harmonization and unification of the law of international trade,

“2. *Conscious* of the fact that the Commission comprises the principal economic and legal systems of the world, and developed and developing countries,

“3. *Recalling* successive resolutions of the General Assembly reaffirming the mandate of the Commission as the core legal body within the United Nations system in the field of international trade law to coordinate legal activities in this field,

“4. *Conscious* of its mandate to further the progressive harmonization and unification of the law of international trade by, inter alia, 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,

“5. *Convinced* that the wide adoption of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards has been a significant achievement in the promotion of the rule of law, particularly in the field of international trade,

“6. *Recalling* that the Conference of Plenipotentiaries which prepared and opened the Convention for signature adopted a resolution, which states, inter alia, that the Conference ‘considers that greater uniformity of national laws on arbitration would further the effectiveness of arbitration in the settlement of private law disputes . . .’,

“7. *Concerned about* differing interpretations of article II, paragraph 2, of the Convention that result in part from differences of expression as between the five equally authentic texts of the Convention,

“8. *Desirous of* promoting uniform interpretation of the Convention in the light of the development of new communication technologies and of electronic commerce,

“9. *Convinced* that uniformity in the interpretation of the term ‘agreement in writing’ is necessary for enhancing certainty in international commercial transactions,

“10. *Considering* that in interpreting the Convention regard is to be had to its international origin and to the need to promote uniformity in its application,

“11. *Taking into account* subsequent international legal instruments, such as the UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Model Law on Electronic Commerce,

"12. [*Recommends*] [*Declares*] that the definition of 'agreement in writing' contained in article II, paragraph 2, of the Convention should be interpreted to include [wording inspired from the revised text of article 7 of the UNCITRAL Model Law on International Commercial Arbitration]."^a

42. In view of the progress that had been made at the current session in connection with draft new article 7 of the Model Law on Arbitration, the Working Group decided that it would be useful to re-examine the various options available to deal with difficulties that had arisen in the practical application of article II, paragraph 2, of the New York Convention before considering the revised draft interpretative instrument. In that respect, the views within the Working Group were divided into essentially two propositions, as summarized below.

43. Strong support was expressed for the view that an interpretative instrument was not sufficient to deal with the practical problems and the existing disharmony in the application of article II, paragraph 2, of the New York Convention and that the Working Group should focus on the preparation of an amending protocol to the New York Convention. It was said that an interpretative instrument of the type being contemplated would have no binding legal effect in international law and was therefore unlikely to be followed by those charged with interpretation of the New York Convention. It was observed that the fact that an interpretative instrument of the type proposed would be non-binding made it questionable whether such an instrument would be of practical effect in achieving the objective of uniform interpretation of the New York Convention.

44. It was further stated that the possible risk of disharmony that might result from the existence, at least for a certain period of time, of two groups of States parties to the New York Convention, namely those that adhered to the Convention in its original form only and those who, in addition, had adhered to the amending protocol, was not a convincing argument to discard the avenue of an amending protocol. In fact, it was said, disharmony already existed in the application of article II, paragraph 2, of the New York Convention and it would not be removed by means of a non-binding interpretative instrument. An amending protocol to article II, and possibly article IV, of the New York Convention was needed if uniformity in the interpretation and application of the Convention was to be achieved.

45. Another argument in favour of an amending protocol underscored the distinction between modification of an existing text and clarification of its interpretation. It was said that it was not appropriate to use an interpretative instrument to declare that article II, paragraph 2, of the Convention should be interpreted as having the meaning of article 7 of the Model Law in the wording being prepared by the Working Group. It was stated that the draft legislative provisions being considered by the Working Group differed significantly from article II, paragraph 2, in that,

for example, under the draft legislative provision an oral agreement that referred to written arbitration terms and conditions would be regarded as valid, whereas under article II, paragraph 2, of the New York Convention, as interpreted in many legal systems, it would not be so regarded. In that connection, some speakers expressed the view that reliance on the provision of article VII of the New York Convention, which allowed, in practice, for the application, in a Contracting State of the Convention, of more favourable provisions of its own laws or treaty obligations in support of an arbitration agreement or arbitral award, was not an effective tool for ensuring uniformity in the respect of the application of the written-form requirement of article II, paragraph 2, of the Convention.

46. The countervailing view, which also received strong support, was that formally amending or creating a protocol to the New York Convention was likely to exacerbate the existing lack of harmony in interpretation, because the adoption of such a protocol or amendment by a number of countries would take a significant number of years and in the interim create more uncertainty. For that reason, that approach was described by a number of delegations as essentially impractical. Given its evident success, shown by the unparalleled number of ratifications, the New York Convention could be rightly regarded as the foundation of international commercial arbitration and that fact by itself demanded that utmost caution be used in considering any changes to its text. Caution was said to be even more important in view of the sovereign character of any diplomatic conference that might be called upon to consider any proposed amendments to the text, which would not be bound by the narrow scope of amendments currently under consideration by the Working Group. The expected positive result of enhancing certainty in the relatively narrow area of article II, paragraph 2, of the New York Convention should be carefully weighed against the imponderable risk of having the entirety of the Convention re-opened for discussion.

47. An additional problem impending upon the preparation of an amending protocol to the New York Convention, it was said, might be the risk of upsetting the liberal interpretation that article II, paragraph 2, of the New York Convention already enjoyed in some jurisdictions. The view was expressed that starting work on a modification of the New York Convention might imply that the text could not be readily understood as allowing the interpretation that was essentially consistent with draft new article 7 of the Model Law on Arbitration currently being formulated by the Working Group. A clarification by way of an interpretative instrument, on the other hand, was said to constitute an appropriate recognition of the fact that there were differing possible interpretations of article II, paragraph 2, of the New York Convention and that the Commission, which might be regarded as persuasive authority in many jurisdictions, could recommend a liberal interpretation of that text.

48. It was further pointed out that the difficulties attendant upon amendment of the New York Convention or the development of a protocol had been extensively considered at earlier sessions of the Working Group and that in view of those difficulties the Working Group had instead

^aPursuant to a request of the Working Group at its thirty-fourth session, the text of draft paragraph 12 was prepared by the Secretariat and presented for consideration by the Working Group in document A/CN.9/WG.II/WP.118, para. 27.

decided to focus on the preparation of an interpretative instrument.

49. The Working Group considered at length the various arguments that were put forward in support of both propositions. The Working Group acknowledged that it could not, at the present stage, reach a consensus on whether to prepare an amending protocol or an interpretative instrument to the New York Convention and that both options should be kept open for consideration by the Working Group or the Commission at a later stage. In the meantime, the Working Group agreed that it would be useful to offer guidance on interpretation and application of the writing requirements in the New York Convention with a view to achieving a higher degree of uniformity. A valuable contribution to that end could be made in the guide to enactment of the draft new article 7 of the Model Law on Arbitration, which the Secretariat was requested to prepare for future consideration by the Working Group, by establishing a “friendly bridge” between the new provisions and the New York Convention, pending a final decision by the Working Group on how to best deal with the application of article II, paragraph 2, of the Convention.

50. While no objections were raised to that course of action, the view was expressed that the mere fact of attempting to address the matter in a guide to enactment of the new draft article 7 of the Model Law on Arbitration appeared to prejudice the consideration of a possible amending protocol to the New York Convention. Raising issues related to the New York Convention in a guide to enactment, that is, an ancillary text of questionable legal value, appended to a new provision of the Model Law, which itself was not a mandatory instrument, was said to be a counterproductive exercise. It was stated that it would be preferable not to attempt to address in any way the issues raised by the interpretation of the writing requirements under the New York Convention. The Working Group took note of those comments.

IV. INTERIM MEASURES OF PROTECTION

51. The Working Group continued its work on draft article 17 of the UNCITRAL Model Law on Arbitration, which contained a definition of interim measures of protection and additional provisions on *ex parte* interim measures. The text considered by the Working Group was as follows:

“1. Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary [in respect of the subject matter of the dispute].

“2. The party requesting the interim measure should furnish proof that:

“(a) There is an urgent need for the measure applied for;

“(b) A significant degree of harm will result if the interim measure is not ordered; and

“(c) There is a likelihood of the applicant for the measure succeeding on the merits of the underlying case.

“3. The arbitral tribunal may require any party to provide appropriate security in connection with such measure.

“4. An interim measure of protection is any temporary measure [, whether it is established in the form of an arbitral award or in another form,] ordered by the arbitral tribunal pending the issuance of the award by which the dispute is finally decided. For the purposes of this article reference to an interim measure includes:

“Variant 1

“(a) A measure to maintain the status quo pending determination of the questions at issue;

“(b) A measure providing a preliminary means of securing assets out of which an award may be satisfied; or

“(c) A measure to restrain conduct by a defendant to prevent current or imminent future harm.

“Variant 2

“(a) A measure to avoid or minimize prejudice, loss or damage; or

“(b) A measure to facilitate later enforcement of an award.

“5. The arbitral tribunal may, where it is necessary to ensure that an interim measure is effective, grant a measure [for a period not exceeding [. . .] days] [without notice to the party against whom the measure is directed] [before the party against whom the measure is directed has had an opportunity to respond] only where:

“(a) It is necessary to ensure that the measure is effective;

“(b) The applicant for the measure provides appropriate security in connection with the measure;

“(c) The applicant for the measure can demonstrate the urgent necessity of the measure; and

“(d) [The measure would be supported by a preponderance of considerations of fairness].

“[6. The party to whom the measure under paragraph 5 is directed shall be given notice of the measure and an opportunity to be heard at the earliest practicable time.]

“7. A measure granted under paragraph 5 may be extended or modified after the party to whom it is directed has been given notice and an opportunity to respond.

“[8. An interim measure of protection may be modified or terminated [on the request of a party] if the circumstances referred to in paragraph 2 have changed after the issuance of the measure.]

“[9. The party who requested the issuance of an interim measure of protection shall, from the time of the request onwards, inform the court promptly of any substantial change of circumstances referred to in paragraph 2.]”

Paragraph 1

52. The Working Group considered a proposal for deleting the phrase in square brackets in the draft paragraph. That phrase was said to lend itself to a restrictive interpretation, for instance, if it were understood to mean that an arbitral tribunal could only order interim measures of protection that were directly related to the assets under dispute. In response to that proposal it was said that a phrase similar to the phrase in question had been used in article 26 of the UNCITRAL Arbitration Rules and should be kept in draft article 17 for purposes of consistency. It was pointed out that, in the context of the UNCITRAL Arbitration Rules, that phrase was meant to be liberally interpreted and, in practice, had not posed an obstacle to the exercise by arbitral tribunals of their power to order interim measures of protection that were appropriate to any given case. Therefore, it was suggested that the phrase in square brackets in paragraph 1 should be retained.

53. Nevertheless, the prevailing view in the Working Group was that the phrase in square brackets should be deleted since it might lead to an undue restriction on the power of the arbitral tribunal to issue interim measures (for example, in that it might be considered not to cover measures for freezing of assets that were strictly speaking not the subject matter of the dispute).

54. The Working Group, however, stressed that the streamlining of paragraph 1 should not be understood as an indication that the current wording of article 17 of the UNCITRAL Model Law on Arbitration and article 26 of the UNCITRAL Arbitration Rules excluded measures that did not relate directly to the goods in dispute.

Paragraph 2

55. General support was expressed in favour of the structure and contents of paragraph 2. Various comments and suggestions were made for improvement of the text. With respect to the opening words of the paragraph, a question was raised as to whether the paragraph should be phrased in terms of obligations binding on the party applying for the interim measure. As a possible alternative, it was suggested that the provision should be formulated as criteria to be applied by the arbitral tribunal when making a decision upon request for an interim measure. Another suggestion was to phrase the provision in more neutral terms, for example through a statement that an interim measure might only be granted if certain conditions were met. The Working Group agreed that those various alternatives might need to be reconsidered at a future session. There was general agreement that the verb “should” should be replaced by a stricter formulation, such as “shall” or “must”. As to the use of the words “furnish proof”, it was observed that the provision should not interfere with the various standards of proof that might be applied in different jurisdictions or within the same jurisdiction. The view was also expressed that requiring “proof” might be excessively cumbersome in the context of interim measures. With a view to avoiding a reference to “proof”, the words “establish”, “demonstrate” or “show” were proposed as possible alternatives to the words “furnish proof”.

56. With respect to subparagraph (b), it was widely felt that the provision should be based on a “balance of convenience” under which the assessment of the degree of harm suffered by the applicant if the interim measure was not granted should be balanced against an evaluation of the harm suffered by the party opposing the measure if that measure was granted. In addition, it was felt that the quantitative approach reflected in the words “a significant degree of harm” might create uncertainties as to how a degree of harm should be considered to be sufficiently “significant” to justify certain provisional measures. It was suggested that a reference to the more qualitative notion of “irreparable harm” should be used.

57. With respect to subparagraph (c), it was suggested that the words “substantial possibility” were preferable to the word “likelihood”. At the close of the discussion, a question was raised as to whether provisional measures should be available in circumstances where a contradiction would exist between the requirements of subparagraphs (a), (b) and (c). A suggestion was made that, at a future session, the Working Group might need to reopen the debate as to whether those three subparagraphs should be made cumulative or alternative requirements.

58. After discussion, the Working Group decided that the following text should be considered by the Secretariat, together with other possible alternatives, when preparing a revised version of paragraph 2 for continuation of the discussion at a future session:

“2. Variant A

The party requesting the interim measure must [show] [demonstrate] [prove] [establish] that:

Variant B

The arbitral tribunal shall only issue an interim measure if it is satisfied that:

Variant C

An interim measure may only be ordered if:

“(a) Variant X

There is [a] [an urgent] need for the measure applied for;

Variant Y

The interim measure applied for is necessary in the particular circumstances of the case;

“(b) Irreparable harm to the applicant [will] [is likely to] result if the interim measure is not ordered and that harm substantially outweighs the harm, if any, that [would] [is likely to] result to the party opposing the interim measure if the measure were ordered; [and] [or]

“(c) There is a substantial possibility that the applicant for the measure will succeed on the merits of the [dispute] [underlying case].”

Paragraph 3

Reference to “The arbitral tribunal may require”

59. The suggestion was made that the provision of some form of security in connection with interim measures

should be made mandatory so as to offer adequate protection to the party against whom such interim measures might be enforced and to reduce the risk of abuse in the use of interim measures.

60. The prevailing view within the Working Group, however, was that, while the provision of security in connection with interim measures was the norm, it should not be made mandatory. It was pointed out in that connection that in some legal systems the question of whether or not security needed to be provided might not be for the arbitral tribunal to decide, but rather for the authority competent for the enforcement of the interim measure. It was also stated that, in practice, there might be situations where the party requesting the interim measure might not be in a position to readily offer appropriate security, for instance, where such party had been deprived of funds by the other party. From a policy perspective, it was felt that it would be preferable to keep the matter within the discretion of the arbitral tribunal.

61. A proposal to add, for purposes of clarity, words such as “if damage is likely to be sustained by the party against whom the measure is requested” at the end of the draft paragraph did not attract sufficient support, since the Working Group felt that the purpose for which security was required was not only to provide a safeguard in the event of damage resulting from the interim measure.

Reference to “any party”

62. Questions were raised as to the exact meaning of the words “any party” in the draft paragraph. Some speakers regarded those words as being vague and suggested that they should be replaced with a more precise formulation, such as “the applicant for the interim measure”. The Working Group, however, was not in favour of replacing those words with another phrase. It was felt that the words “any party” afforded the desirable degree of flexibility to encompass, for example, the submission of alternative guarantees by the party against whom the measure was requested in order to avoid the interim measure being ordered.

63. Subject to linguistic changes to ensure consistency among the language versions, the Working Group therefore adopted the substance of the draft paragraph. It was suggested that the above discussion should be reflected in the guide to enactment of the model legislative provision.

Paragraph 4

64. As a general comment, it was suggested that, to the extent that draft paragraph 4 defined the scope of interim measures, it should be placed immediately after draft paragraph 1. That suggestion was adopted by the Working Group.

Reference to “[, whether it is established in the form of an arbitral award or in another form,]”

65. The Working Group began its substantive discussion of the draft paragraph by considering a proposal to delete

the entire phrase within square brackets in the *chapeau* of the draft paragraph. In support of that proposal it was said that the phrase in question was not needed since the possible spectrum of interim measures mentioned therein was already covered by the words “any temporary measure”. The Working Group did not follow that proposal, however, since it was of the view that the phrase in question substantially added to the draft paragraph by clarifying that, depending on the circumstances and on the jurisdiction, interim measures might be issued in a variety of forms. The Working Group proceeded to consider proposed amendments to that phrase.

66. One suggestion was that the words “arbitral award” should be replaced by the words “partial or interim award”. In support of that proposal it was stated that the words “arbitral award” were often understood as referring to the final award in the arbitration proceedings, whereas an order of interim measures, even if issued in the form of an award, was typically an interlocutory decision. Some support was expressed for that proposal, although most speakers objected to the use of the words “partial award”, since those words typically referred to a final award that disposed of part of the dispute, but would not appropriately describe an interim measure. Doubts were expressed as to whether the words “interlocutory award” would adequately cover the various types of interim measures that might be issued in the form of an award. After discussion, the preference within the Working Group was for simply deleting the word “arbitral” without further qualifying the nature of the award.

67. Another proposal was to delete the words “or in another form” after the word “award”. Such deletion was justified, it was said, in the interest of ensuring due process and the orderly conduct of the arbitral proceedings. As currently drafted, the provision contemplated the issuance of interim measures in a form other than a formal award. That situation was said to be problematic since in some legal systems only formal awards and not every procedural order or decision of an arbitral tribunal was subject to judicial review in the course of setting-aside or enforcement procedures. If the provision allowed the issuance of interim measures by means other than a formal award, the party against whom the interim measure was requested might be deprived of the rights it might otherwise have under the applicable law, for instance to challenge the validity or enforceability of the arbitral award. That, it was said, was the reason why some of the jurisdictions that had enacted the Model Law on Arbitration had expressly provided that an order of interim measures had to be issued as a formal award.

68. The prevailing view within the Working Group, however, was not in favour of deleting the words “or in another form”. It was said that it would be undesirable for the draft paragraph to be overly prescriptive in respect of the form that an interim measure had to take. The fact that the draft paragraph did not require the order of interim measures to be issued as a formal award, it was said, could not be regarded as diminishing any recourse or other legal means available to the party against whom such measure was ordered. It was pointed out in that connection, that the question of whether an order of interim measures

constituted an “award” for the purposes of setting-aside or enforcement rules of the forum State was not predicated upon the title or form given to the order by the arbitral tribunal. That question was settled by applicable domestic law. The draft model legislative provision, it was stated, should not interfere with any power that the competent court might have to qualify such an order as an award despite the form or title given to it by the arbitral tribunal. In that connection, it was pointed out that the question as to whether an interim measure, whether or not qualified as an “award”, was subject to setting aside under article 34 of the Model Law on Arbitration, might need to be further considered in the context of future discussions on enforcement of interim measures.

Reference to “pending the issuance of the award”

69. In view of the fact that interim measures might be requested or issued at different stages of arbitral proceedings, it was suggested that the words “pending issuance of the award” should be replaced by words such as “at any time prior to the issuance of the award”. The Working Group accepted that suggestion.

Variants 1 and 2

70. As a general comment it was said that, since the lists of measures contained in both variants could only be of an illustrative and non-exhaustive nature, it would be preferable to present them in the guide to enactment, rather than in the body of the provision. The Working Group was invited to consider, in that connection, whether variants 1 and 2 were indeed mutually exclusive or whether they could not be usefully merged into a single list.

71. The Working Group was of the view, however, that it would be useful for the draft paragraph to list, albeit in a non-exhaustive fashion, types of measures that might be ordered by an arbitral tribunal, rather than simply offering such illustration in the relevant portion of the guide to enactment. The Working Group agreed that the opening words of paragraph 4 should make it abundantly clear that the list of provisional measures provided in the various subparagraphs was intended to be non-exhaustive.

72. In that connection, although support was expressed in favour of the more general formulation of variant 2, the preference of the Working Group was generally for the more descriptive approach followed under variant 1.

Subparagraph (a)

73. While general support was expressed for the substance of the subparagraph, it was felt that the purpose of the provisional measure might be not only to maintain but also to restore the status quo. It was agreed that subparagraph (a) should be redrafted accordingly.

Subparagraph (b)

74. It was widely agreed that subparagraph (b) should be reformulated along the following lines “a measure

providing a preliminary means of securing or facilitating the enforcement of the award”.

Subparagraph (c)

75. It was generally felt that the ambit of the provision should be broadened to cover also cases where the purpose of the interim measure was not to restrain but to order affirmative conduct. Along the same lines, it was felt that the scope of the provision should not cover only measures ordered against the defendant but also measures addressed to other parties. The Working Group agreed that subparagraph (c) should read along the following lines: “a measure to restrain or order conduct of any party to prevent current or imminent future harm”.

Proposed new subparagraph (d)

76. With a view to facilitating the issuance of interim measures aimed at preventing destruction of evidence, it was suggested that among the illustrative list contained in paragraph 4, mention should be made of “a measure intended to provide a preliminary means of preserving evidence”. That suggestion was accepted by the Working Group.

Paragraph 5

77. Diverging views were expressed as to whether, as a matter of general policy, it would be suitable for a revision of the Model Law on Arbitration to establish the possibility for interim measures to be ordered ex parte by an arbitral tribunal. Under one view, in line with existing arbitration laws in a number of countries, the possibility of ordering an interim measure of protection on an ex parte basis should be reserved only to courts of justice. It was stated that no exception should be made to the principle that each party should have equal access to the arbitral tribunal and a full opportunity of presenting its case, as expressed in article 18 of the Model Law. Recognizing the possibility that ex parte measures might be ordered by the arbitral tribunal was said to open an avenue for dilatory and unfair practices that should be avoided. It was also said that ex parte interim measures could have a damaging effect on third parties. However, the contrary view was widely expressed that the same principles that parties should be treated with equality and be given a full opportunity of presenting their case generally applied to courts of justice and in many countries were not regarded as sufficient grounds for refusing the possibility of ordering ex parte measures in exceptional circumstances. The prevailing view was that introducing a provision dealing with such ex parte interim measures into the Model Law would constitute a useful addition to the text and meet the needs of arbitration practice.

78. Various suggestions were made with a view to limiting the occurrence of possibly abusive applications for ex parte interim measures. One suggestion, inspired by rules applied by the International Centre for Settlement of Investment Disputes, was that the authority of the arbitral

tribunal to grant interim measures *ex parte* should be made contingent on a previous agreement being concluded to that effect by the parties. It was pointed out in response that, in the more general context of commercial arbitration, it was unrealistic to imagine that parties would agree on such a procedural rule either before or after the dispute had arisen. Another proposal was that only provisional measures intended to maintain the status quo pending determination of the question at issue could be ordered *ex parte* by the arbitral tribunal. That proposal was objected to on the grounds that it would not cover the situation where the interim measure was aimed at restoring a situation altered by the aggressive action of a party. Yet another proposal was that *ex parte* interim measures should only be regarded as acceptable where circumstances made it impossible to notify the other party. A further proposal, which attracted support from a number of delegations, was that the revised text of article 17 of the Model Law should establish an obligation for any party who sought an *ex parte* interim measure to inform the arbitral tribunal of all circumstances, including circumstances adverse to its position, that the arbitral tribunal was likely to find relevant and material to its determination of whether the requirements of paragraph 5 had been met. Such an obligation was referred to as “full and frank disclosure”, and was described as already known in certain legal systems. Doubts were expressed, however, by delegations familiar with other legal systems as to whether the proposed obligation would be entirely covered by the more widely known concept of “good faith”. Concerns were raised regarding the acceptability of such an obligation if it resulted in requiring a party to act positively against its own interests. Questions were also raised regarding the exact contents of the obligation and regarding the consequences that might flow from failure by the applicant to comply. It was suggested that further research might be needed as to such consequences, which might include revocation of the interim measure or damages if the interim measure had been improperly procured.

79. Also with a view to limiting the possibly negative impact of *ex parte* interim measures, another suggested approach was to limit or exclude the possibility of court enforcement of *ex parte* interim measures. Support was expressed in favour of exploring the ways in which the court enforcement of an interim measure initially ordered *ex parte* could be made subordinate to its later confirmation *inter partes* by the arbitral tribunal. Support was also expressed in favour of establishing the *ex parte* nature of a provisional measure as a possible ground for refusing enforcement. Doubts were expressed, however, as to whether interim measures ordered *ex parte* by an arbitral tribunal would still present any attractiveness to practitioners if the revised text of the Model Law made them unenforceable. In that connection, it was pointed out that in certain countries where the court system would experience difficulties in reacting expeditiously to a request for an *ex parte* interim measure, it would be essential to establish the enforceable character of such an interim measure when ordered by an arbitral tribunal. The Working Group did not come to a conclusion regarding the enforcement of *ex parte* interim measures. It was agreed that the issue would need to be considered further in the context of the general discussion regarding enforcement of interim measures.

Chapeau of draft paragraph 5

80. Turning its attention to the specific formulation of paragraph 5, the Working Group, discussed the definition of *ex parte* interim measures in the *chapeau* of draft paragraph 5. A suggestion was made that the *chapeau* of draft paragraph 5 should be prefaced with the words “In exceptional circumstances”. While the view was generally shared that *ex parte* interim measures should only be considered in exceptionally urgent circumstances, doubts were expressed as to whether the inclusion of the suggested words in the draft provision would be sufficiently clear to provide an objective criterion. As a matter of drafting, it was pointed out that the words “where it is necessary to ensure that an interim measure is effective” were redundant with subparagraph (a) and should be deleted.

81. With respect to the words in square brackets “for a period not exceeding [. . .] days”, the view was expressed that the matter of time limitation of the measure should be left to the discretion of the arbitral tribunal. Another view was that the issue of time limitation would be more appropriately dealt with in the context of a limitation of the time set forth to notify the defendant of the interim measure under draft paragraph 6. The prevailing view was that the duration of any *ex parte* interim measure should be limited and that the words should be retained. It was suggested that the limitation on the duration of an interim measure of protection granted under paragraph 5 should not affect the authority of the arbitral tribunal under paragraph 2 to grant, confirm, extend, or modify an interim measure of protection after the party against whom the measure was directed had been given notice and an opportunity to respond.

82. With respect to the alternative wordings between square brackets “without notice to the party against whom the measure is directed” and “before the party against whom the measure is directed has had an opportunity to respond”, some preference was expressed for the more descriptive wording along lines of “before the party against whom the measure is directed has had an opportunity to respond”. The view was expressed that the two wordings might be combined to reflect the situation where the applicant was unable to give notice to the respondent, for example where the respondent could not be located in time, as distinct from the situation where the applicant chose not to give notice to the respondent so as not to undermine the effectiveness of the interim measure, for example where the respondent could be expected to transfer assets out of the jurisdiction.

83. As to the requirements that should be met for an interim measure to be granted *ex parte*, it was generally agreed that interim measures considered under draft paragraph 5 should at least meet all the prerequisites for the issuance of an interim measure set forth under draft paragraph 2.

Subparagraph (a)

84. The substance of subparagraph (a) was found generally acceptable. The view was expressed, however, that the notion that the measure should be “effective” was

insufficiently precise. It was suggested to use the words “in order to ensure that the execution of the order is not frustrated”.

Subparagraph (b)

85. The production by the applicant of appropriate security in connection with the interim measure was regarded by a number of delegations as essential to avoid abusive applications for ex parte interim measures. Doubts were expressed, however, as to whether the existence of such security should be made a mandatory pre-requisite for the issuance of an ex parte interim measure or whether the issue should be left to the discretion of the arbitral tribunal.

Subparagraph (c)

86. While the view was expressed that the reference to the urgent necessity of the measure should be the determining factor for envisaging the issuance of an ex parte interim measure, concern was expressed regarding the possible redundancy of subparagraph (c) of draft paragraph 5 with subparagraph (a) of draft paragraph 2. To the extent that urgency would be retained as a general criterion under draft paragraph 2, it should be deleted from draft paragraph 5, unless it could be qualified so as to provide a distinct criterion in the context of ex parte interim measures.

Subparagraph (d)

87. In view of its earlier deliberations regarding draft paragraph 2, the Working Group agreed that subparagraph (d) was not needed and should be deleted.

88. With a view to reflecting some of the above-mentioned views and concerns, various suggestions were made for simplifying the text of draft paragraph 5. One suggestion read as follows: “Upon receipt of a request to issue an interim measure, the arbitral tribunal shall have the power to take any measure it deems necessary in order to assure the effectiveness of the interim measure in case it is granted.” Another proposal read as follows: “The arbitral tribunal may, where the requirements of paragraph 2 are met and where it is necessary to ensure that an interim measure is effective, grant a measure before the party against whom the measure is directed has had an opportunity to respond.” Yet another proposal was made for a redraft of paragraph 5 and the remainder of draft article 17 as follows:

“Paragraph 5

“[In exceptional circumstances,] the arbitral tribunal may grant an interim measure of protection for a period not exceeding [. . . days], without notice to the party against whom the measure is directed or before the party against whom the measure is directed has had an opportunity to respond, where:

“(a) The requirements of paragraph 2 are met; and

“(b) The arbitral tribunal determines [, and so states in a written finding,] that it is necessary to

proceed in such manner in order to ensure that the measure is effective.

“New paragraph 6

“A party who seeks an interim measure of protection under paragraph 5 shall have an obligation to inform the arbitral tribunal of all circumstances, including circumstances adverse to its position, that the arbitral tribunal is likely to find relevant and material to its determination whether the requirements of that paragraph have been met.

“At the beginning of present paragraph 6, to be renumbered, add the following text

“Unless the arbitral tribunal makes a determination under paragraph 5(b) that it is necessary to proceed without notice to the party against whom the measure is directed in order to ensure that the measure is effective, that party shall . . .

“Reformulation of present paragraph 7, to be renumbered

“The limitation on the duration of an interim measure of protection granted under paragraph 5 shall not affect the authority under paragraph 2 of the arbitral tribunal to grant, confirm, extend or modify an interim measure of protection after the party against whom the measure is directed has been given notice and an opportunity to respond.

“Present paragraph 3 should be placed here if the consensus is to make the order of security discretionary in all cases, whether ex parte or not

“Reformulation of present paragraph 8, to be renumbered

“The arbitral tribunal may modify or terminate an interim measure of protection at any time in light of additional information or a change of circumstances.

“Reformulation of present paragraph 9, to be renumbered

“Replace ‘court’ with ‘arbitral tribunal’

“Add ‘in these circumstances’ after ‘substantial change’

“Replace ‘referred to in paragraph 2’ and substitute ‘on the basis on which the application sought or the arbitral tribunal granted the interim measure of protection’.

“Proposal on enforcement

“A court before which recognition or enforcement of an award or order of an interim measure of protection issued under article 17, paragraph 5, is sought [shall not] [need not] refuse recognition or enforcement on the grounds set forth in article 36, paragraph 1 (a)(ii), if the court determines that it is necessary to proceed without notice to the party against whom the measure is directed in order to ensure that the measure is effective.”

89. Some support was expressed in favour of the three proposals. The discussion focused on the suggested

revision of paragraph 5 and the suggested wording for a new paragraph 6 in the latter proposal. For lack of sufficient time, the Working Group did not consider the remainder of that proposal.

90. With respect to the words in square brackets “, and so states in a written finding”, doubts were expressed as to whether the proposed text was intended simply to refer to the fact that the decision of the arbitral tribunal should be reasoned (in which case the additional wording was probably superfluous), or whether it would result in the obligation for the arbitral tribunal to express in writing the reasons for which it found it necessary to proceed *ex parte* (in which case the obligation could be regarded as excessively burdensome). It was stated in response that it was essential to ensure that explanations in writing would be produced by the arbitral tribunal and specifically address the reasons for which it considered it necessary to proceed *ex parte*.

91. The view was expressed that a limit should be stated regarding the duration of a provisional measure ordered *ex parte*. While it was widely realized that it might be difficult to achieve consensus as to a precise duration, it was suggested that including words along the lines of “for a limited period of time” to be determined by the arbitral tribunal might sufficiently cover the point. Another view that attracted support was that in the case of *ex parte* interim measures, the provision of appropriate security by the

applicant should be mandatory, particularly since a question might arise as to whether any claim for damages that could result from harm caused to the respondent as a result of the *ex parte* interim measure would constitute a new claim or fall within the scope of the arbitration. It was suggested that that question would need to be answered in the context of the revision of the Model Law.

92. A suggestion was made to reverse the order of new subparagraphs (a) and (b).

93. With respect to suggested new paragraph 6, a suggestion was made that the words “including circumstances adverse to its position” should be deleted. Another suggestion was that wording along the lines of “all circumstances of which the party who seeks the interim measure was or should have been aware” should be used. It was pointed out that such wording might avoid the ambiguities and uncertainties that might be associated with the words, “circumstances [...] that the arbitral tribunal is likely to find relevant and material to its determination whether the requirements of that paragraph have been met”.

94. The Working Group did not come to a conclusion on the issue of paragraph 5. The Secretariat was requested to prepare a revised draft, with possible variants, to reflect the various views, concerns and proposals expressed at the current session.

**E. Note by the Secretariat on the settlement of commercial disputes:
preparation of uniform provisions on written form for arbitration
agreements, working paper submitted to the
Working Group on Arbitration at its thirty-sixth session
(A/CN.9/WG.II/WP.118) [Original: English]**

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat

entitled “Possible future work in the area of international commercial arbitration” (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the

time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (*k*)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (*g*)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (*c*)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (*i*)); and the power of the arbitral tribunal to award interest (para. 107 (*j*)). It was noted with approval that, with respect to "online" arbitrations (that is, arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (*m*)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group on the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to the requirement of written form for the arbitration agreement, the Commission noted that the Working Group had considered the draft model legislative provision revising article 7, paragraph 2, of the UNCITRAL Model Law on International Commercial Arbitration (see A/CN.9/WG.II/WP.113, paras. 13 and 14) and a draft interpretative instrument regarding article II, paragraph 2, of the New York Convention (see A/CN.9/WG.II/WP.113, para. 16). Consistent with a view expressed at the thirty-fourth session of the Working Group (see A/CN.9/487, para. 30), concern was expressed as to whether a mere reference to arbitration terms and conditions or to a standard set of arbitration rules available in written form could satisfy the written form requirement. It was stated that such a reference should not be taken as satisfying the form requirement since the written text being referred to was not the actual agreement to arbitrate but rather a set of procedural rules for carrying out the arbitration (that is, a text that would most often exist prior to the agreement and result from the action of persons that were not parties to the actual agreement to arbitrate). It was pointed out that, in most practical circumstances, it was the agreement of the parties to arbitrate that should be required to be made in a form that was apt to facilitate subsequent evidence of the intent of the parties. In response to that concern, it was generally felt that, while the Working Group should not lose sight of the importance of providing certainty as to the intent of the parties to arbitrate, it was also important to work towards facilitating a more flexible interpretation of the strict form requirement contained in the New York Convention, so as not to frustrate the expectations of the parties when they agreed to arbitrate. In that respect, the Commission took note of the possibility that the Working Group would examine further the meaning and effect of the more-favourable-right provision of article VII of the New York Convention.⁷

6. The present note has been prepared on the basis of the discussions in the Working Group with respect to the written form for arbitration agreements (A/CN.9/487, paras. 22-63). The first part deals with the issue of the possible addition to article 7 of the UNCITRAL Model Law on International Commercial Arbitration. The second part deals with the interpretation of the New York Convention.

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), para. 313.

7. Previous discussion regarding the two topics may be found in the following documents:

(a) Report of UNCITRAL on the work of its thirty-second session (A/54/17, paras. 344-350);

(b) Report of UNCITRAL on the work of its thirty-third session (A/55/17, paras. 389-399);

(c) Report of UNCITRAL on the work of its thirty-fourth session (A/56/17, paras. 309-313);

(d) Note by the Secretariat on possible future work in the area of international commercial arbitration (A/CN.9/460, paras. 20-31).

(e) Report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468, paras. 88-106);

(f) Report of the Working Group on Arbitration on the work of its thirty-third session (A/CN.9/485 and Corr.1, paras. 21-77);

(g) Report of the Working Group on Arbitration on the work of its thirty-fourth session (A/CN.9/487, paras. 22-63);

(h) Working Paper submitted to the Working Group on Arbitration at its thirty-second session (A/CN.9/WG.II/WP.108/Add.1, paras. 1-40);

(i) Working Paper submitted to the Working Group on Arbitration at its thirty-third session (A/CN.9/WG.II/WP.110, paras. 10-51);

(j) Working Paper submitted to the Working Group on Arbitration at its thirty-fourth session (A/CN.9/WG.II/WP.113);

These documents can be found on the UNCITRAL website (www.uncitral.org) under “Working Groups” and “Working Group on Arbitration”.

II. MODEL LEGISLATIVE PROVISIONS ON WRITTEN FORM FOR THE ARBITRATION AGREEMENT

8. At its thirty-fourth session (June-July 2001), the Working Group considered a draft model legislative provision revising article 7 of the UNCITRAL Model Law on International Commercial Arbitration (see A/CN.9/WG.II/WP.113, paras. 11-14). The considerations of the Working Group are reflected in document A/CN.9/487, paras. 22-41. Having concluded its consideration of the draft provision, the Working Group requested the Secretariat to prepare a revised draft provision, based on the discussion in the Working Group, for consideration at a future session (see A/CN.9/487, para. 18).

A. Revised text of the model legislative provision

9. The Working Group may wish to use the following revised text as a basis for its deliberations:

Article 7. Definition and form of arbitration agreement

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

2. The arbitration agreement shall be in writing. “Writing” includes any form that provides a [tangible] record of the agreement or is [otherwise] accessible as a data message so as to be usable for subsequent reference.

[3. “Data message” means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy.]

4. For the avoidance of doubt, the writing requirement in paragraph 2 is met if the arbitration clause or arbitration terms and conditions or any arbitration rules referred to by the arbitration agreement are in writing, notwithstanding that the contract or the separate arbitration agreement has been concluded orally, by conduct or by other means not in writing.

5. Furthermore, an arbitration agreement is in writing if it is contained in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by the other.

6. The reference in a contract to a text containing an arbitration clause constitutes an arbitration agreement provided that the reference is such as to make that clause part of the contract.

[7. For purposes of article 35, the written arbitration terms and conditions, together with any writing incorporating by reference or containing those terms and conditions, constitute the arbitration agreement.]

B. Remarks on the revised text of the model legislative provision

Paragraph 1

10. Paragraph 1 reproduces the unchanged text of paragraph 1 of the UNCITRAL Model Law on International Commercial Arbitration.

Paragraph 2

Existing interpretations of the notion of “writing”

11. In the course of its deliberations at its thirty-fourth session, the Working Group decided that appropriate explanations should be given in the guide to enactment of the draft model legislative provision as to the intent that lay behind paragraph 2 not to conflict with existing

interpretations given to the notion of “writing”, in particular where a liberal interpretation might be given readily, through case law or otherwise, to the notion of “writing” under either the Model Law or the New York Convention. Clarification as to the preservation of existing interpretations of the notion of “writing” may be particularly important for those countries that would not adopt the revised version of article 7 of the Model Law, or during the transitional period before the enactment of that revised provision. (see A/CN.9/487, paras. 25 and 26).

Reference to “provides a record of the agreement or is otherwise accessible”

12. The text of draft paragraph 2 as considered by the Working Group at its previous session has been drafted on the basis of two recent UNCITRAL texts, the combination of which in a single provision may need to be further examined by the Working Group from the perspectives of substance and drafting. On the one hand, article 7, paragraph 2, of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit provides that “An undertaking may be issued in any form which preserves a complete record of the text of the undertaking . . .”. On the other hand, article 6, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce provides that “Where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.” That provision is inseparable from the definition of “data message” contained in article 2 (a) of that instrument, which reads “‘Data message’ means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy.” The notion of “record” does not appear in the text of the UNCITRAL Model Law on Electronic Commerce, but electronic records are clearly intended to be covered under the broadly defined notion of “data message”. The only reason for combining in the draft provision the traditional notion of “record” with the more innovative notion of “data message” is thus apparently to make it abundantly clear that the traditional paper document is included among the acceptable forms of recording an arbitration agreement. That matter did not need to be dealt with in the UNCITRAL Model Law on Electronic Commerce and may need to be addressed in the draft revision of article 7 of the UNCITRAL Model Law on International Commercial Arbitration. However, in the absence of additional explanations, the notion of “record” may raise issues of translation in the various official languages and create difficulties in those legal systems where such notions as “record” or “business record” are not heavily relied upon in commercial law. Further clarification in the text might be needed, for example to indicate that the provision is intended to address “tangible” records.

13. To the extent that the text would use the notion of “record” to refer to a paper document recording the text or otherwise demonstrating the existence of the arbitration agreement, the conceptual distinction between “record” on the one hand and “data message” on the other hand would probably lead to the deletion of the word “otherwise”. The

guide to enactment might need to elaborate on the reasons for which, contrary to article 7, paragraph 2, of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the draft provision does not refer to “a complete record of the text” of the agreement.

Paragraph 3

Reference to “data message”

14. To the extent the model provision intends to refer to the notion of “data message”, it is submitted that it should reproduce the definition contained in article 2 (a) of the UNCITRAL Model Law on Electronic Commerce. That is the purpose of paragraph 3.

Paragraph 4

15. Paragraph 4 is based on the understanding reached by the Working Group at its thirty-third and thirty-fourth sessions that the model legislative provision should recognize the existence of various contract practices by which oral arbitration agreements may be concluded with reference to written terms of an agreement to arbitrate and that in those cases the parties may have a legitimate expectation of a binding agreement to arbitrate (see A/CN.9/485 and Corr.1, para. 40 and A/CN.9/487, para. 29).

16. The text of paragraph 4 reflects the reasoning reached by the Working Group at its thirty-fourth session (see A/CN.9/487, paras. 29-32). The effect of such a provision would be that the allegation of a party that an arbitration agreement had been concluded orally with reference to a pre-existing set of arbitration rules (presumably available in written form) or to procedures set out in the law applicable to the arbitration could result in the other party being drawn into arbitral proceedings irrespective of the absence of any evidence as to the existence and contents of the alleged arbitration agreement. The Working Group may wish to discuss further the consequences of such a rule.

17. In the course of its deliberations, the Working Group may also wish to take into consideration the concerns expressed by the Director of the General Legal Division of the Office of Legal Affairs of the Secretariat in a letter to the UNCITRAL secretariat dated 23 May 2001. Those concerns are expressed on behalf of the United Nations as a potential party to arbitration proceedings. The following are excerpts from that letter:

“5. By virtue of its immunity from legal process, the UN cannot be sued in court. However, pursuant to article VIII, section 29, of the Convention on the Privileges and Immunities of the United Nations (the ‘General Convention’), the United Nations ‘shall make provisions for appropriate modes of settlement of [inter alia] disputes arising out of contracts or disputes of a private law character to which the UN is a party.’ [. . .] Pursuant to this provision, it has been the practice of the UN to make provision in its commercial agreements (e.g., contract and lease agreements) for recourse to arbitration in the event of disputes that cannot be settled by direct negotiations or other amicable means (see A/C.5/49/65).

With respect to disputes of a private law character that do not arise out of commercial agreements, except for particular situations in which other means of settling such disputes are provided, the practice of the Organization has been to submit such disputes to arbitration where they cannot be settled by these or other amicable means (see A/C.5/49/65). For such cases, the Organization enters into separate arbitration agreements. Both the arbitration clauses in contracts and the separate arbitration agreements provide that the arbitration proceedings are to be conducted under the UNCITRAL Arbitration Rules. Also, in both cases, the UN agrees to be bound by the award of the arbitral tribunal as the final adjudication of the dispute.

“6. In essence, under the draft revision of article 7(2) of the UNCITRAL Model Law, the requirement in the existing article 7(2) that an arbitration agreement be ‘in writing’ would be satisfied even where a contract containing an arbitration clause, or a separate arbitration agreement, were concluded other than in writing, for example, orally or by virtue of the ‘conduct’ of a party, if the arbitration clause, arbitration terms and conditions, or arbitration rules referred to by the agreement, are in writing. Moreover, such a ‘writing’ would include ‘non-traditional’ forms, such as electronic or data messages.

“7. The UN may be subjected to such arbitration, the results of which it accepts as binding, only to the extent that it has expressly agreed to do so. As noted above, agreements by the UN to submit to arbitration are contained in arbitration clauses contained in written contracts signed by the UN, or in written arbitration agreements signed by the UN. In both cases, the requirement of a written document signed by the UN ensures that the UN has agreed to submit to arbitration. Moreover, in its separate arbitration agreements, the UN typically includes various provisions to protect its legitimate interests, depending on the circumstances of the particular case, such as provisions clearly defining and circumscribing the issues to be adjudicated, provisions specifying that the arbitrators are to apply internationally accepted principles of international commercial law rather than the law of a particular national legal system, provisions regulating the scope of discovery that may be ordered by the arbitrators and provisions preserving the UN’s privileges and immunities.

“8. Under the text under consideration within the Working Group, the requirement of a ‘written’ arbitration agreement would be met if an oral contract or agreement referred, for example, to written arbitration terms and conditions. This requirement would be satisfied even if there existed only partial written arbitration terms and conditions, i.e. terms and conditions dealing with some issues but not others that the UN would want to regulate the arbitration, such as those referred to above.

“9. The writing requirement would also be satisfied merely by a reference in an oral contract or agreement to written arbitration rules. However, a reference to such rules, such as the UNCITRAL Arbitration Rules, would not cover other issues, such as those mentioned

above, that the UN typically regulates in its arbitration agreements.

“10. In addition, I point out that a provision of this nature would enable a claimant to convene an arbitral tribunal, which, pursuant to its ‘*compétence/compétence*’, would have authority to decide its own jurisdiction. Under the contemplated provision, this would require a respondent to submit to complex evidentiary hearings which would be necessary in order for the arbitral tribunal to determine the existence of a contract or arbitration agreement by ‘conduct’ or ‘orally’ and, if it finds such a contract or agreement, the existence and content of a ‘written’ arbitration clause, arbitration terms and conditions or arbitration rules. While, as noted above, a contract entered into by the UN must be in writing, we would be concerned that an arbitral tribunal thus convened might seek to establish that the UN had entered into an arbitration agreement orally or ‘by conduct’. If it did, [. . .] it might find that the UN is subject to arbitration proceedings on terms and conditions that do not deal with issues which the UN would have regulated in an arbitration agreement, and, thus, which do not fully protect its interests. The UN would not wish such issues to be left to be resolved by the Arbitral Tribunal itself. This is precisely why the UN regulates such issues in its arbitration agreements.”

While the specific context of arbitration cases where the United Nations is a party does not need to be addressed in the draft provision, the general policy concerns underlying the above-mentioned letter may need to be addressed in the more general context of international commercial arbitration.

Paragraph 5

18. Paragraph 5 reproduces language contained in the current text of article 7, paragraph 2, of the UNCITRAL Model Law on International Commercial Arbitration. It was adopted unchanged by the Working Group at its thirty-fourth session (see A/CN.9/487, para. 36).

Paragraph 6

19. The text of paragraph 6 was adopted in substance by the Working Group at its thirty-fourth (see A/CN.9/487, para. 37) and thirty-third (see A/CN.9/485 and Corr.1, para. 42) sessions. It has been slightly reworded so as to refer to any “text containing an arbitration clause” and not to restrict the scope of the paragraph to cases where the reference would be to an “arbitration clause” not contained in the contract.

Paragraph 7

20. The Working Group decided that paragraph 7 should be placed between square brackets until further discussion had taken place as to whether the substance of the provision should be included in article 7 or in an amendment

to article 35. The Secretariat was requested to study the implications of a possible revision of article 35 for continuation of the discussion by the Working Group (see A/CN.9/487, para. 40).

21. It should be noted that article 35, paragraph 2, of the Model Law mirrors article IV of the New York Convention. Any deviation from the existing text of article 35 would therefore require additional work towards amending the New York Convention or providing means to secure a uniform yet innovative interpretation of article IV of the New York Convention.

22. More fundamentally, the question raised by the form requirements that may be imposed at the level of recognition and enforcement of an award refer back to the central issue raised by the proposed text of paragraph 4. If the purpose of paragraph 4 is simply to facilitate the use of modern means of communication in the context of international commercial arbitration and to alleviate the burden resulting from the requirement that an arbitration agreement should be in the form of an original document, it is probably possible to deal with the entire issue of form within a revised version of article 7 of the Model Law. To address the issue of the "original arbitration agreement" under article 35, the revised text of article 7 would probably need to establish additional rules as to how the functional equivalent of an "original" document may be provided in an electronic environment. Articles 7 and 8 of the UNCITRAL Model Law on Electronic Commerce may provide useful guidance as to how such additional rules might be drafted.

23. However, if the purpose of paragraph 4 is to establish that evidence as to the existence and substance of the arbitration agreement could be replaced by a mere reference to terms and conditions of the arbitral procedure as set out in a set of arbitration rules or a law on arbitration, with no further written evidence being produced as to the existence or contents of the agreement, it is doubtful that such a fundamental change could be introduced without a complete overhaul of article 35 of the Model Law.

Examples of circumstances where the writing requirement is met

24. The previous version of the draft text considered by the Working Group contained an additional paragraph that read as follows: "7. Examples of circumstances that meet the requirement that an arbitration agreement be in writing as set forth in this article include, but are not limited to, the following illustrations: [*Secretariat asked to prepare a text based on Working Group's discussions*]." At its thirty-fourth session, the Working Group decided that such illustrations played a useful role and should be retained for educational purposes. However, they should not appear in the text of article 7 but might be taken into consideration when preparing the guide to enactment or any explanatory material that might accompany the model legislative provision. The Working Group may wish to discuss further the practical examples that might be given as illustrations in the guide to enactment.

III. INTERPRETATIVE INSTRUMENT REGARDING ARTICLE II, PARAGRAPH 2, OF THE NEW YORK CONVENTION

A. Revised text of the interpretative instrument

25. The Working Group at its thirty-fourth session discussed a preliminary draft interpretative instrument relating to article II, paragraph 2, of the New York Convention and requested the Secretariat to prepare a revised draft of the instrument, taking into account the discussion in the Working Group, for consideration at a future session (see A/CN.9/487, para. 18).

26. The text of the draft declaration adopted by the Working Group, as contained in the report of its thirty-fourth session (A/CN.9/487, para. 63), reads as follows:

"Declaration regarding interpretation of article II, paragraph 2, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York, 10 June 1958"

"The United Nations Commission on International Trade Law,

"1. *Recalling* resolution 2205 (XXI) of the General Assembly of 17 December 1966, which established the United Nations Commission on International Trade Law with the object of promoting the progressive harmonization and unification of the law of international trade,

"2. *Conscious* of the fact that the Commission comprises the principal economic and legal systems of the world, and developed and developing countries,

"3. *Recalling* successive resolutions of the General Assembly reaffirming the mandate of the Commission as the core legal body within the United Nations system in the field of international trade law to coordinate legal activities in this field,

"4. *Conscious* of its mandate to further the progressive harmonization and unification of the law of international trade by, inter alia, 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,

"5. *Convinced* that the wide adoption of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards has been a significant achievement in the promotion of the rule of law, particularly in the field of international trade,

"6. *Recalling* that the Conference of Plenipotentiaries which prepared and opened the Convention for signature adopted a resolution, which states, inter alia, that the Conference 'considers that greater uniformity of national laws on arbitration would further the effectiveness of arbitration in the settlement of private law disputes ...',

"7. *Concerned about* differing interpretations of article II, paragraph 2, of the Convention that result in part from differences of expression as between the five equally authentic texts of the Convention,

“8. *Desirous of* promoting uniform interpretation of the Convention in the light of the development of new communication technologies and of electronic commerce,

“9. *Convinced* that uniformity in the interpretation of the term ‘agreement in writing’ is necessary for enhancing certainty in international commercial transactions,

“10. *Considering* that in interpreting the Convention regard is to be had to its international origin and to the need to promote uniformity in its application,

“11. *Taking into account* subsequent international legal instruments, such as the UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Model Law on Electronic Commerce,”

“12. *[To be prepared by the Secretariat].*”

B. Remarks on the revised text of the interpretative instrument

Operative provision

27. Should the Working Group pursue the preparation of an interpretative instrument relating to article II, paragraph 2, of the New York Convention, an operative provision would need to be added at the end of the instrument, based on the approach taken in the revised text of article 7 of the Model Law. The operative provision might read along the following lines:

“12. *[Recommends] [Declares]* that the definition of ‘agreement in writing’ contained in article II, paragraph 2, of the Convention should be interpreted to include [wording inspired from the revised text of article 7 of the UNCITRAL Model Law on International Commercial Arbitration].”

Preservation of existing interpretations of article II of the New York Convention

28. In the course of its thirty-fourth session, the Working Group heard concerns that it was necessary to avoid any implication that the declaration was seeking to impose a new interpretation of the New York Convention (see A/CN.9/487, para. 61). Those concerns were reminiscent of a view expressed in the context of the discussion regarding the revision of article 7 of the UNCITRAL Model Law on International Commercial Arbitration, according to which the use of the words “for the avoidance of doubt” was essential to make it clear that the substantial rule embodied in the draft model legislative provision was not intended to alter any liberal interpretation that might be given readily, through case law or otherwise, to the notion of “writing” under either the Model Law or the New York Convention (see A/CN.9/487, para. 25). The Working Group may wish to discuss whether that point (which in the context of a revision of the Model Law could appropriately be dealt with in the guide to enactment) should be dealt with in a

new recital for possible inclusion in the draft declaration.

29. However, depending on the contents of the revised version of article 7 of the Model Law, in particular paragraph 4, further discussion may be required as to whether the technique of a declaration encouraging interpretation of article II, paragraph 2, of the New York Convention by reference to article 7 of the Model Law is an appropriate way of promoting uniform interpretation of the Convention. At the thirty-fourth session of the Working Group, the view was expressed that, to the extent that the declaration was intended to promote an interpretation of article II, paragraph 2, of the New York Convention in line with the revised draft article 7 of the Model Law, it would be regarded in a number of countries as bringing forward an innovative or revolutionary interpretation of the form requirement under article II, paragraph 2, of the New York Convention (see A/CN.9/487, para. 61). In a significant number of countries, such a “revolutionary” interpretation might be regarded as an unwelcome development.

30. There was general agreement within the Working Group that the effect of the declaration would not be binding on the Governments, national judiciaries or arbitrators to whom it was addressed. It was acknowledged that the text merely reflected a considered conviction or view of the Commission, which was suggested for consideration by persons engaged in interpreting article II, paragraph 2, in particular judges and arbitrators (see A/CN.9/487, para. 61). However, the Working Group may wish to discuss further whether a controversial declaration in respect of a such a successful and consensual instrument as the New York Convention would be apt to promote its uniform interpretation. The Working Group may wish to consider possible alternatives to the interpretative instrument as currently drafted.

Possible alternatives to the draft interpretative instrument

31. As one possible alternative, the Working Group may wish to give further consideration to the possibility of promoting a liberal approach to the form requirements contained in the New York Convention through the more-favourable-law provision of article VII of the Convention. As noted in paragraphs 20-22 of document A/CN.9/WG.II/ WP.108/Add.1:

“20. In considering the possibility of amending the Model Law as a tool for interpreting article II, paragraph 2, of the New York Convention (without amending the Convention), the Working Group may wish to consider also that national legislation may operate in the context of the more-favourable-law provision of article VII of the Convention. According to article VII, paragraph 1,

‘1. The provisions of the present Convention shall not [. . .] deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon.’

“21. Pursuant to this article, it may be considered that, if the law of the country where the award is to be

enforced (or the law applicable to the arbitration agreement) contains a less stringent form requirement than the Convention, the interested party may rely on that national law. That understanding would be in line with the purpose of the Convention, which is to facilitate recognition and enforcement of foreign awards. That purpose is achieved by removing conditions for recognition and enforcement in national laws that are more stringent than the conditions in the Convention, while leaving to operate any national provisions that give special or more favourable rights to a party seeking to avail itself of an award.

“22. It should be noted, however, that the acceptability of allowing less restrictive form requirements to operate through article VII, paragraph 1, of the Convention would depend on whether article II, paragraph 2, of the Convention is regarded as establishing a maximum requirement of form (thus leaving States free to adopt a less stringent requirement) or whether the Convention is interpreted as providing a unified form requirement with which arbitration agreements must comply under the Convention. Furthermore, it should be noted that, according to some views, article VII, paragraph 1, may be invoked to recognize more favourable national provisions on form only if the enforcement mechanism of the New York Convention is replaced by the national law on enforcement of foreign arbitral awards (whether provided by a statute or developed by case law). It is said that only if such a national enforcement regime exists, can that regime, through article VII, paragraph 1, be used in lieu of the regime of the Convention. The Working Group may wish to discuss the validity and implications of these considerations. It may also wish to discuss whether these considerations relating to article VII should be taken into account in drafting possible amendments to the Model Law so as to establish a regime that will operate in harmony with the New York Convention.”

32. A second alternative that may require further consideration would be to prepare a protocol to the New York Convention. In that respect, it may be recalled that paragraph 17 of document A/CN.9/WG.II/WP.108/Add.1 read as follows:

“17. One possible means of solving the above-mentioned difficulties would be to modernize the New York Convention in respect of the form of the arbitration agreement. When the Commission discussed this issue, various views were expressed as to the means through which modernization of the New York Convention could be sought (A/54/17, paras. 344 and 347). One view was that the issues related to the form of the arbitration clause should be dealt with by way of an additional protocol to the New York Convention. It was explained that redrafting, or promoting uniform interpretation of, article II, paragraph 2, could only be achieved with the required level of authority through treaty provisions similar in nature to those of the New York Convention. While support was expressed for that view, concern was expressed that any attempt to revise the New York Convention might jeopardize the excellent results reached over 40 years of international recognition and enforcement of foreign arbitral awards through worldwide acceptance of that Convention. In response to that concern, however, it was pointed out that the very success of the New York Convention and its establishment as a world standard should make it possible for UNCITRAL to undertake a limited overhaul of the text if such work was needed to adapt its provisions to changing business realities and to maintain or restore its central status in the field of international commercial arbitration.”

33. In the context of that second alternative, the Working Group may wish to consider whether it would wish to recommend preparing a protocol restricted to revising article II and probably also article IV of the New York Convention.

**F. Note by the Secretariat on the settlement of commercial disputes:
preparation of uniform provisions on interim measures of protection,
working paper submitted to the Working Group on Arbitration
at its thirty-sixth session**

(A/CN.9/WG.II/WP.119) [Original: English]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on Arbitration on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (*k*)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (*g*)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (*c*)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (*i*)); and the power of the arbitral tribunal to award interest (para. 107 (*j*

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

awards that had been set aside in the State of origin (para. 107 (*m*)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, held in Vienna from 25 June to 13 July 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to the issues related to interim measures of protection, the Commission noted that the Working Group had considered a draft text for a revision of article 17 of the UNCITRAL Model Law on International Commercial Arbitration and the text of paragraph 1 (*a*) (i) of a draft new article prepared by the Secretariat for addition to that Model Law (see A/CN.9/WG.II/WP.113, para. 18). The Working Group was requested to continue its work on the basis of revised draft provisions to be prepared by the Secretariat.

A. Interim measures ordered by an arbitral tribunal

6. At its thirty-fourth session (21 May-1 June 2001) the Working Group considered a draft article containing an express power for arbitral tribunals to order interim measures of protection and a definition of the interim measures that might be ordered (see A/CN.9/487, para. 64). For consideration at a future session, the Secretariat was requested to prepare alternative texts that would establish the terms, conditions and circumstances in which an arbitral tribunal could or should issue interim measures of protection. The texts should be illustrative rather than exhaustive in order to avoid the risk of being read in a limiting way. It was suggested that the draft should list general categories following the approach taken in other international instruments such as the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (Brussels 1968 and Lugano 1988). It was also suggested that the model legislative provision contain a provision requiring that the party seeking the interim measure provide appropriate security for enforcement of the measure.

7. To assist the Secretariat in its work on interim measures issued by arbitral tribunals, a short questionnaire was prepared and sent to arbitrators and counsel in arbitral proceedings to gather information on interim measures that had been issued in arbitral proceedings.

B. Interim measures ordered by a court

8. At its thirty-second session (20-31 March 2000), the Working Group considered, in the context of the discussion of interim measures that might be issued by an arbitral tribunal, a proposal for the preparation of uniform rules for situations in which a party to an arbitration agreement turned to a court with a request to obtain an interim measure of protection (see A/CN.9/468, paras. 85-87). It was pointed out that it was particularly important for parties to have effective access to such court assistance before the arbitral tribunal was constituted, but that also after the constitution of the arbitral tribunal a party might have good reason for requesting court assistance. It was added that such requests might be made to courts in the State of the place of arbitration or in another State.

9. It was observed that in a number of States there were no provisions dealing with the power of courts to issue interim measures of protection in favour of parties to arbitration agreements; the result was that in some States courts were not willing to issue such interim measures while in other States it was uncertain whether and under what circumstances such court assistance was available. It was said that, if the Working Group decided to prepare uniform provisions on that topic, the International Law Association Principles on Provisional and Protective Measures in International Litigation as well as the preparatory work that led to those Principles would be useful in considering the content of the proposed uniform rules.

10. The Working Group took note of the proposal and decided to consider it at a future session.

11. At its thirty-third session (20 November-1 December 2000) the Working Group considered preparatory work undertaken by the Secretariat with regard to the topic (see A/CN.9/WG.II/WP.111 paras. 2-29) and expressed its support for future work to enhance the effectiveness of arbitration in international trade. While noting that the topic concerned court procedure, an area where harmonization traditionally had been difficult to achieve, it was said that legal certainty in that area was desirable for the good functioning of international commercial arbitration. It was noted that the work on the topic would have to be founded on broad empirical information and that the Secretariat should contact Governments and arbitration organizations with a view to obtaining such information. The Secretariat was requested to prepare preliminary studies and proposals on the basis of the information received.

12. The Secretariat prepared a short questionnaire which was forwarded to Governments to ascertain information on powers of courts to order interim measures in support of arbitration and examples of measures that may have been issued.

13. The first part of the present working paper summarizes the information obtained from the surveys on interim measures issued by both courts and arbitral tribunals. The second part provides a summary of work being undertaken by other international organizations in respect of interim measures ordered by courts. The third part proposes ways in which some of the issues raised may be addressed, based

⁶Ibid., *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, para. 396.

upon the discussion in the Working Group and a revision of the draft text considered by the Working Group at its thirty-fourth session, in 2001.

II. BACKGROUND INFORMATION REGARDING INTERIM MEASURES OF PROTECTION UNDER DOMESTIC LAW

A. General remarks

14. Interim measures of protection play an essential role in many legal systems in facilitating the traditional litigation process, as well as arbitration. Courts and arbitral tribunals often receive requests from a party to arbitral proceedings for interim measures of protection. When issued by a court, such measures may be directed to one or both of the parties involved in the dispute or to third parties. When issued by an arbitral tribunal, such measures may generally not be directed to third parties. Interim measures of protection are generally temporary in nature, covering only the period up to entry into force of the arbitration award. Depending upon the measure, the circumstances justifying its continued existence no longer apply at the time the award is made or the interim measure is merged into the award. Referred to by different expressions (interim measures of protection, provisional orders, interim awards, conservatory measures and preliminary injunctive relief) their aims are broadly twofold. First, they are intended to preserve the position of the parties pending resolution of their dispute, a function often referred to as “preserving the status quo”. A second aim is to ensure that the final award or judgement can be enforced by preserving, in the jurisdiction in which enforcement will be sought, assets or property that can be applied to satisfy the award or judgement. There is no evidence to suggest that the objectives differ in the international commercial arbitration context from those sought in the context of domestic litigation.

15. In considering how some of the issues related to the ordering of interim measures by courts in support of arbitration may be addressed, the Working Group may wish to note the importance of ensuring that parties choosing to resolve their disputes through arbitration do not forfeit any rights to avail themselves of any interim relief measure that they would have had in litigation. Such an approach would help to achieve the goals of greater coherence and uniformity.

B. Classification of interim measures

16. Interim measures may be divided into different categories. Although the distinction between these different categories of measures is not always clear and specific measures can fall into more than one of the categories, the division between the different types may assist in understanding the extent to which certain domestic laws may restrict the power to issue certain types of measures, such as attachments. It is not suggested that the uniform provisions to be prepared by UNCITRAL should reflect any such classification or encourage any such restriction.

Broadly speaking, interim measures are sometimes divided into two principal categories: those aimed at avoiding prejudice, loss or damage; and those which are intended to facilitate later enforcement of the award.

1. *Measures to avoid or minimize prejudice, loss or damage*

17. Measures to avoid or minimize loss or damage by, for example, preserving a certain state of affairs until a dispute is resolved by the rendering of a final award and avoiding prejudice, for instance, by preserving confidentiality, include:

(a) Orders that the goods that are the subject matter of the dispute are to remain in a party’s possession but be preserved, or be held by a custodian (in some legal systems referred to as sequestration);

(b) Orders that the respondent hand over property to the claimant on condition that the claimant post security for the value of the property and that the respondent may execute upon the security if the claim proves to be unfounded;

(c) Orders for inspection at an early stage where it is clear that a given situation may change before the arbitral tribunal addresses the issue relating to it. For example, if a dispute turned upon the berthing of vessels at a port and it is known that the port is going to become a construction zone, the arbitral tribunal may make orders for inspection of the port at an early stage;

(d) Orders that one party provide to the other party certain information, such as a computer access code, that would enable, for example, certain work to be continued or completed;

(e) Orders for the sale of perishable goods with the proceeds to be held by a third person;

(f) Appointment of an administrator to manage income-producing assets in dispute, the cost of which is to be borne as directed by the arbitral tribunal;

(g) Orders that performance of the contract in dispute be continued;

(h) Orders to take appropriate action to avoid the loss of a right, such as by paying the fees needed to renew a trade mark or a payment to extend a licence of software;

(i) Orders directing certain information to be kept confidential and measures to be taken to ensure that confidentiality.

2. *Enforcement facilitation measures*

18. Measures to facilitate later enforcement of an award include:

(a) Orders which are intended to freeze assets pending determination of the dispute, as well as orders not to move assets or the subject matter of the dispute out of a jurisdiction and orders not to dispose of assets in the jurisdiction where enforcement of the award will be sought;

(b) Orders concerning property belonging to a party to the arbitration which is under the control of a third party (for example, to prevent a party's funds from being released by a bank);

(c) Security for the amount in dispute involving, for example, an order to pay a sum of money into a specified account, the provision of specified property, or the presentation of a guarantee by a third person such as a bank or surety; or

(d) Security for costs of arbitration which might require, for example, depositing a sum of money with the arbitral tribunal or the provision of a bond or guarantee, usually to cover the respondent's costs if the claimant is unsuccessful.

C. Power to order interim measures in support of arbitration

19. Though each State's procedural rules may differ, the process of applying for interim measures from a court may involve several steps to determine both the conditions and the extent to which a court may be empowered to order interim measures relating to an international commercial arbitration. Firstly, the power to grant interim measures may be shared between the arbitral tribunal and domestic courts. Secondly, there is an issue of the boundaries between the respective competences of the arbitral tribunal and the court to issue a particular interim measure. The question of how to resolve the issue of enforcement of the interim relief is also important (this issue is currently being considered by the Working Group—see A/CN.9/487, paras. 76-87).

20. Legal systems take different approaches to the issue of interim measures in support of arbitration and the institution that may be empowered to issue such measures. Broadly speaking, these fall into three main categories: those where the power is reserved to the court; those where it is reserved to the arbitral tribunal once it has been constituted or arbitral proceedings have been initiated; and those where both the court and the arbitral tribunal have such powers. There are also a number of instances where the power of the court is not specifically provided in law and it is therefore uncertain whether interim measures can be ordered by the court in support of arbitration. In some of these countries, the courts have nevertheless interpreted the absence of a prohibition as allowing them to issue such measures. In some federal or non-unitary jurisdictions, the power to issue interim measures may be divided between different levels of the courts, with some interim measures in the competence of a State, province or canton and the detail of the laws differing between them.

1. Power exclusive to the courts

21. Many legal systems recognize as a general principle that courts may issue interim measures in support of arbitration proceedings. The power to issue such measures is often included explicitly in arbitration or civil procedure laws and may allow interim relief to be ordered by the courts both before and during arbitral proceedings. Some of

these laws provide that only the court has the power to issue interim measures, whether before or after initiation of arbitral proceedings or constitution of the arbitral tribunal.⁷ Among these laws are some that specifically preclude the arbitral tribunal from issuing interim measures, even to the extent of refusing to enforce the parties' agreement to confer the power to issue these measures on the arbitral tribunal.

2. Power exclusive to the arbitral tribunal

22. Other laws provide that the authority to issue interim relief is vested exclusively in the arbitral tribunal and the courts do not have the power to issue interim measures in support of arbitration. The court's lack of jurisdiction may be the result of provisions that oust the jurisdiction of the court where there is an arbitration agreement. The power of the arbitral tribunal arises from the interpretation of the arbitration agreement as an agreement to seek a final and binding resolution of disputes by an impartial third party and this agreement cannot co-exist with the right of either party to alter the subject matter of the dispute in such a way as to destroy or obstruct the arbitral tribunal in making a final and effective award.⁸ Some courts have regarded the existence of a valid arbitration agreement as a decision by the parties to completely exclude court jurisdiction, including the jurisdiction to grant interim measures.⁹ Under some laws where the power to issue interim measures is reserved for the arbitral tribunal, the court may nevertheless assist the arbitral tribunal in the interests of the parties to the arbitration. This assistance may include ensuring the effectiveness of the future arbitral procedure by ordering urgent measures for preparing the case or safeguarding the enforcement of the award.

23. The court's lack of jurisdiction may also arise because the law does not specifically address the issue of interim measures in the period before initiation of arbitral proceedings or constitution of the arbitral tribunal. Interim relief may not be available from the arbitrators because the arbitral tribunal is not yet constituted, or because arbitrators do not have the authority to order the specific relief requested.

24. Given that the authority of an arbitral tribunal derives from the parties' agreement, it follows that an arbitral tribunal's powers must be determined by first examining the terms on which the parties have agreed to arbitrate. Parties may have agreed on either institutional or ad hoc arbitration under an established set of rules such as the UNCITRAL Arbitration Rules. In both cases, the arbitral

⁷The phrase "constitution of the arbitral tribunal" has several different possible meanings, including the moment the arbitrators are chosen by the parties; the date of appointment of the tribunal; and the date the tribunal has its first meeting, either with or without parties or their representatives present.

⁸*E-Systems, Inc. v. Islamic Republic of Iran* 2 Iran-U.S. Cl. Trib. Rep. 51, 57 (1983).

⁹Where the UNCITRAL Model Law on International Commercial Arbitration has been adopted, however, it is clear that a request to a court for interim relief is not incompatible with the existence of a valid arbitration agreement (art. 9).

tribunal's powers will be determined by an established set of rules. It may also be necessary to examine the substantive law governing the proceedings where this law either overrides the parties' agreement or supplements it.

3. *Concurrent powers*

25. Under a third approach, the arbitral tribunal and the courts have concurrent power to issue interim measures, with the parties deciding where to apply for interim relief, although the court will generally be the only body with the power to order interim measures before the arbitral tribunal has been constituted. In some laws where the power is concurrent the range of measures available from the court is sometimes broader before the arbitral tribunal has been constituted than after it has been constituted. Conservatory measures, for example, may be requested before and after constitution of the arbitral tribunal, while some measures having both conservatory and executory purposes may only be issued before the constitution of the arbitral tribunal.

26. A number of institutional arbitration rules recognize the power of arbitrators to issue interim measures and address the division of power between the arbitral tribunal and the court, generally providing that an application to a judicial authority after transmission of the file to the arbitral tribunal or constitution of the arbitral tribunal is not inconsistent with or deemed to be a waiver of the agreement to arbitrate.¹⁰ A number of those rules require the applicant for the measure to promptly inform the arbitral tribunal of the application to the court.

4. *Consecutive powers*

27. A further approach divides the powers between the court and the arbitral tribunal by reference to the constitution of the latter or the initiation of arbitral proceedings. Under these laws, the court has the power to issue interim measures before the arbitral tribunal is constituted but not after it has been constituted, on the basis that once constituted it is for the arbitral tribunal to issue interim measures if required

5. *Power of courts to issue is uncertain*

28. In some legal systems the power of the courts to issue interim measures in support of arbitration is not certain because it is not explicitly stated in either arbitration laws or civil procedure laws or rules. These systems require interpretation of the laws of civil procedure, with some courts deriving such power from the absence of a prohibition against issuing interim measures.

6. *Limitations on powers*

(a) *Courts*

29. The courts in a number of countries have tried to establish the limits of the powers of the courts in issuing interim measures. A number of precedents are slowly building up, defining the situations in which the court may legitimately intervene to support the work of the arbitral tribunal without usurping its authority. The conclusions reached, however, vary from country to country, making it difficult to predict the extent to which a national court may be prepared to intervene. As noted above, courts often draw a distinction between the time before and the time after the arbitral tribunal has been constituted or the arbitration initiated.¹¹

30. Other limitations on the power of the court to issue interim measures relate to the existence of certain specified circumstances. These might include limiting the power of the court to issue interim measures to those circumstances where the rights of a third party are involved; an *ex parte* application is involved; or the court's powers will be more effective than those of an arbitrator.

31. A further limitation on which there appears to be a consensus is where the relief requested goes to the heart of the substantive dispute. Some legislation provides, and courts in some countries have held, that the court has the power to issue interim measures, but that in doing so its power does not extend to a discussion of, or preliminary decision on, the substantive dispute. Where the party requesting the interim measure is in effect seeking to obtain a ruling on the merits of the dispute, courts will deny the request. According to some reports, even where arbitrators have broad authority, they use it reluctantly so as not to appear to be deciding on the merits or in favour of one party. Courts seem similarly reluctant to use their coercive powers to avoid making a decision that may turn out to be premature, that is, before the facts and the law of the case have been fully presented to the arbitral tribunal. Courts will generally avoid prejudicing the essence of the case by issuing, for example, a measure that effectively interprets the contract. Some courts, in refusing to exercise their interim relief powers, focus on the parties' expressed intent to submit their dispute to the confidential, neutral arbitration forum.

(b) *Arbitral tribunals*

32. A number of limitations operate in respect of the arbitral tribunal's power to order interim measures. The first is the point at which the power of the arbitral tribunal arises (whether by reference to the constitution of the arbitral tribunal or transmission of the file to the arbitral tribunal or to some other time as defined in the law or applicable arbitration rules). This power may arise some time after the dispute commences and after the interim measure may be required.

¹⁰UNCITRAL Arbitration Rules, article 26; International Chamber of Commerce Rules of Arbitration, article 23, para. 2; American Arbitration Association Commercial Arbitration Rules, rule 36; London Court of International Arbitration Rules, article 25.

¹¹One national law provides that the power to issue interim measures is limited to the period after the award has been made and filed with the court, the purpose being to ensure that the award can be enforced.

33. A second limitation is that an arbitral tribunal has no enforcement power of its own and enforcement of a measure ordered by an arbitral tribunal must be sought in the courts. A third limitation is that an arbitrator or arbitral tribunal has no power to bind any person not a party to the arbitration and thus cannot issue a measure directed to any third person.

D. The applicant for interim measures

34. Where the court has exclusive authority, there are two distinct approaches to the question of who may apply to the court for interim measures in support of arbitration. Some laws require the arbitral tribunal or arbitrator to make the request to the court (a party to the proceedings is specifically prohibited), but generally it is a party to the arbitration who will be the applicant. A request to an arbitral tribunal to issue an interim measure would be made by a party to the proceedings.

35. Many laws provide for *ex parte* applications for interim measures, provided that the applicant gives security for damages in case it is later determined that the order should not have been issued. To obtain *ex parte* relief, the applicant is most often required to show requisite urgency, that is, that irreparable harm will result if the applicant is required to seek the requested relief under customary procedures requiring many days' notice. In exceptional cases, some laws allow the requirement of security to be waived. Where the interim relief is sought before the arbitral tribunal is constituted, some laws require that the arbitral proceedings be commenced within a fixed period, which may vary from a number of days to a number of months.

36. Where the application for interim relief is denied, a number of laws permit the applicant to appeal either with or without leave of court. Other laws simply deny the right to appeal.

E. Types of interim measures that may be ordered

1. Courts

37. Different legal systems have characterized interim measures of protection in different ways and using different classifications. While the terminology "provisional and conservatory measures" is often used, the distinction between the two is not always clear and there is no universally accepted classification of interim relief. This distinction may, however, be important because some laws allow courts to order one type of measure but not the other, or distinguish between the two in terms of what orders may be made before and after constitution of the arbitral tribunal (see, for example, para. 25 above). In addition, countries adopt different approaches to the scope and variety of interim measures available from a court in support of arbitration and may draw a distinction between measures that may be ordered in support of domestic and foreign arbitration (see, for example, para. 45 below).

38. The types of measures that may be ordered by courts vary. Orders against an entity's property that direct an

authority to seize or take control of the property and orders compelling a party to do or refrain from doing a specified act, appear to be the type of measures most commonly issued. In some discussions, however, the general notion of interim measures is intended to include any procedural measures or measures concerned with the management of the arbitral process that may be issued.

39. Some arbitration laws enumerate the types of specific measures available, while in others they are described by reference to a general formulation, such as measures that are "conservatory or preventive and concretely adequate to secure the effectiveness of the threatened right." In some of the examples where the measures are not enumerated in the arbitration law, interim measures in the arbitral context are afforded the same treatment as in other court-supervised adversary matters as provided in civil procedure laws and rules of court.

40. Despite differences in terminology, standard types of measures widely available from courts in support of arbitration typically include:

(a) Orders to protect the property in dispute or protect certain rights of a non-monetary nature, typically addressed to the parties to the dispute (referred to as "attachment" in certain jurisdictions);

(b) Orders to prevent a party from removing assets or money kept by that party or placed with a third party (referred to as "injunctions" in certain jurisdictions);

(c) Preservation, custody or sale of perishable goods;

(d) Orders requiring a party to conserve goods in its possession (referred to as "sequestration" in certain jurisdictions);

(e) Property inspection orders;

(f) Appointment of a receiver to hold property that should not be in either party's possession until the dispute is resolved;

(g) Orders requiring a party to post security for the costs of the other party should the action prove to be unsuccessful.

2. Arbitral tribunals

41. In line with article 17 of the UNCITRAL Model Law on International Commercial Arbitration, many national laws limit the types of interim measures that may be ordered by an arbitral tribunal by requiring that any such measure be "in respect of the subject matter of the dispute". In that respect, it may be recalled that article 17 of the Model Law was drafted against the background of article 26 of the UNCITRAL Arbitration Rules, which refers to the arbitral tribunal taking, at the request of either party, "any interim measures it deems necessary in respect of the subject matter of the dispute, including measures for the conservation of the goods forming the subject matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods." The reference in those texts to "the subject matter of the dispute" and the illustration provided in the UNCITRAL Arbitration Rules regarding the sale of perishable goods is generally not understood

as restricting the power of the arbitral tribunal to order any type of interim measure it deems appropriate. However, such references to “the subject matter of the dispute” and to “conservation of goods forming the subject matter of the dispute” have suggested to at least one commentator that the measures contemplated relate to the preservation or sale of goods rather than preventing the transfer of assets to another jurisdiction. By comparison, the language used in the International Chamber of Commerce Rules of Arbitration, which allow an arbitral tribunal to “order any interim or conservatory measure it deems appropriate”, is seen as possibly providing a broader discretion. The American Arbitration Association Commercial Arbitration Rules also may be broader by allowing the arbitrator to “take whatever interim measures he or she deems necessary” and not making any reference to the subject matter of the dispute. The revision of the text of article 17 of the Model Law may provide the occasion to clear any misunderstanding, either through redrafting of the provision or by way of appropriate explanations in the guide to enactment.

F. Elements to be satisfied for issuance of interim measures

42. Many laws establish a number of prerequisites for the issuance of interim measures by courts in support of arbitration, the most common of which are:

- (a) That appropriate security should be posted by the applicant for damages that may arise from the order issued;
- (b) That there is an urgent need for the measure applied for;
- (c) That the applicant for the measure should demonstrate that a significant degree of harm will result if the interim measure is not ordered, generally called “irreparable” or “substantial” harm;¹² and
- (d) In most jurisdictions, that there is a likelihood of the applicant succeeding on the merits of the underlying case.

43. The prerequisites for the issue of interim measures by the arbitral tribunal depends on the applicable law and the rules governing the arbitration proceedings. The preconditions for the granting of interim measures are generally set out in the applicable law, although there is no uniformity in this area and the laws and rules do not provide any detail on the prerequisites, even though interim measures of protection have potentially far-reaching consequences. In many of the international rules, an arbitral tribunal is given a broad discretion to determine if a requested interim measure is appropriate¹³ or necessary.¹⁴ Typical preconditions include that the issue sought to be addressed in the interim measure requires urgent redress, that there is a risk

to the subject matter in the dispute, that there would be irreparable harm or serious or actual damage if the measure requested is not granted, that no other remedy is available and that security is provided.¹⁵

G. Interim measures from courts in support of foreign arbitration

44. In an international dispute where the interim relief is sought in a country other than the country where the arbitration takes place, the question of jurisdiction arises: do the national courts have jurisdiction to grant interim relief in support of foreign arbitration and on what grounds? As a general principle, a form of relief that is directed towards specified property, or a third party holding it, is more likely to be territorially restricted than an injunction against the party personally. The injunction against the party will apply irrespective of where the property is situated.

45. Countries have adopted different approaches to the issue of measures in support of foreign arbitration. The laws of some countries allow recourse to the court not only in cases where the arbitration takes place in the country of the court, but also in cases where the arbitration takes place outside the country. Those laws generally refer to the need to be able to enforce the measure within the jurisdiction of the court issuing the measure, such as requiring the presence of assets in its territory (whether of a resident or non-resident)¹⁶ or they may require the presence of the respondent to the application for interim measures.¹⁷ In some countries, for example, the law requires that the court have jurisdiction over the respondent before an interim measure can be ordered or enforced.

46. Other examples of conditions required by some national laws for the granting of interim measures in support of foreign arbitration include that the foreign arbitral award would be enforceable in that jurisdiction of the court issuing the measure;¹⁸ that full disclosure of the existence

¹⁵The UNCITRAL Arbitration Rules provide that the “tribunal shall be entitled to require security for the costs of such measures” (art. 26, para. 2); under the London Court of International Arbitration Rules the arbitral tribunal may order a party to provide “security for the legal or other costs” upon such terms as “the Arbitral Tribunal considers appropriate”. Some national laws that expressly empower arbitral tribunals to issue interim measures also include express power to require appropriate security either by payment of a specific amount (in Guatemala, 10 per cent of the amount being claimed) or the provision of a bond, guarantee or other security.

¹⁶Under some laws certain measures can only be granted where the assets in respect of which the order is sought belong to non-resident debtors.

¹⁷In one country legislation provides that the powers conferred on the court with regard to interim relief are exercisable even if the seat of the arbitration is outside the country or no seat has been designated or determined. Nevertheless, the court may still refuse to grant interim relief if in the opinion of the court the fact that the seat of the arbitration is outside the country makes it inappropriate to do so. Because the law has only recently been enacted it is not entirely clear how the courts will exercise this discretion. It seems likely that, if the courts at the place where the arbitration has its seat are themselves competent to order interim measures, then the home court may regard the seat-of-arbitration courts as the natural forum for the grant of such measures and will itself decline to grant relief.

¹⁸Austria, §387(2) Exekutionsordnung.

¹²The concept of irreparable harm generally contemplates that the harm that would result would be such that remedies at law (that is, damages) could not be adequate compensation.

¹³International Chamber of Commerce Rules, article 23, para. 1; London Court of International Arbitration Rules, article 25, para. 1(a).

¹⁴UNCITRAL Arbitration Rules, article 26, para. 1; American Arbitration Association Rules, article 23, para. 1.

of the arbitration agreement has been made;¹⁹ that the request for the interim measure has been made by the arbitral tribunal; or that the conditions of the legislation of the country in which the measure is sought are met.²⁰ There are also laws that provide that interim measures to be enforced outside the country may be ordered only if there is a chance that they will be enforced in the foreign jurisdiction.

47. In many countries, however, the law does not provide that this type of assistance may be granted by local courts. In some laws, an application to the courts for protective measures may only be granted where an application has already been made to that court for a decision on the merits, which is clearly not possible where there is an arbitration agreement in existence. In other laws, the court may order protective measures in cases where the arbitration takes place within the jurisdiction of the court, but not abroad.²¹

48. In a further category of countries, the position is not clear either because the relevant legislation does not address the issue or because there have been no reports of cases in which such an order has been sought.²²

III. INTERNATIONAL WORK ON PROVISIONAL MEASURES

49. The questions concerning the availability, effectiveness and enforcement of interim measures on an international level have been the subject of work by a number of different international organizations, some of which are currently drafting texts that include provisions on interim measures.

A. International Law Association Principles

50. At its sixty-seventh Conference, in 1996, the International Law Association adopted the "Principles of Provisional and Protective Measures in International

Litigation",²³ which were prepared by a group of experts under the aegis of the Association. The Principles were reproduced verbatim in paragraph 108 of A/CN.9/WG.II/WP.108.

51. The International Law Association Principles seek to establish rules of general application for the assistance of law reformers at both the national and international level on the exercise by courts of independent jurisdiction for granting provisional and protective measures with the objective of securing assets out of which an ultimate judgment may be satisfied.²⁴ The Principles were drafted bearing in mind "a paradigm case of measures to freeze the assets of the defendant held in the form of sums on deposit in a bank account with a third party bank."²⁵ The Association recommended the Principles for possible use by UNCITRAL and the Hague Conference on Private International Law and in national statutory reforms.²⁶ It must be noted however that these Principles were drafted with the international litigation process in mind, as opposed to interim measures granted by a court in support of an international arbitration. Nevertheless, a number of the issues addressed are relevant to any consideration of interim measures issued by courts in support of arbitration. The Principles are summarized below.

Scope (principles 1 and 2)

52. The Principles adopt a twofold classification of the purposes performed by provisional measures in civil and commercial litigation: (a) to maintain the status quo pending determination of the issues at trial; or (b) to secure assets out of which an ultimate judgment may be satisfied. The distinction is one that is commonly made in national legal systems and reflects the need for different types of relief (see A/CN.9/WG.II/WP.108, para. 63 and paras. 16-18 above). The Principles focus upon measures in category (b) above simply because those measures represent measures commonly available and thus capable of comparative analysis.

Availability of provisional and protective measures (principle 3)

53. When used in the context of arbitration, the Principles would seem to imply that it is desirable that interim measures be available to foreigners and citizens alike and in respect of arbitrations held in both the country of the court issuing the measure and in a foreign country. As noted above, practice varies with respect to the availability of interim measures in support of foreign arbitration.

¹⁹Canada, *Ruhrkohle Handel Inter GmbH et al and Fednav Ltd. et al*, unreported judgement of the Federal Court of Canada, Trial Division T-212-91, supports the view that an arrest may be maintained in a foreign arbitration matter provided full disclosure of the arbitration agreement is made and that court proceedings are subsequently stayed.

²⁰German courts do not differentiate between foreign and national arbitral proceedings as long as the Civil Procedure Code provides for a State court's jurisdiction to grant interim relief. In Greece, as long as the conditions of the Greek Code of Civil Procedure with regard to interim relief are satisfied, the Greek court will grant interim relief in support of a foreign arbitration.

²¹Courts in India have interpreted the 1996 Arbitration and Conciliation Act to mean that a court may only order interim relief in support of a domestic arbitration. In China it would seem that it is not possible to apply for interim relief if the seat of arbitration is not in China.

²²In the United States of America there is no provision in State statutes or the Federal Arbitration Act allowing interim remedies by the courts when the parties have agreed to arbitration, except in the case of maritime arbitration: 9 USC §8. However United States courts have often derived their authority to provide interim relief from State law. See *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 253 No. 2 (2d Cir.1991) *Borden Inc. v. Meiji Milk Products Co. Ltd.*, 919 F.2d 822 (2d Cir. 1990).

²³International Law Association, report of the sixty-seventh Conference, held at Helsinki, 12-17 August 1996, Committee on International Civil and Commercial Litigation, second interim report on provisional and protective measures in international litigation, published by the International Law Association, London 1996.

²⁴The principle of independence of the jurisdiction to grant provisional and protective measures is in line with article 24 of the 1968 Brussels (and Lugano) Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters.

²⁵International Law Association report, page 186.

²⁶International Law Association report, page 201.

Discretionary nature of the award of interim measures (principle 4)

54. The granting of relief would generally be discretionary rather than mandatory and subject to certain specified considerations. Those might include, for example, *prima facie* consideration of the merits of the applicant's case and the relative consequences to the parties if the measure is either granted or refused.

55. Case law in a number of countries shows that courts are not prepared to issue interim relief in support of arbitration in any situation that would involve a preliminary discussion of the merits of the case. The willingness of the court to grant the interim measure usually depends to a great extent on the urgency of the measure and the potential damage to the applicant should the measure be refused. If it is clear that the applicant is not merely trying to frustrate the arbitral proceedings it would seem that there is a greater chance that the measure will be ordered and the court will avoid having to look at the substantive issues.

Hiding of assets (principle 5)

56. The Principles recognize that the respondent should not be able to hide its assets by putting them into, for example, a corporation or a trust, while still retaining either *de facto* or beneficially the ownership of the assets. While stating the general principle, the International Law Association Committee noted that this problem was a complex one and required further research and elaboration.

Due process and protection for the respondent (principles 6-8)

57. While it might not always be possible to give the respondent prior notice that an order for interim measures is being sought, particularly where the element of surprise is important, as a general rule the respondent is entitled to be informed promptly of the measure ordered. The Principles stress that the respondent should be given the opportunity to be heard within a reasonable time and to object to the provisional and protective measure.

58. As another safeguard for the respondent, the court may need to have the authority to require security or other conditions (such as an undertaking by the applicant to indemnify the respondent if the measure proves to be unjustified) from the applicant for potential injury to the respondent or to third parties which may result from the granting of the order, such as where the order is unjustified or too broad. If an undertaking as to damages might prove insufficient and the court considers ordering security, an additional consideration might relate to the ability of the applicant to respond to a claim for damages for such injury. The type of measure requested is a common determinant of the conditions that may attach to an interim measure.²⁷

²⁷In Sweden, section 6, chapter 15 of the Procedural Code provides that security is essential for the granting of an interim measure. The security can be in the form of a personal letter or guarantee, or a pledge, or a bank guarantee. The applicant can be exonerated from this demand only by showing extraordinary grounds for the claim: Execution Code ch 2, s 25.

Access to information concerning the respondent's assets (principle 9)

59. In some countries little relief is available to an applicant in the area of access to information concerning the respondent's assets and the applicant may have no legal right, for example, to be informed by a third party as to the assets held at the bank by the respondent. Other legal systems make more expansive provision for ancillary disclosure. As the Principles note, there are important competing policies underlying these two different positions; for example, the need for disclosure particularly in fraud cases to enable an applicant to trace and recover assets effectively, as against the importance of maintaining bank secrecy and the right to privacy as to personal financial affairs.

Jurisdiction (principles 10-12, 16 and 17)

60. A limitation on the granting of interim measures of relief in support of foreign proceedings may be the requirement that courts of the forum in which the measure is sought have jurisdiction over the substantive dispute. In some countries, for example, some interim measures of protection cannot be ordered unless the substantive proceedings are taking place, or would take place, in a court of that jurisdiction or in an arbitral tribunal within that jurisdiction. In other cases, the provision for the granting of interim relief in support of foreign court proceedings is limited to the group of countries party to particular conventions (such as the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters). In yet other cases, that provision will apply to foreign court proceedings anywhere in the world without the law specifying any basis on which the court of the country in which relief is sought could assess jurisdiction in relation to the substantive issues in the claim. In such jurisdictions, the courts have indicated that the relief should not be limited to exceptional cases,²⁸ provided that it is not granted as a matter of routine or without very careful consideration. Such considerations might include, for example, whether the interim relief might hamper or obstruct the management of the case by the court seized of the substantive proceedings or give rise to a risk of conflicting, overlapping or inconsistent orders in other courts and whether the primary court was requested to give such relief and declined to do so.

61. The Principles propose that jurisdiction could be derived from the mere presence of assets, subject to conditions. These include that the presence of assets (or, in fact, the granting of an interim measure of protection in relation to those assets) should not be used as a basis for founding more general substantive jurisdiction. This condition reflects the common position in a number of different countries; the applicant would have an obligation to file a substantive action, within a reasonable time, either in the forum or abroad and there should be a reasonable possibility that any judgement rendered abroad would be recognized in the forum which granted the interim relief.

²⁸*Credit Suisse Fides Trust v. Cuoghi* [1998] Queen's Bench Division 818 (United Kingdom).

62. Where the court is properly exercising jurisdiction over the substance of the matter, the wide scope of orders that may be made over the respondent personally is a feature of the law of many countries. The court's power would cover issuing provisional and protective orders addressed to a respondent personally to freeze the respondent's assets, irrespective of their location and regardless of whether the respondent is or was physically present within the jurisdiction.

63. Where, however, the court is not exercising jurisdiction over the substance of the matter, and is exercising jurisdiction purely in relation to the grant of provisional and protective measures, there is a need for caution. The court's jurisdiction may need to be restricted to assets located within the jurisdiction, in particular to ensure that third parties are protected from the conflicts of jurisdiction which might otherwise arise. Subject to international law, national rules (including rules of the conflict of laws) will determine the location of assets.

*Duration of the validity of the interim measure
(principle 13)*

64. The provisional and protective measure should be valid for a specified limited time. This principle is connected with the respondent's right to be heard. It may also be important where the measure sought may be controversial, such as an ex parte measure, or where it has the potential to be particularly onerous on the respondent if prolonged. In the case of ex parte measures, the requirement that the applicant must return to the court for a renewal of the measure will allow the respondent to be heard at that time. The court can then consider renewal in the light of developments in the arbitral tribunal where the substantive action is being heard.

Duty to inform (principle 15)

65. The applicant for provisional and protective measures should be required to promptly inform the arbitral tribunal of orders that have been made at the applicant's request. It is also important that the applicant be required to inform the court requested to make an interim order of the current status of arbitration proceedings on the merits and proceedings for provisional and protective measures in other jurisdictions. The duty to inform is discussed in the context of enforcement of interim measures in paragraph 643 of A/CN.9/WG.II/WP.110.

*Cross-border recognition and international
judicial assistance (principles 18-20)*

66. While not seeking to impose an obligation to recognize orders made in other States, encouraging cooperation in the making of local complementary orders may lead to tangible results, both in recognition and judicial assistance. At the request of a party, a court may take into account orders granted in other jurisdictions. Further, it may be appropriate for courts to cooperate where necessary in

order to achieve the efficacy of orders issued by other courts and to consider the appropriate local remedy.

67. The fact that an order is provisional in nature, rather than final and conclusive, should not by itself be an obstacle to cooperation or even recognition or enforcement. Enforcement of interim measures is addressed in A/CN.9/WG.II/WP.110, paragraphs 52-80; A/CN.9/WG.II/WP.113, paragraphs 17 and 18, and A/CN.9/487, paragraphs 64-87.

**B. Preparation of draft fundamental principles
and rules of transnational civil procedure
by the American Law Institute and the
International Institute for the
Unification of Private Law**

68. This is a joint project to draft procedural rules that a country could adopt for adjudication of disputes arising from international transactions. The draft principles are intended to be interpretative guides to the draft rules and could be adopted as principles of interpretation. They could also be adopted as guidelines in interpreting existing national codes of procedure. Correlatively, the draft rules can be considered as an exemplification of the principles. The November 2001 revision of the draft fundamental principles contains the following principles relating to provisional measures:

"3.3 Jurisdiction may be exercised on the basis of sequestration of property located within the forum State, but only if no other reasonably convenient forum is available.

"3.4 Provisional measures may be provided with respect to property in the forum State, even if the courts of another State have jurisdiction over the controversy.

"4.3 A person should not be required to provide security for costs, or for liability for provisional measures, solely because that person is not domiciled in the forum State. In any event, security for costs should not restrict access to justice.

"26.1 Procedures should be available for prompt, speedy, effective and efficient execution of a provisional remedy, a judgement for money, including costs, or a judgement for an injunction, awarded in a proceeding under these Principles.

"27.1 A final judgement or provisional remedy in a proceeding under these Principles and its eligibility for effective enforcement, should be accorded the same recognition, in the forum and other States, as other judgements or provisional remedies of the forum.

"28.1 The courts of a State that has recognized these Principles should provide support to the courts of any other State that is conducting litigation under these Principles, including the grant of protective or provisional relief, or assisting in the identification, preservation, or production of directly relevant evidence."

69. The November 2001 version of the draft rules contains the following provisions (with commentary) on interim measures:

“17.1 In accordance with forum law and subject to applicable international conventions, the court may issue an injunction to restrain or require conduct of any person who is subject to the court’s authority where necessary to preserve the status quo or to prevent irreparable injury pending the litigation. The extent of such a remedy shall be governed by the principle of proportionality.

“17.1.1 A court may issue such an injunction, before the opposing party has opportunity to respond, only upon proof showing urgent necessity and a preponderance of considerations of fairness in support of such relief. The party or persons to whom the injunction is directed shall have opportunity at the earliest practicable time to respond concerning the appropriateness of the injunction.

“17.1.2 The court may, after hearing those interested, issue, dissolve, renew, or modify an injunction.

“17.1.3 The applicant is liable for full indemnification of the person against whom an injunction is entered if it turns out that the injunction was wrongly granted.

“17.1.4 The court may require the applicant for relief to post a bond or to assume a duty of indemnification of the person against whom an injunction is entered.

“17.2 An injunction may restrain a person over whom the court has jurisdiction from transferring property or assets, wherever located, pending the conclusion of the litigation and require a party to promptly reveal the whereabouts of its assets, including assets under its control, and of persons whose identity or location is relevant.

“17.3 When the property or assets are located abroad, recognition and enforcement of an injunction under the previous subsection is governed by the law of the country where the property or assets are located, and by means of an injunction by the competent court of that country.

“34.2 An order of a court of first instance granting or denying an injunction sought under rule 17 is subject to immediate review. The injunction remains in effect during the pendency of the review, unless the reviewing court orders otherwise.”

70. The following is the commentary on the rules:

“C-17.1 The term “injunction” refers to an order requiring or prohibiting the performance of a specified act, for example, preserving property in its present condition. Rule 17.1 authorizes the court to issue an injunction that is either affirmative, in that it requires performance of an act, or negative in that it prohibits a specific act or course of action. Availability of other provisional

remedies or interim measures, such as attachment or sequestration, should be determined by forum law, including applicable principles of international law.

“C-17.2 Rule 17.1.1 authorizes the court to issue an injunction without notice to the person against whom it is directed where doing so is justified by urgent necessity. ‘Urgent necessity,’ required as a basis for an ex parte injunction, is a practical concept, as is the concept of preponderance of considerations of fairness. The latter term corresponds to the common-law concept of ‘balance of equities’. Considerations of fairness include the strength of the merits of the applicant’s claim, the urgency of the need for a provisional remedy and the practical burdens that may result from granting the remedy. Such an injunction is usually known as an ex parte injunction. In common-law procedure such an order is usually referred to as a ‘temporary restraining order.’

“The question for the court, in considering an application for an ex parte injunction, is whether the applicant has made a reasonable and specific demonstration that such an order is required to prevent an irreparable deterioration in the situation to be addressed in the litigation and that it would be imprudent to postpone the order until the opposing party has opportunity to be heard. The burden is on the party requesting an ex parte injunction to justify its issuance. However, opportunity for the opposing party or person to whom the injunction is addressed to be heard should be afforded at the earliest practicable time.

“C-17.3 Rules of procedure or ethics generally require that a party requesting an ex parte injunction make full disclosure to the court of all aspects of the situation, including those favourable to the opposing party. Failure to make such disclosure is ground to vacate an injunction and may be a basis of liability for damages against the requesting party.

“C-17.4 As indicated in rule 17.1.2, if the court had declined to issue an injunction ex parte, it may nevertheless issue an injunction upon a hearing. If the court previously issued an injunction ex parte, it may renew or modify its order in light of the matters developed at the hearing. The burden is on the plaintiff to show that the injunction is justified.

“C-17.5 Rule 17.1.4 authorizes the court to require a bond or other indemnification, as protection against the disturbance and injury that may result from an injunction. The particulars of such indemnification should be determined by reference to the general law of the forum.

“C-17.6 Rule 17.2 permits the court to restrain transferring property located outside the forum State and to require disclosure of the party’s assets. In the law of the United Kingdom this is referred to as a Mareva injunction. The Brussels Convention requires recognition of such an injunction by signatories to that Convention because an injunction is a judgement. This subsection also authorizes an injunction requiring disclosure of the identity and location of persons to facilitate enforcement of an eventual judgement.

“C-17.7 Rule 34.2 provides for the review of an order granting or denying a preliminary injunction, according to the procedure of the forum. Review by a second-instance arbitral tribunal is regulated in different ways in various systems so that only a general principle providing for an immediate review is stated here. The guarantee of a review is particularly necessary when the injunction has been issued *ex parte*. However, it should also be recognized that such a review may entail a loss of time or procedural abuse.

“C-17.8 Rule 17.3 deals with a preliminary injunction that concerns property or assets located in another country. In transnational litigation property or assets may need to be ‘blocked’ or ‘disclosed’ in a country different from the one of the court having jurisdiction of the case. A further problem concerns the enforcement of such an injunction. Whether the injunction should be recognized depends on the rules and principles of the law of the country where the property or assets are located.

“C-34.3 Rule 34.2 permits *pendente lite* interlocutory appellate review of orders granting or denying an injunction. See rule 17. The injunction remains in effect during the pendency of the review, unless the reviewing court orders otherwise. The court may determine that an injunction should expire or be terminated if circumstances warrant.”

C. Hague Conference on Private International Law: draft convention on jurisdiction and foreign judgements in civil and commercial matters

71. The interim text prepared by the Permanent Bureau and the Co-reporters on the basis of the discussion in Commission II of the first part of the Diplomatic Conference (6-20 June 2001) contains a number of alternative provisions addressing provisional and protective measures, although it has not yet been resolved whether these measures should be included within the scope of the convention.²⁹ These provision are as follows:

“Article 13 *Provisional and protective measures*

“[Alternative A

“1. A court seized³⁰ and having jurisdiction under articles [. . .] to determine the merits of the case has jurisdiction to order provisional and protective³¹ measures.

²⁹Article 1, para. 2 (k) provides that the Convention does not apply to:

(k) *Alternative A*

[provisional and protective measures other than interim payment orders;]

Alternative B

[provisional or protective measures [other than those mentioned in articles 13 and 23A];]

³⁰It has been suggested that it would be sufficient if a court is seized after a provisional and protective measure is made. This would require the addition of the words ‘or about to be seized’ or similar.

³¹The description ‘provisional and protective’ is intended to be cumulative, that is to say, the measures must meet with both criteria.

“2. A court of a Contracting State [may] [has jurisdiction to],³² even where it does not have jurisdiction to determine the merits of a claim, order a provisional and protective measure in respect of property in that State or the enforcement of which is limited to the territory of that State, to protect on an interim basis a claim on the merits which is pending or to be brought by the requesting party in a Contracting State which has jurisdiction to determine that claim under articles [. . .].³³

“3. Nothing in this Convention shall prevent a court in a Contracting State from ordering a provisional and protective measure for the purpose of protecting on an interim basis a claim on the merits which is pending or to [sic] brought by the requesting party in another State.³⁴

“4. In paragraph 3³⁵ a reference to a provisional and protective measure means

“(a) A measure to maintain the status quo pending determination of the issues at trial; or

“(b) A measure providing a preliminary means of securing assets out of which an ultimate judgment may be satisfied; or

“(c) A measure to restrain conduct by a defendant to prevent current or imminent future harm.]

“[Alternative B³⁶

“A court which is or is about to be seized of a claim and which has jurisdiction under articles [3 to 15] to determine the merits thereof may order provisional and protective measures, intended to preserve the subject matter of the claim.]

“ . . .

³²A form of words has also been suggested that would make it clear that Contracting States are obliged to provide this jurisdiction, although it was also stressed that this would not interfere with the discretion of the courts of such States either to make or to refuse to make such orders.

³³It was noted that some States, especially those in the Commonwealth other than the United Kingdom, did not provide for jurisdiction to make provisional and protective orders unless the court was seized of jurisdiction to determine the merits of the case. This could operate to the detriment of foreign plaintiffs who sought to ‘freeze’ assets within the jurisdiction in aid of litigation pending elsewhere. The provision is intended to provide such States with jurisdiction to make such orders based on the existence of property in the forum and limited to the territory of the forum. There was no consensus on this provision.

³⁴This provision is intended to overcome any restrictions imposed on the exercise of jurisdiction by the courts of Contracting States by the list of prohibited jurisdictions (at present found in Article 18). The provision would also allow the exercise of jurisdiction to make provisional and protective orders under national law without the restrictions imposed by the list of prohibited jurisdictions. It is proposed to remove the reference to article 13 in article 17 in order to allow the exercise of such jurisdiction under national law. Some delegations took the view that this paragraph was the only provision on provisional and protective measures that should be included in the Convention.

³⁵It has been proposed that this definition should apply also to paragraphs 1 and 2.

³⁶This proposal is linked with the second alternative in article 1(2)(k) which in itself contains the options either to exclude provisional or protective measures entirely from the scope of the Convention or to permit a limited jurisdiction to make such orders. Alternative B provides for such a limited jurisdiction, if so desired.

“[Article 23A Recognition and enforcement of provisional and protective measures³⁷

“[Alternative A

“1. A decision ordering a provisional and protective measure, which has been taken by a court seized³⁸ with the claim on the merits, shall be recognized and enforced in Contracting States in accordance with articles [25, 27-34].

“2. In this article a reference to a provisional or protective measure means —

“(a) A measure to maintain the status quo pending determination of the issues at trial; or

“(b) A measure providing a preliminary means of securing assets out of which an ultimate judgement may be satisfied; or

“(c) A measure to restrain conduct by a defendant to prevent current or imminent future harm.]”

“[Alternative B

“Orders for provisional and protective measures issued in accordance with article 13³⁹ shall be recognized and enforced in the other Contracting States in accordance with articles [25, 27-34].]”

IV. POSSIBLE PROVISIONS

72. The material discussed above suggests that, with respect to interim measures in support of arbitration issued by both courts and arbitral tribunals, there are a number of issues that the Working Group may wish to address.

73. Those issues are: whether there is the power to order interim measures and if so, the scope and extent of that power; the relationship between the court and the arbitral tribunal once the arbitral tribunal has been constituted and their respective powers to issue interim measures (including before the arbitral tribunal is constituted); the pre-conditions for issue of such measures; the conditions that

may attach to the interim measures issued; the type and scope of measures that may be issued; and whether the measures can be enforced in a foreign jurisdiction. In respect of court ordered measures there is an additional issue of whether the power to order interim measures extends to both domestic and foreign arbitration.

A. Interim measures ordered by an arbitral tribunal

74. At its thirty-fourth session, in 2001, the Working Group discussed the question of interim measures of protection issued by an arbitral tribunal on the basis of draft provisions prepared by the Secretariat (see A/CN.9/487, paras. 65-75). The revised draft provisions presented below have been prepared on the basis of the considerations in the Working Group elaborating on article 17 of the UNCITRAL Model Law on International Commercial Arbitration.

Draft article 17

1. Unless otherwise agreed by the parties, the arbitral tribunal may, at the request of a party, order any party to take such interim measure of protection as the arbitral tribunal may consider necessary [in respect of the subject-matter of the dispute].

2. The party requesting the interim measure should furnish proof that:

(a) There is an urgent need for the measure applied for;

(b) A significant degree of harm will result if the interim measure is not ordered; and

(c) There is a likelihood of the applicant for the measure succeeding on the merits of the underlying case.

3. The arbitral tribunal may require any party to provide appropriate security in connection with such measure.

4. An interim measure of protection is any temporary measure [, whether it is established in the form of an arbitral award or in another form,] ordered by the arbitral tribunal pending the issuance of the award by which the dispute is finally decided. For the purposes of this article reference to an interim measure includes:⁴⁰

Variant 1

(a) A measure to maintain the status quo pending determination of the questions at issue;

(b) A measure providing a preliminary means of securing assets out of which an award may be satisfied; or

³⁷The two alternatives which do not appear to differ much in substance, provide for the recognition and enforcement of provisional and protective orders made by a court that is seized (or about to be seized) of the substantive dispute. Such a provision is opposed naturally by those delegations that favour exclusion of such measures from the scope of the Convention. But several delegations that favoured the inclusion of a provision relating to such measures in the jurisdictional or procedural part of the Convention, opposed making provision for the recognition and enforcement of provisional and protective orders. Note also that there may be a need to address the extent to which similar relief is known in the State of the court addressed; and procedures to safeguard the interests of third parties or of the defendant (e.g. an undertaking to pay damages).

³⁸It was suggested that it would be sufficient if a court is seized after a provisional and protective measure is made as long as it is already seized by the time of recognition and enforcement of the provisional and protective measure is sought abroad.

³⁹This refers back to the proposal made as alternative B in article 13, above. The order must have been made by a court that is seized or about to be seized of a claim and that has jurisdiction to determine the merits thereof.

⁴⁰This provision could be accompanied by an explanation providing more detail on the measures that might fit within these broad categories, along the lines set forth in paras. 17 and 18 or a more general formulation along the lines of para. 40 above.

(c) A measure to restrain conduct by a defendant to prevent current or imminent future harm.⁴¹

Variant 2

(a) A measure to avoid or minimize prejudice, loss or damage; or

(b) A measure to facilitate later enforcement of an award.

5. The arbitral tribunal may, where it is necessary to ensure that an interim measure is effective, grant a measure [for a period not exceeding [. . .] days] [without notice to the party against whom the measure is directed] [before the party against whom the measure is directed has had an opportunity to respond] only where:

(a) It is necessary to ensure that the measure is effective;

(b) The applicant for the measure provides appropriate security in connection with the measure;

(c) The applicant for the measure can demonstrate the urgent necessity of the measure; and

(d) [The measure would be supported by a preponderance of considerations of fairness.⁴²]

[6. The party to whom the measure under paragraph 5 is directed shall be given notice of the measure and an opportunity to be heard at the earliest practicable time.]

7. A measure granted under paragraph 5 may be extended or modified after the party to whom it is directed has been given notice and an opportunity to respond.

[8. An interim measure of protection may be modified or terminated [on the request of a party] if the circumstances referred to in paragraph 2 have changed after the issuance of the measure.]

[9. The party who requested the issuance of an interim measure of protection shall, from the time of the request onwards, inform the court promptly of any substantial change of circumstances referred to in paragraph 2.]

B. Interim measures by a court order

75. As noted above, there is some uncertainty as to the power of courts to issue interim measures in cases where there is a valid arbitration agreement. While article 9 of the UNCITRAL Model Law provides that is not incompatible with an arbitration agreement for a party to request interim measures of protection and for a court to grant it, the Model Law does not positively resolve the question of whether the court has the power to issue interim measures. In some jurisdictions, therefore, adoption of article 9 may not be

sufficient to establish that the court has express power to issue interim measures in support of arbitration.

76. The Working Group may wish to consider whether a provision clarifying the issue of the court's power should be formulated. If such a provision were to be considered, the Working Group may also wish to consider three related questions, which the Working Group discussed at its thirty-fourth session (New York, 21 May-1 June 2001) (see A/CN.9/487, paras. 64-68), in the context of arbitral tribunal ordered interim measures as follows:

(a) The scope of the power and whether it should be limited in any way, such as by reference to the "subject matter of the dispute" or some other formulation (as included in article 17 of the UNCITRAL Model Law) and whether such measures may be ordered *ex parte*;

(b) Preconditions for the issuance of interim measures and whether they should be included in the provision, such as requirements that appropriate security be provided by a party (see article 17 of the UNCITRAL Model Law), that it be demonstrated that the measure is required urgently, or that it be demonstrated that a significant degree of harm will result if the measure is not ordered (common examples of these conditions are set forth in para. 42 above);

(c) The types of measures that the court may order in support of arbitration and whether they should be specifically enumerated in the provision in order to provide assistance to courts and achieve a degree of consistency and clarity or whether they should be included by reference to broader categories of measures. These references could be included in the provision as purely illustrative (and not exhaustive) of the types of measures the court may issue or they could be discussed in an explanatory guide to the provisions.

77. In view of the Working Group's discussion in respect of interim measures of protection ordered by an arbitral tribunal and the degree of similarity of the issues discussed in respect of court-ordered measures, the Working Group may wish to consider whether provisions along the lines of those presented above in respect of measures ordered by an arbitral tribunal may be appropriate for application to court-ordered measures, with appropriate reference to the court and taking into account the changes suggested below.

78. In article 17, paragraph 1, of the draft provision, the references to agreement by the parties could be deleted as it would be inappropriate to an application for court-ordered interim measures. The provision would be intended to apply to requests for the issue of interim measures in support of both domestic and foreign arbitral proceedings.

79. Provisions relating to the types of measures and the conditions for their issuance already exist in national laws (at least in respect of parties to litigation). In line with the discussion referred to above in respect of interim measures ordered by an arbitral tribunal, the Working Group may wish to consider whether to establish a set of harmonized provisions on the types of measures and the conditions that will be applicable to their issuance by courts in support of arbitral proceedings or whether, alternatively, to apply the existing provisions with respect to litigation to interim

⁴¹Article 23A, alternative A, Hague Conference on Private International Law: draft convention on jurisdiction and foreign judgements in civil and commercial matters, interim text, June 2001.

⁴²American Law Institute/International Institute for the Unification of Private Law rules of transnational civil procedure, April 2001, rule 17.1.1.

measures in support of arbitration. A harmonized provision establishing the types of measures that can be issued might refer to general categories of measures along the lines as presented above in article 17, paragraph 4, of the draft provision. An alternative approach reflecting the provisions existing with respect to litigation might be:

4. The court shall have the same power of issuing interim measures of protection for the purposes of and in relation to arbitration proceedings as it has for the purposes of and in relation to proceedings in the court.⁴³

80. At its last session, the Working Group discussed the possibility of an arbitral tribunal ordering interim measures on an ex parte basis, noting with some concern the different positions with respect to enforcement between ex parte measures ordered by a court and by an arbitral tribunal (see A/CN.9/487, para. 70). As noted in paragraph 35 above, many jurisdictions allow courts to issue interim measures in support of arbitration on an ex parte basis under certain conditions. These include provision of security for damages and demonstration of the requisite urgency.

81. The Working Group may wish to consider whether the question of the court's power to issue interim measures on an ex parte basis should be addressed in uniform provisions and if so, whether the conditions discussed in respect of their issuance by arbitral tribunals should serve as a model. If a provision along the lines of that discussed in paragraph 79 above were to be adopted, the question of the ex parte issuance of interim measures would follow the position with respect to litigation. To promote the adoption of a more uniform position, the Working Group may wish to consider a provision along the lines of that presented above as article 17, paragraphs 5 and 6, of the draft provision.

C. Relationship between courts and arbitral tribunals

82. As discussed above, a number of different approaches are evident in respect of the power to issue interim measures and how this is divided between the court and the arbitral tribunal. To ensure effective availability of interim measures to parties that have agreed to arbitrate, it is desirable that they have access to both the arbitral tribunal and to the court. As noted in paragraph 75 above, that goal is only partially achieved by article 9 of the Model Law that an application to the courts for interim measures is neither inconsistent with, nor constitutes a waiver of, an agreement to arbitrate. The Working Group may wish to consider whether this issue requires further consideration.

D. Enforcement of interim measures

83. At its thirty-fourth session, in 2001, the Working Group discussed the question of enforcement of interim measures of protection issued by an arbitral tribunal under article 17 on the basis of draft provisions prepared by the Secretariat. (see A/CN.9/487, paras. 76-87), although for lack of time the Working Group did not complete its consideration of the enforcement provision. The revised

draft provisions presented below have been prepared on the basis of those parts of the provision considered in the Working Group.

Enforcement of interim measures of protection

1. Upon an application by an interested party, made with the approval of the arbitral tribunal, the competent court shall refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if:¹

(a) The party against whom the measure is invoked furnishes proof that:

- (i) [*Variant 1*] The arbitration agreement referred to in article 7 is not valid; [*Variant 2*] The arbitration agreement referred to in article 7 appears not to be valid, in which case the court may refer the issue of the [jurisdiction of the arbitral tribunal] [validity of the arbitration agreement] to be decided by the arbitral tribunal in accordance with article 16 of this Law];
- (ii) The party against whom the interim measure is invoked was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or
- (iii) The party against whom the interim measure is invoked was unable to present its case with respect to the interim measure [in which case the court may suspend the enforcement proceedings until the parties have been heard by the arbitral tribunal]; or
- (iv) The interim measure has been terminated, suspended or amended by the arbitral tribunal.

(b) The court finds that:

- (i) The measure requested is incompatible with the powers conferred upon the court by its procedural laws, unless the court decides to reformulate the measure to the extent necessary to adapt it to its own powers and procedures for the purpose of enforcing the measure; or
- (ii) The recognition or enforcement of the interim measure would be contrary to the public policy of this State.

2. Upon application by an interested party, made with the approval of the arbitral tribunal, the competent court may, in its discretion, refuse to recognize and enforce an interim measure of protection referred to in article 17, irrespective of the country in which it was ordered, if the party against whom the measure is invoked furnishes proof that application for the same or similar interim measure has been made to a court in this State, regardless of whether the court has taken a decision on the application.

⁴³See section 47, Commercial Arbitration Act, Queensland, Australia.

3. The party who is seeking enforcement of an interim measure shall promptly inform the court of any termination, suspension or amendment of that measure.

4. In reformulating the measure under paragraph 1(b)(i), the court shall not modify the substance of the interim measure.

5. Paragraph 1(a)(iii) does not apply [*Variant 1*] to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that the measure was ordered to be effective for a period not exceeding [30] days and the enforcement of the measure is requested before the expiry of that period. [*Variant 2*] to an interim measure of protection that was ordered without notice to the party against whom the measure is invoked provided that such interim measure is confirmed by the arbitral tribunal after the other party has been able to present its case with respect to the interim measure. [*Variant 3*] if the arbitral tribunal, in its discretion, determines that, in light of the circumstances referred to in article 17, paragraph 2, the interim measure of protection can be effective only if the enforcement order is issued by the court without notice to the party against whom the measure is invoked.

¹The conditions set forth in this article are intended to limit the number of circumstances in which the court must refuse to enforce interim measures. It would not be contrary to the level of harmonization sought to be achieved by these model provisions if a State were to adopt fewer circumstances in which enforcement must be refused.

84. The Working Group may also wish to consider the question of enforcement of interim measures issued by a court in support of arbitration, particularly as the issue arises solely in respect of enforcement of measures issued by a court in a foreign jurisdiction. There is currently no multilateral international regime dealing with the enforcement of court orders, although the Hague Conference on Private International Law, as discussed above, is currently working on a convention that may extend to provisional measures. In the absence of such a regime (and given the difficulty of achieving agreement on a multilateral regime that would extend to provisional measures), the Working Group may wish to consider alternative approaches. These may include, for example, a regime of coordination and cooperation between courts, inspired by article 26 of the UNCITRAL Model Law on Cross-Border Insolvency and by International Law Association Principles 18-20. As noted in paragraph 66 above, in the absence of an obligation to recognize orders made in other States or to cooperate with courts and arbitral tribunals in other jurisdictions, encouraging cooperation in the making of local complementary orders may lead to tangible results, both in recognition and judicial assistance. This may be applicable particularly in cases where the enforcement of an interim measure is sought in a number of jurisdictions, such as the freezing of assets. It could cover the sharing of information between courts, coordinating among jurisdictions the effect given to foreign interim measures and coordinating and cooperating on the issue of appropriate local remedies.

G. Compilation of comments by Governments and international organizations on the draft model law on international commercial conciliation (A/CN.9/513 and Add.1 and 2)
[Original: English/French/Russian/Spanish]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a note by the Secretariat entitled "Possible future work in the area of international

commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL

Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.¹

2. The Commission entrusted the work to one of its working groups, which it renamed the Working Group on Arbitration and decided that the priority items for the Working Group should be conciliation,² requirement of written form for the arbitration agreement,³ enforceability of interim measures of protection⁴ and possible enforceability of an award that had been set aside in the State of origin.⁵

3. At its thirty-third session, in 2000, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/468). The Commission took note of the report with satisfaction and reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with the topics identified for future work. Several statements were made to the effect that, in general, the Working Group, in deciding the priorities of the future items on its agenda, should pay particular attention to what was feasible and practical and to issues where court decisions had left the legal situation uncertain or unsatisfactory. Topics that were mentioned in the Commission as being potentially worthy of consideration, in addition to those which the Working Group might identify as such, were the meaning and effect of the more-favourable-right provision of article VII of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") (A/CN.9/468, para. 109 (k)); raising claims in arbitral proceedings for the purpose of set-off and the jurisdiction of the arbitral tribunal with respect to such claims (para. 107 (g)); freedom of parties to be represented in arbitral proceedings by persons of their choice (para. 108 (c)); residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V of the New York Convention (para. 109 (i)); and the power of the arbitral tribunal to award interest (para. 107 (j)). It was noted with approval that, with respect to "online" arbitrations (that is, arbitrations in which significant parts or even all of the arbitral proceedings are conducted using electronic means of communication) (para. 113), the Working Group on Arbitration would cooperate with the Working Group on Electronic Commerce. With respect to the possible enforceability of awards that had been set aside in the State of origin (para. 107 (m)), the view was expressed that the issue was not expected to raise many problems and that the case law that gave rise to the issue should not be regarded as a trend.⁶

4. At its thirty-fourth session, in 2001, the Commission took note with appreciation of the reports of the Working Group on the work of its thirty-third and thirty-fourth sessions (A/CN.9/485 and Corr.1 and A/CN.9/487, respectively). The Commission commended the Working Group for the progress accomplished thus far regarding the three main issues under discussion, namely, the requirement of written form for the arbitration agreement, the issues related to interim measures of protection and the preparation of a model law on conciliation.

5. With regard to conciliation, the Commission noted that the Working Group had considered articles 1-16 of the draft model legislative provisions (A/CN.9/WG.II/WP.113/Add.1 and Corr.1). It was generally felt that work on the provisions could be expected to be completed by the Working Group at its subsequent session. The Commission requested the Working Group to proceed with the examination of the provisions on a priority basis, with a view to the instrument being presented in the form of a draft model law for review and adoption by the Commission at its thirty-fifth session, in 2002.⁷

6. At its thirty-fifth session, held in Vienna in November 2001, the Working Group discussed draft model legislative provisions on conciliation on the basis of the documents prepared by the Secretariat (A/CN.9/WG.II/WP.115 and A/CN.9/WG.II/WP.116). The deliberations and conclusions of the Working Group with respect to that item are reflected in document A/CN.9/506. Having completed its consideration of the substance of the provisions of the draft model legislative provisions on international commercial conciliation, the Working Group requested the Secretariat to establish a drafting group to review the entire text with a view to ensuring consistency between the various draft articles in the various language versions. The final version of the draft provisions as approved by the Working Group is contained in the annex to document A/CN.9/506, in the form of a draft model law on international commercial conciliation. The Secretariat was requested to revise the text of the draft guide to enactment and use of the Model Law, based on the deliberations in the Working Group. It was noted that the draft Model Law, together with the draft guide to enactment and use, would be circulated to member States and observers for comment and presented to the Commission for review and adoption at its thirty-fifth session, to be held in New York from 17 to 28 June 2002 (A/CN.9/506, para. 13).

8. In preparation for the thirty-fifth session of the Commission, the text of the draft model law as approved by the Working Group was circulated to all Governments and to interested international organizations for comment. The comments received as at 12 April 2002 from five Governments and one non-governmental organization are reproduced below.

¹Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17), para. 337.

²Ibid., paras. 340-343.

³Ibid., paras. 344-350.

⁴Ibid., paras. 371-373.

⁵Ibid., paras. 374 and 375.

⁶Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 396.

⁷Ibid., Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), para. 315.

II. COMPILATION OF COMMENTS

A. States

*Belarus**[Original: Russian]*

1. In article 1, paragraph 4 (*b*), after the words “If a party does not have a place of business, reference is to be made to the party’s habitual residence” add “(location)”. Paragraph 4 (*b*) would then read as follows:

“(b) If a party does not have a place of business, reference is to be made to the party’s habitual residence (location).”

2. Add the following article to the draft UNCITRAL Model Law on International Commercial Conciliation:

“Conciliation shall be deemed to have been attained if the claimant has reached an agreement with the

respondent (renounced the claim), the respondent has reached an agreement with the claimant (acknowledged the claim) or if the parties have reached an agreement as a result of mutual concessions. Mutual concessions with respect to the object of the dispute shall be possible if they do not contradict the imperative norms of the law and the nature of the contentious legal relationship. Mutual concessions shall also be permitted with respect to the division of the costs of the case and the time limits and procedure for the performance by the parties of the obligations that they have assumed.”

*Ecuador**[Original: Spanish]*

1. Article X, “Suspension of limitation period”, which appears in the annex to document A/CN.9/506 as footnote 3 to article 4 of the draft Model Law and is foreseen as being optional, should be in the main part of the Model Law. Without a provision having that content, in general, for those who do not wish to adopt the aforementioned optional provision there would result an interruption of the limitation period, which, at the end of an unsuccessful attempt at conciliation, would have to start running again from day one, which would not happen if suspension was specified.

2. In article 8 it would be better to delete the words “or a member of the panel”, since they open up the possibility of one of the conciliators (where there are more than one) meeting or communicating on his/her own with the parties together or with each of them separately. Such authorization through the Model Law would not contribute to the transparency necessary as evidence of the impartiality of the conciliator, even though he/she has been designated by one of the parties. Consequently, Ecuador considers that the original version of [old] article 9, the one examined by the Working Group during its thirty-fifth session, should be retained.

*France**[Original: French]**Article 1. Scope of application and definitions**Paragraph 3*

1. France agrees with the criterion adopted for the scope of application of the Model Law: by referring to intrinsic internationality, independent of any spatial criterion, it has the great merit of simplicity.

Paragraph 8

2. It is the understanding of France that the draft law, at the disposal of the parties wishing to conciliate, does not apply to conciliation at the initiative of a court. It would not, therefore, necessarily be redundant to specify such an exclusion explicitly.

Article 3. Variation by agreement

3. This article, which specifies which of the Model Law’s provisions—of a residual nature—may not be excluded, should also cite article 15 “Enforceability of settlement agreement”. The adopted text should therefore include this additional reference.

Article 4. Commencement of conciliation proceedings

4. Including article X as an optional article has the merit of highlighting the problematic nature of the question of the limitation period.

*Article 14. Resort to arbitral or
judicial proceedings*

Paragraph 1

5. In the interests of giving effect to a conciliation settlement when there is an express conciliation clause, France proposes that the paragraph read as follows:

“Where the parties have agreed to conciliate, such an undertaking shall be given effect by the arbitral tribunal or the court until *evidence is furnished that the procedure was undertaken unsuccessfully.*”

Article 15. Enforceability of settlement agreement

6. As things stand, we support this provision. Indeed, France would be opposed to having an arbitral proceeding grafted onto the settlement agreement. Converting a conciliation settlement into an arbitral award is not at all acceptable since it would amount to attaching the same status to an act between two private persons as to a court

decision. There are two possibilities: either the conciliation settlement is turned into a “real” arbitral award, but here one would have to qualify the enforceability of an award as being “in due form”, with the proceedings becoming far more cumbersome as a result and more expensive for the parties (thus running counter, of course, to the whole spirit of conciliation); or else there could be a kind of quasi-automatic equating of the conciliation settlement to an arbitral award, which would entail some degree of exposure to abuse since the contract (conciliation settlement) would not be subject to scrutiny by a court of the country in which the settlement is invoked except in a limited range of cases (cf. for France, article 1502 NCPC (New Code of Civil Procedure)).

7. In order to meet this concern, France proposes the following wording:

“The authority of *res judicata* and/or the enforceability of such agreement shall, as appropriate, be recognized or granted by the law or the competent authority of the country in which the agreement is invoked.”

Hungary

[Original: English]

Article 1

Paragraph 6

1. The parties are free to agree to exclude the applicability of the Model Law. In the view of the Hungarian party there is a need for a legally binding minimum law with respect to conciliation proceedings that is able to ensure the equality of the parties. A permissive legislation would attenuate this precondition. If paragraph 6 remains unchanged, an agreement has to be reached in order to ensure that the parties are permitted to exclude the applicability of the whole Law or only a certain part (some provisions) of it. The latter solution is preferable.

Article 14

Paragraph 1

2. Taking into consideration the current Hungarian law on judicial procedure it is difficult to fulfil the provisions of this paragraph. Those provisions can be performed only by voluntary acceptance of the parties.

Article 15

3. According to Hungarian Act LIII of 1994 the provisions of article 15 of the Model Law cannot be applied in Hungary. Chapter II, section 10 of that Act lays down the rule that judicial execution shall be ordered by the issuance of an executable document. Executable

documents are (i) certificate of execution issued by a court, (ii) document with a writ of implementation issued by a court, (iii) a judicial order or restraint of execution, or order of transfer, furthermore, a decree of direct court notice. The Act narrows down the number of enforceable documents. A direct enforcement of the settlement agreement cannot be favoured, because it could have effects similar to the ones when declaring the direct enforcement of a contract.

4. A solution could be found through the conciliation-mediation proceedings which would be carried out under the auspices of a permanent court of arbitration. The rules of procedure of the Hungarian Arbitration Court (attached to the Hungarian Chamber of Commerce and Industry) contain the following provisions: “At the joint request of the parties the President of the Arbitration Court shall appoint the conciliator-mediator as sole arbitrator. The sole arbitrator shall render an award containing the agreement reached and signed by the parties.” (52§(2) Rules of Proceedings of the Court of Arbitration attached to the Hungarian Chamber of Commerce and Industry, effective as of 1 September 2001).

5. Furthermore, it is to be pointed out that the conversion of a settlement agreement into an arbitration award could also be reached outside of the framework of a permanent arbitration proceedings. After having reached an agreement in the course of the conciliation proceedings the parties could at the same time establish an ad hoc arbitration and appoint the conciliator as a sole arbitrator. In that case the parties are able to transform their settlement agreement into an arbitral award which can be enforced without any difficulties.

Turkey

[Original: English]

1. In article 5 of the draft, "Number of conciliators", no articles are included relating to "joint action" of the mediation committee at the construction stage of an agreement between the parties in order to ensure harmony during the mediation process, and it is considered that this will create a loophole with regard to the field of application of the law.
2. It is suggested that the obligation to keep the information relating to the mediation process confidential included in article 10, be broadened so as to ensure that such confidentiality covers the protection of images and names and also that trade secrets or other information are kept between the parties, in a way to include the negotiation agreement as well.
3. With regard to paragraph 3 of article 11, which covers the disclosure of information and documents submitted during the mediation process, it is suggested that a phrase be inserted to this paragraph stating that the information and documents submitted in the mediation process may also be disclosed upon "approval of the parties" as well as

by the order of law and in line with the application or execution of the negotiation agreement.

4. In order to prevent the use of information and documents received from the parties by the mediator when fulfilling his/her duty, article 13 of the draft stipulates that a mediator cannot act as an arbitrator in the arbitration process following the mediation process. It is suggested that the tribunal process following the mediation process also be added to this phrase along with a statement indicating that the negotiator, who is banned from disclosing the information he/she acquired as per article 11, cannot act as arbitrator or be a referee, representative or attorney to any of the parties.

5. It is suggested that an article on mediation expenses be added to the draft.

6. The draft does not include any arrangements as regards the course of the mediation process or re-election procedures in case of decease or resignation of the mediator.

B. Intergovernmental organizations

Permanent Court of Arbitration

[Original: English]

1. This comment deals under A. with art. 4 of the final draft of the Working Group on Arbitration (A/CN.9/506). In addition, under B. some comments are made on art. 1 in relation to the comments made on art. 4 under A.

1. Article 4

2. This article reads (emphasis added):

Article 4. Commencement of conciliation proceedings

"1. Unless otherwise agreed by the parties, the *conciliation proceedings* in respect of a particular dispute that has arisen *commence* on the day on which the parties to the dispute agree to engage in conciliation proceedings.

"2. *If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.*"

3. It is submitted that article 4, paragraph 2, should not apply when, as normally is the case, conciliation

proceedings commence on the basis of a prior agreement of the parties to conciliate (such as a conciliation clause in a commercial contract). The requirement of accepting the invitation to conciliate should only apply when parties have not already agreed to enter into conciliation proceedings in order to settle their dispute. In this case, the agreement of the other party is indeed required. Unlike conciliation on the basis of a prior agreement to conciliate, this rarely occurs. Inviting a party to conciliate when a dispute has arisen may be regarded by the other party as a sign of weakness.

4. This obstacle does not exist when parties have concluded a prior agreement to conciliate. If the parties previously agreed to resort to conciliation, no subsequent agreement to conciliate should be needed when a dispute arises. Allowing for the possibility to reject engaging in conciliation proceedings would deprive the original agreement of any meaning. The original agreement should oblige the parties to appoint a conciliator or panel of conciliators and to have at least one meeting with the conciliator or panel of conciliators.

5. Modern conciliation rules provide for such consequences of an agreement to conciliate. For example, the Mediation Rules of the World Intellectual Property Organization state in article 18:

“The mediation shall be terminated:

“... ”

- “(iii) by a written declaration of a party at any time after attending the first meeting of the parties with the mediator ...”

Similarly the Mediation Procedure rules of the Center for Public Resources Institute for Dispute Resolution in New York state in article 3 (b) that a party may withdraw only “after attending the first session”.

Also the Guide to the International Chamber of Commerce Alternative Dispute Resolution Rules, which accompanies the new Rules (2001), states on page 20 with respect to article 2.A:

“Where there is an agreement to refer to the Rules”:

“... parties may not withdraw from the proceedings prior to a first discussion with the Neutral”.

6. Not only article 4 but also article 12 and article 6 of the final draft of the Working Group will need modification if the examples mentioned in paragraph 5 above are followed.

Article 12

7. Article 12 deals with “Termination of conciliation”. According to this article “The conciliation proceedings are terminated” on the grounds enumerated under (a)-(d). Ground (d) deals with withdrawal from the conciliation proceedings by one party “by a written declaration of a party”.

8. The one-sided withdrawal should be maintained, but should be limited to “a written declaration by one party to the other party and the conciliator or the panel of conciliators *after the first meeting* with them”.

Article 6

9. Article 6 deals with the “Appointment of conciliators”. This article does not guarantee that a conciliator will be appointed in all circumstances. Paragraph 4 of the article only provides for assistance by an “appropriate institution or person” when parties are looking for a suitable person to be appointed by them. However, this institute or person should also act as appointing authority when parties fail to agree on the appointment of the conciliator.

10. In order to cover the failure of the parties to appoint a conciliator, article 6 should introduce the same fallback provision as in the UNCITRAL Arbitration Rules: appointment by an institute or person acting as appointing authority. The appointing authority may be agreed upon by the parties or, if not agreed by the parties, shall be designated by the Secretary-General of the Permanent Court of Arbitration.

2. Comments on Article 1 in relation to the comments made in part one above.

Article 1

Paragraph 8

1. Article 1, “Scope of application and definitions” *excludes in paragraph 8* the application of the Model Law “when a judge or an arbitrator ... attempts to facilitate a settlement”.

2. This provision acknowledges that an arbitrator may act as conciliator in order to facilitate attempts to reach a settlement. However, an arbitrator has been appointed to *decide* the dispute. Acting as conciliator will put the arbitrator in a delicate position if his attempt to reach a settlement fails. For example, what about the confidentiality of information received from the parties during these attempts? What about the confidentiality of acknowledgments made by parties in the course of the conciliation if the arbitral proceedings continue because no settlement has been reached? There is also the risk that the arbitrator might be challenged if, during the conciliation intermezzo, the arbitrator, in the view of one of the parties, may not have acted impartially. It is therefore submitted to delete “or an arbitrator” in paragraph 8 of article 1.

3. The Model Law excludes a conciliator from acting as arbitrator unless otherwise agreed by the parties (article 13). A similar exclusion should be made for an arbitrator acting temporarily as conciliator. It is therefore submitted to exclude in an additional article the arbitrator from acting as conciliator, unless otherwise agreed by the parties.

4. In arbitration practice it does indeed occur that parties request the arbitrators, who are already well-informed about the case, to assist them in attempts to conciliate. Arbitrators should refrain from accepting such an invitation. Instead, the arbitrators could suspend the arbitral proceedings for a short period and recommend to the parties to resort to conciliation under well-drafted conciliation rules with the assistance of a third party, well trained in conciliation.

5. In view of the authority of an arbitral tribunal, the parties may be well inclined to accept this recommendation. If the attempt to reach a settlement were to be successful, the arbitral tribunal could, on request of the parties, incorporate the settlement in an award on agreed terms. See further [the author’s] *Quo Vadis Arbitration?* (1999), 372-374.

Article 1

Paragraph 7

6. Paragraph 7 of article 1 makes the Model Law applicable in several cases “subject to the provisions of paragraph 8” of the article. The Model Law applies first of all to a conciliation agreement between the parties “whether reached before or after a dispute has arisen”. The conciliation agreement has been discussed in part one above.

According to paragraph 7, the Model Law applies as well in part one *in case an obligation to conciliate is "established by law"*.

7. This makes the Model Law, when transformed into national law, applicable to an obligation to conciliate, established in another national law. The current version of the draft, requiring a subsequent agreement of the parties to engage in conciliation proceedings when a dispute has arisen, should not apply in case the law obliges to conciliate.

8. *The Model Law also applies in case a "direction or suggestion of a court, arbitral tribunal or competent governmental entity" has been made.*

The court

9. When conciliation has been directed by a court, this should not be frustrated by a party rejecting to engage in conciliation proceedings.

The arbitral tribunal

10. The same applies when the arbitral tribunal may have directed or suggested that the parties should enter into settlement negotiations.

A competent governmental entity

11. Also in this case a direction by this entity should not be frustrated by a party rejecting to engage in conciliation proceedings.

12. In all these cases, conciliation will take place without a previous agreement of the parties to conciliate. Moreover, in all these cases a conciliator or conciliators should be appointed and a first meeting with the conciliator or conciliators has to take place before a party can withdraw from the conciliation proceedings.

13. Under the Model Law the same conciliation regime should apply to the situation described under part one as well as part two.

Conclusion

14. The draft model law on international commercial conciliation, as submitted to the Commission for approval, should be modified along the lines as suggested under part one. When this is done, the same regime will apply to conciliation under a previous agreement to conciliate and to conciliation taking place in the cases mentioned under part two.

A/CN.9/513/Add.1

Compilation of comments by Governments and international organizations on the model law on international commercial conciliation

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I. INTRODUCTION

1. In preparation for the thirty-fifth session of the United Nations Commission on International Trade Law (UNCITRAL), the text of the UNCITRAL draft model law on international commercial conciliation was circulated to

all Governments and to interested international organizations for comment. The text of the draft model law was approved by the Working Group on Arbitration at its thirty-fifth session and annexed to the report of that session (A/CN.9/506). Additional comments received as at 30 April 2002 from one Government are reproduced below.

II. COMPILATION OF COMMENTS

A. States

*Philippines**[Original: English]**Article 1. Scope of application and definitions*

“1. This Law applies to international *commercial* conciliation.”

1. The definition of the term “commercial” should be included in the body of the draft UNCITRAL model law on international commercial conciliation (the “draft law”). The inclusion of such definition is necessary to determine the scope and application of the proposed draft law and at the same time determine whether the transaction is definitely commercial or not.

“2. For the purposes of this Law, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator or the panel of conciliators does not have the authority to impose upon the parties a solution to the dispute.”

2. Although it is agreeable that the conciliator or the panel of conciliators is not given the authority to impose upon the parties a solution to the dispute, it is however desirable that the conciliator or panel of conciliators be given at least the expressed authority to make non-binding proposals for possible solution in the settlement of the dispute, subject to the agreement of the parties. This will expedite the settlement of dispute.

“3. A conciliation is international if:

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

“(b) The State in which the parties have their places of business is different from either;

“(i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or

“(ii) The State with which the subject matter of the dispute is most closely connected.”

3. The terms “substantial part of the obligations” and “most closely connected” should be elaborated and explained further. It may happen that, in a single contract, a series of transactions are required to be performed, each act constituting an integral part of the contract or substantial part of the performance of the obligation.

“8. This Law does not apply to

“(a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and

“(b) [. . .]”

4. It is suggested that clarification should be made whether the provision applies to cases where the conciliation proceeding has already been commenced and thereafter a party to the dispute filed a case in court to preserve his or her right. It is uncertain furthermore whether the court can totally disregard the findings in the conciliation proceedings and make a determination on its own with regard to the facts necessary for the settlement of the dispute.

Article 6. Appointment of conciliators

“6. When a person is approached in connection with his or her possible appointment as a conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.”

5. The last sentence of the above provision could lead to abuse and should be amended to make it still necessary for the conciliator appointed to personally inform the parties on the circumstances that might affect his or her impartiality or independence as a conciliator to the dispute, when such facts or circumstances are already known to the parties. In addition, article 6 should provide provisions regarding the qualifications, replacement and incapacity of the conciliator.

Article 8. Communication between conciliator and parties

“Unless otherwise agreed by parties, the conciliator, the panel of conciliators or a member of the panel may meet or communicate with the parties together or with each of them separately.”

6. It must be noted that under the UNCITRAL Conciliation Rules, article 9, paragraph 2, states that:

“Unless the parties have agreed upon the place where the meetings with the conciliator are to be held, such place will be determined by the conciliator, after consultation with the parties, having regard to the circumstances of the conciliation proceedings.”

Article 11. Admissibility of evidence in other proceedings

“1. Unless otherwise agreed by the parties, a party that participated in the conciliation proceedings or a third

person, including a conciliator, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding, any of the following:

“(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;

“(b) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;

“(c) Statements or admissions made by a party in the course of the conciliation proceedings;

“(d) Proposals made by the conciliator;

“(e) The fact that a party to the conciliation had indicated its willingness to accept a proposal for the settlement made by the conciliator;

“(f) A document prepared solely for purposes of the conciliation proceedings.”

7. It is suggested that the draft law should state that the executed and signed conciliation agreement be presented as part of proof regarding the conciliation proceeding itself. The conciliation agreement, it must be noted, constitutes a binding contract between the parties to the settled dispute.

Article 15. Enforceability of settlement agreement

“If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and enforceable. . . [the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement].”

8. It is suggested that the term “final” be inserted before the word “binding” to give emphasis to the effect of the settlement agreement. The insertion of the word “final” in the provision will serve as a caveat that the settlement agreement cannot be disregarded or changed arbitrarily.

A/CN.9/513/Add.2

Compilation of comments by Governments and international organizations on the draft model law on international commercial conciliation

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I. INTRODUCTION

1. In preparation for the thirty-fifth session of the United Nations Commission on International Trade Law (UNCITRAL), the text of the UNCITRAL draft model law on international commercial conciliation was circulated to all Governments and to interested international organizations for comment. The text of the draft model law was approved by the Working Group on Arbitration at its thirty-fifth session and annexed to the report of that session (A/CN.9/506). Additional comments received after the deadline of 15 March 2002 from one Government are reproduced below.

II. COMPILATION OF COMMENTS

A. States

*Morocco**[Original: French]*

1. The draft constitutes a legal platform for helping countries to introduce amendments as they adapt to current developments.
2. It should be noted in this regard that the provisions in the draft give States that wish to incorporate this law into their domestic law the possibility of adapting and amending it in accordance with their own particular situation.
3. The following questions arise in connection with specific points:
 - (a) In order to determine clearly the enforceability of conciliation proceedings, the question arises whether conciliation is mandatory or optional;
 - (b) May the internal justice system adopt documents, statements and reports submitted during conciliation proceedings?
4. The title of article 1 should be amended to read: “Definitions and scope of application”.
5. The definitions of the three words “international”, “commercial” and “conciliation” should be incorporated into article 1.
6. The issue of the enforceability of the agreement concluded between the parties during the conciliation proceedings raises the question of procedures for enforcement.
7. The competent Moroccan authorities consider the draft a useful contribution to efforts to establish an appropriate legislative framework for the settlement of commercial disputes, that is, a framework able to accommodate simple, quick, extrajudicial proceedings which are better suited to the nature of such disputes.

H. Draft guide to enactment and use of the UNCITRAL Model Law on International Commercial Conciliation

(A/CN.9/514) [Original: English]

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I. PURPOSE OF THE GUIDE

1. In preparing and adopting model legislative provisions on international commercial conciliation, the United Nations Commission on International Trade Law (UNCITRAL) was mindful that such provisions would be a more effective tool for States modernizing their legislation if accompanied by background and explanatory information. The Commission was also aware of the likelihood that the model provisions would be used in a number of States with limited familiarity with conciliation as a method of dispute settlement. Primarily directed to executive branches of Governments and legislators preparing the necessary legislative revisions, the information provided in the present Guide should also provide useful insight to other users of the text, including commercial parties, practitioners, academics and judges.

2. Much of this Guide is drawn from the *travaux préparatoires* of the Model Law. The Guide explains why the provisions in the Model Law have been included as essential basic features of a statutory device designed to achieve the objectives of the Model Law. When it drafted the model provisions, the Commission assumed that explanatory material would accompany the text of the Model Law. For example, some issues are not settled in the Model Law but are addressed in the Guide, which is designed to provide an additional source of inspiration to States enacting the Model Law. It might also assist States in considering which provisions of the Model Law, if any, might have to be varied to accommodate particular national circumstances.

3. This Guide to Enactment has been prepared by the Secretariat pursuant to a request made by UNCITRAL. It reflects the Commission's deliberations and decisions at the session where the Model Law was adopted and the considerations of UNCITRAL's Working Group on Arbitration, which conducted the preparatory work.

4. [The Guide was adopted by the Commission on [insert date].] [The Guide was approved by the Commission on [insert date] for publication under the responsibility of the Secretariat.]

II. INTRODUCTION TO THE MODEL LAW

A. Notion of conciliation and purpose of the Model Law

5. The term "conciliation" is used in the Model Law as a broad notion referring to proceedings in which a person or a panel of persons assists the parties in their attempt to reach an amicable settlement of their dispute. There are critical differences among the dispute resolution processes of negotiation, conciliation and arbitration. Once a dispute arises, the parties typically seek to resolve their dispute by negotiating without involving anyone outside the dispute. If the negotiations fail to resolve the dispute, a range of dispute settlement mechanisms is available, including arbitration and conciliation.

6. In arbitration, the parties entrust the dispute resolution process and the outcome of the dispute to the arbitral tribunal, which imposes a binding decision on the parties. Conciliation differs from party negotiations in that conciliation involves third-person assistance in an independent and impartial manner to settle the dispute. It differs from arbitration because in conciliation the parties retain full control over the process and the outcome and the process is non-adjudicatory. In conciliation, the conciliator assists the parties in negotiating a settlement that is designed to meet the needs and interests of the parties in dispute (see A/CN.9/WG.II/WP.108, para. 11). The conciliation process is an entirely consensual one in which parties that are in dispute determine how to resolve the dispute, with the assistance of a neutral third party. The neutral third party has no authority to impose a solution on the parties to the dispute.

7. In practice, proceedings in which the parties are assisted by a third person to settle a dispute are referred to by expressions such as conciliation, mediation or similar terms. The notion of "alternative dispute resolution" is also used to refer collectively to various techniques and adaptations of procedures for solving disputes by conciliatory methods rather than by an adjudicating method such as arbitration. The Model Law uses the term "conciliation" to encompass all such procedures. To the extent that such "alternative dispute resolution" procedures are characterized by features mentioned above, they are covered by the Model Law (see A/CN.9/WG.II/WP.108, para. 14).

8. Conciliation is being increasingly used in dispute settlement practice in various parts of the world, including regions where until a decade or two ago it was not commonly used. As well, the use of conciliation is becoming a dispute-resolution option preferred and promoted by courts and government agencies as well as in community and commercial spheres. This trend is reflected, for example, in the establishment of a number of private and public bodies offering services to interested parties designed to foster the amicable settlement of disputes. Alongside this trend, various regions of the world have actively promoted conciliation as a method of dispute settlement and the development of national legislation on conciliation in various countries has given rise to discussions calling for internationally harmonized legal solutions designed to facilitate conciliation (see A/CN.9/WG.II/WP.108, para. 15).

9. Conciliation proceedings are dealt with in a number of rules of arbitral institutions and institutions specializing in the administration of various forms of alternative methods of dispute resolution, as well as in the UNCITRAL Conciliation Rules, which the Commission adopted in 1980. The Conciliation Rules are widely used and have served as a model for rules of many institutions (see A/CN.9/WG.II/WP.108, para. 12). The prevailing view that has emerged is that, in addition to the existence of such Rules, it would be worthwhile to prepare uniform legislative rules to support the increased use of conciliation. It has been noted that, while certain issues, such as the admissibility of certain evidence in subsequent judicial or arbitral proceedings or the role of the conciliator in subsequent proceedings could typically be solved by reference to sets of rules such as the UNCITRAL Conciliation Rules, there were many cases

where no such rules were agreed upon. The conciliation process might thus benefit from the establishment of non-mandatory legislative provisions that would apply when the parties mutually desired to conciliate but had not agreed on a set of conciliation rules. Moreover, in countries where agreements as to the admissibility of certain kinds of evidence were of uncertain effect, uniform legislation might provide a useful clarification. In addition it has been pointed out with respect to certain issues, such as facilitating enforcement of settlement agreements resulting from conciliation, that the level of predictability and certainty required to foster conciliation could only be achieved through legislation.^a

10. Conciliation proceedings may differ in procedural details depending on what is considered the best method to foster a settlement between the parties. The provisions governing such proceedings, as contained in the Model Law, are designed to accommodate such differences and leave the parties and conciliators free to carry out the conciliatory process as they consider appropriate. Essentially, the provisions seek to strike a balance between protecting the integrity of the conciliation process, for example by ensuring that the parties' expectations regarding the confidentiality of the mediation process are met whilst also providing maximum flexibility by preserving party autonomy.

B. The Model Law as a tool for harmonizing legislation

11. A model law is a legislative text that is recommended to States for incorporation into their national law. Unlike an international convention, model legislation does not require the State enacting it to notify the United Nations or other States that may have also enacted it. States are strongly encouraged, however, to inform the UNCITRAL secretariat of any enactment of the new Model Law (or any other model law resulting from the work of UNCITRAL).

12. In incorporating the text of the model legislation into its legal system, a State may modify or leave out some of its provisions. In the case of a convention, the possibility of changes being made to the uniform text by the States parties (normally referred to as "reservations") is much more restricted; in particular, trade law conventions usually either totally prohibit reservations or allow only very few, specified ones. The flexibility inherent in model legislation is particularly desirable in those cases where it is likely that the State would wish to make various modifications to the uniform text before it would be ready to enact it as national law. Some modifications may be expected in particular when the uniform text is closely related to the national court and procedural system. This, however, also means that the degree of, and certainty about, harmonization achieved through model legislation is likely to be lower than in the case of a convention. Because of the flexibility inherent in a model law, the number of States enacting model legislation is likely to be higher than the number of States adhering to a convention. In order to achieve a

satisfactory degree of harmonization and certainty, States should consider making as few changes as possible in incorporating the Model Law into their legal systems, but, if changes are made, they should remain within the basic principles of the Model Law. A significant reason for adhering as much as possible to the uniform text is to make the national law as transparent and familiar as possible for foreign parties, advisers and conciliators who participate in conciliations in the enacting State.

C. Background and history

13. International trade and commerce have grown rapidly, with cross-border transactions being entered into by a growing number of entities, including small and medium-sized ones. With the increasing use of electronic commerce, where business is frequently conducted across national boundaries, the need for effective and efficient dispute resolution systems has become paramount. UNCITRAL has drafted the Model Law to assist States in designing dispute resolution processes that are intended to reduce costs of dispute settlement, foster maintaining a cooperative atmosphere between trading parties, prevent further disputes and inject certainty into international trade. By adopting the Model Law, and by educating parties engaged in international commerce about its purposes, the parties will be encouraged to seek non-adjudicative dispute settlement methods, which will increase stability in the marketplace.

14. The objectives of the Model Law, which include encouraging the use of conciliation and providing greater predictability and certainty in its use, are essential for fostering economy and efficiency in international trade.

15. The Model Law was developed in the context of recognition of the increasing use of conciliation as a method for settling commercial disputes. The Model Law was also designed to provide uniform rules in respect of the conciliation process. In many countries, the legal rules affecting conciliation are set out in various pieces of legislation and take differing approaches on issues such as confidentiality and evidentiary privilege and exceptions thereto. Uniformity on such topics helps provide greater integrity and certainty in the conciliation process. The benefits of uniformity are magnified in cases involving conciliation via the Internet where the applicable law may not be self evident.

16. At its thirty-second session, in 1999, the Commission had before it a note by the Secretariat entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460). Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission generally considered that the time had come to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices. The Commission entrusted the work to its Working Group on

^aSee *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, para. 342.

Arbitration, and decided that the priority items should include work on conciliation. The Model Law was drafted over three sessions of the Working Group, the thirty-third, thirty-fourth and thirty-fifth sessions (A/CN.9/485 and Corr.1, A/CN.9/487 and A/CN.9/506, respectively).

17. At its thirty-fifth session, the Working Group completed its examination of the provisions and considered the draft guide to enactment. The Secretariat was requested to revise the text of the draft guide to enactment and use of the Model Law, based on the deliberations in the Working Group. It was noted that the draft model law, together with the draft guide to enactment and use, would be circulated to member States and observers for comment, and presented to the Commission for review and adoption at its thirty-fifth session, to be held in New York from 17 to 28 June 2002 (see A/CN.9/506, para. 13).

[Note by the Secretariat: this section recording the history of the Model Law is to be completed after final consideration and adoption of the Model Law by the Commission.]

D. Scope

18. In preparing the Model Law and addressing the subject matter before it, the Commission had in mind a broad notion of conciliation, which could also be referred to as “mediation”, “alternative dispute resolution”, “neutral evaluation” and similar terms. The Commission’s intent is that the Model Law should apply to the broadest range of commercial disputes. The Commission agreed that the title of the Model Law should refer to international commercial conciliation. While a definition of “conciliation” is provided in article 1, the definitions of “commercial” and “international” are contained in a footnote to article 1 and in paragraph 3 of article 1, respectively. While the Model Law is restricted to international and commercial cases, the State enacting the Model Law may consider extending it to domestic commercial disputes and some non-commercial ones (see footnote 1 to article 1).

19. The Model Law should be regarded as a balanced and discrete set of provisions and could be enacted as a single statute or as part of a law on dispute settlement.

E. Structure of the Model Law

20. The Model Law contains definitions, procedures and guidelines on related issues based upon the importance of party control over the process and outcome.

21. Article 1 delineates the scope of the Model Law and defines conciliation generally and its international application specifically. These are the types of provisions that would generally be found in legislation to determine the range of matters the Model Law is intended to cover. Article 2 provides guidance on the interpretation of the Model Law. Article 3 expressly provides that all the provisions of the Model Law may be varied by party agreement except for article 2 and paragraph 3 of article 7.

22. Articles 4 through 12 cover procedural aspects of the conciliation. These provisions will have particular

application to the circumstances where the parties have not adopted rules governing a conciliation and thus are designed to be in the nature of default provisions. They are also intended to assist parties in dispute that may have defined dispute resolution processes in their agreement, in this context acting as a supplement to their agreement.

23. The remaining provisions of the Model Law (articles 12-15) address post-conciliation issues to avoid uncertainty resulting from an absence of statutory provisions governing these issues.

F. Assistance from the UNCITRAL secretariat

24. In line with its training and assistance activities, the UNCITRAL secretariat may provide technical consultations for Governments preparing legislation based on the Model Law. UNCITRAL provides technical consultation for Governments considering legislation based on other UNCITRAL model laws, or considering adhesion to one of the international trade law conventions prepared by UNCITRAL.

25. Further information concerning the Model Law as well as the Guide and other model laws and conventions developed by UNCITRAL, may be obtained from the secretariat at the address below. The secretariat welcomes comments concerning the Model Law and the Guide, as well as information concerning enactment of legislation based on the Model Law.

UNCITRAL secretariat
United Nations Vienna International Centre
PO Box 500
A 1400, Vienna, Austria

Telephone: + (43) (1) 26060-4060 or 4061
Telefax: + (43) (1) 26060-5813
Electronic mail: uncitral@uncitral.org
Internet home page: www.uncitral.org

III. ARTICLE-BY-ARTICLE REMARKS

Article 1. Scope of application

1. This Law applies to international¹ commercial² conciliation.

¹States wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text: [...] *[Note by the Secretariat: this footnote recording the changes to be brought to the text of the Model Law by States enacting it for domestic as well as international conciliation will be completed after final consideration and adoption of the Model Law by the Commission.]*

²The term “commercial” should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.

2. For the purposes of this Law, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person, or a panel of persons, to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator or the panel of conciliators does not have the authority to impose upon the parties a solution to the dispute.
3. A conciliation is international if:
 - (a) The parties to an agreement to conciliate have, at the time of the conclusion of that agreement, their places of business in different States; or
 - (b) The State in which the parties have their places of business is different from either:
 - (i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or
 - (ii) The State with which the subject matter of the dispute is most closely connected.
4. For the purposes of this article:
 - (a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;
 - (b) If a party does not have a place of business, reference is to be made to the party’s habitual residence.
5. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.
6. The parties are free to agree to exclude the applicability of this Law.
7. Subject to the provisions of paragraph 8 of this article, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.
8. This Law does not apply to:
 - (a) Cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempts to facilitate a settlement; and
 - (b) [. . .].
26. The purpose of article 1 is to delineate the scope of application of the Model Law by expressly restricting it to international commercial conciliation. Article 1 defines the terms “conciliation” and “international” and provides the means of determining a party’s place of business where more than one place of business exists or a party has no place of business.
27. In preparing the Model Law, it was generally agreed that the application of the uniform rules should be restricted to commercial matters (see A/CN.9/468, para. 21,

A/CN.9/485 and Corr.1, paras. 113-116, and A/CN.9/487, para. 89). The term “commercial” is defined in general terms in footnote 2 to article 1, paragraph 1. The purpose of the footnote is to be inclusive and broad and to overcome any technical difficulties that may arise in national law as to which transactions are commercial. It was inspired by the definition set out in the footnote to article 1 of the UNCITRAL Model Law on International Commercial Arbitration. No strict definition of “commercial” is provided in the Model Law, the intention being that the term is to be interpreted broadly so as to cover matters arising from all legal relationships of a commercial nature, whether contractual or not. Footnote 1 provides an illustrative list of relationships that are to be considered commercial, thus emphasizing the breadth of the suggested interpretation and indicating that the test is not based on what the national law may regard as “commercial”. This may be particularly useful for those countries where a discrete body of commercial law does not exist and as between countries in which such a discrete law exists, the footnote may play a harmonizing role. In certain countries, the use of footnotes in a statutory text might not be regarded as acceptable legislative practice. National authorities enacting the Model Law might thus consider the possible inclusion of the text of the footnote in the body of the enacting legislation itself.

28. As originally drafted, the place of conciliation was one of the main elements triggering the application of the Model Law. In drafting the Model Law however, the Commission agreed that this approach might be inconsistent with current practice. Since parties often did not formally designate a place of conciliation and since, as a practical matter, the conciliation could occur in several places, it was believed to be problematic to use the somewhat artificial idea of the place of conciliation as the primary basis for triggering the application of the Model Law. For these reasons, the Model Law does not provide an objective rule for determining the place of conciliation (see A/CN.9/506, para. 21).

29. Paragraph 2 of article 1 sets out the elements for the definition of conciliation. The definition takes into account the existence of a dispute, the intention of the parties to reach an amicable settlement and the participation of an impartial and independent third person or persons who assists the parties in an attempt to reach an amicable settlement. The intent is to distinguish conciliation on the one hand from binding arbitration and on the other hand from mere negotiations between the parties or their representatives. The words “does not have the authority to impose upon the parties a solution to the dispute” are intended to further clarify and emphasize the main distinction between conciliation and a process such as arbitration (see A/CN.9/487, para. 101 and A/CN.9/WG.II/WP.115, remark 8).

30. Inclusion of the words “whether referred to by the expression conciliation, mediation or an expression of similar import” is intended to indicate that the Model Law applies irrespective of the name given to the process. The broad nature of the definition indicates that there was no intention to distinguish among styles or approaches to mediation. The Commission intends that the word “conciliation” would express a broad notion of a voluntary

process controlled by the parties and conducted with the assistance of a neutral third person or persons. Different procedural styles and techniques might be used in practice to achieve settlement of a dispute and different expressions might be used to refer to those styles and techniques. In drafting the Model Law, the Commission intended that it should encompass all the styles and techniques that fall within the scope of article 1.

31. In principle, the Model Law only applies to international conciliation as defined in paragraph 3 of article 1. Paragraph 3 establishes a test for distinguishing international cases from domestic ones. The requirement of internationality will be met if the parties to the conciliation agreement have their places of business in different States at the time that the agreement was concluded or where the State in which either a substantial part of the obligations of the commercial relationship is to be performed or with which the subject matter of the dispute is most closely connected, differs from the State in which the parties have their places of business. Paragraph 4 provides a test for determining a party's place of business where the party either has more than one place of business or where the party has no place of business. In the first case, the place of business is that bearing the closest relationship with the agreement to conciliate. Factors that may indicate that one place of business bears a close relationship with the agreement to conciliate may include that a substantial part of the obligations of the commercial relationship that is the subject of the dispute is to be performed at that place of business, or that the subject matter of the dispute is most closely connected to that place of business. Where a party has no place of business, reference is made to the party's habitual residence.

32. The Model Law should not be interpreted as encouraging enacting States to limit its applicability to international cases. The Commission, in adopting the Model Law, agreed that the acceptability of the Model Law would be enhanced if no attempt was made to interfere with domestic conciliation (see A/CN.9/487, para. 106). However, the Model Law contains no provision that would, in principle, be unsuitable for domestic cases (see A/CN.9/506, para. 16 and A/CN.9/WG.II/WP.116, para. 36). An enacting State may in the implementing legislation, extend the applicability of the Model Law to both domestic and international conciliation as provided in footnote 1 to paragraph 1 (see A/CN.9/506, para. 17). Also, paragraph 5 allows the parties to agree to the application of the Model Law (that is, to opt in to the Model Law) to a commercial conciliation even if the conciliation is not international as defined in the Model Law. Despite the fact that the Model Law is expressly expressed to be limited to commercial conciliation, nothing in the Model Law should prevent an enacting State from extending the scope of the Model Law to cover conciliation outside the commercial sphere. It should be noted that in some jurisdictions, particularly in federal States, considerable difficulties might arise in distinguishing international trade from domestic trade (see A/CN.9/506, para. 16).

33. Paragraph 6 allows parties to exclude the application of the Model Law. Paragraph 6 may be used, for example, where the parties to an otherwise domestic conciliation

agree for convenience on a place of conciliation abroad without intending to make the conciliation "international".

34. Paragraph 7, while recognizing that conciliation is a voluntary process based on the agreement of the parties, also recognizes that some countries have taken measures to promote conciliation, for example by requiring the parties in certain situations to conciliate or by allowing judges to suggest, or to require, that parties conciliate before they continue with litigation. In order to remove any doubt about the application of the Model Law in all these situations, paragraph 7 provides that the Model Law applies irrespective of whether a conciliation is carried out by agreement between the parties or pursuant to a legal obligation or request by a court, arbitral tribunal or competent governmental entity. The Model Law does not deal with such obligations or with the sanctions that may be entailed by failure to comply with them. Provisions on these matters depend on national policies that do not easily lend themselves to worldwide harmonization. It is suggested that, even if the enacting State does not require parties to conciliate, the provision should nevertheless be enacted because parties in the enacting State may commence conciliation proceedings pursuant to a request by a foreign court, in which case the Model Law should also apply.

35. Paragraph 8 allows enacting States to exclude certain situations from the sphere of application of the Model Law. Subparagraph (a) expressly excludes from the application of the Model Law any case where either a judge or arbitrator, in the course of adjudicating a dispute, undertakes a conciliatory process. This process may be either at the request of the parties that are in dispute or in the exercise of the judge's prerogatives or discretion. This exclusion was considered necessary to avoid undue interference with existing procedural law. Another area of exclusion might be conciliations relating to collective bargaining relationships between employers and employees, given that a number of countries may have established conciliation systems in the collective bargaining system that may be subject to particular policy considerations that might differ from those underlying the Model Law. A further exclusion could relate to a conciliation that is conducted by a judicial officer (see A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 5 and A/CN.9/WG.II/WP.115, remark 7). Given that such judicially conducted conciliation mechanisms are conducted under court rules and that the Model Law is not intended to deal with the jurisdiction of the courts of any State, it may be appropriate also to exclude these from the scope of the Model Law.

References to UNCITRAL documents

- A/CN.9/460, paras. 8-10
- A/CN.9/468, paras. 18 and 19
- A/CN.9/485 and Corr.1, paras. 108 and 109, 111-120 and 123 and 124
- A/CN.9/487, paras. 88-109
- A/CN.9/506, paras. 15-36
- A/CN.9/WG.II/WP.108, para. 11
- A/CN.9/WG.II/WP.110, paras. 83-85 and 87-90
- A/CN.9/WG.II/WP.113/Add.1, footnotes 1-7
- A/CN.9/WG.II/WP.115, remarks 1-13
- A/CN.9/WG.II/WP.116, paras. 23-36

Article 2. Interpretation

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

36. Article 2 provides guidance for the interpretation of the Model Law by courts and other national or local authorities with due regard being given to its international origin. It was inspired by article 7 of the United Nations Convention on Contracts for the International Sale of Goods, article 3 of the UNCITRAL Model Law on Electronic Commerce, article 8 of the UNCITRAL Model Law on Cross-Border Insolvency and article 4 of the UNCITRAL Model Law on Electronic Signatures (see A/CN.9/506, para. 49). The expected effect of article 2 is to limit the extent to which a uniform text, once incorporated into local legislation, would be interpreted only by reference to the concepts of local law. The purpose of paragraph 1 is to draw the attention of courts and other national authorities to the fact that the provisions of the Model Law (or the provisions of the instrument implementing the Model Law) while enacted as part of domestic legislation and therefore domestic in character, should be interpreted with reference to its international origin in order to ensure uniformity in the interpretation of the Model Law in various countries. Inclusion of court decisions interpreting the Model Law in the Case Law on UNCITRAL Texts (CLOUT) will assist this development.

37. Paragraph 2 states that, where a question is not settled by the Model Law, reference may be made to the general principles upon which it is based. As to the general principles on which the Model Law is based, the following non-exhaustive list may be considered:

(a) To promote conciliation as a method of dispute settlement by providing international harmonized legal solutions to facilitate conciliation that respect the integrity of the process and promote active party involvement and autonomy by the parties;

(b) To promote the uniformity of the law;

(c) To promote frank and open discussions of parties by ensuring confidentiality of the process, limiting disclosure of certain information and facts raised in the conciliation in other subsequent proceedings, subject only to the need for disclosure required by law or for the purposes of implementation or enforcement;

(d) To support developments and changes in the conciliation process arising from technological developments such as electronic commerce.

Reference to UNCITRAL document

A/CN.9/506, para. 49

Article 3. Variation by agreement

Except for the provisions of article 2 and article 7, paragraph 3, the parties may agree to exclude or vary any of the provisions of this Law.

38. With a view to emphasizing the prominent role given by the Model Law to the principle of party autonomy, this provision has been isolated in a separate article. This type of drafting is also intended to bring the Model Law more closely in line with other UNCITRAL instruments (for example, article 6 of the United Nations Convention on Contracts for the International Sale of Goods, article 4 of the UNCITRAL Model Law on Electronic Commerce and article 5 of the UNCITRAL Model Law on Electronic Signatures). Expressing the principle of party autonomy in a separate article may further reduce the desirability of repeating that principle in the context of a number of specific provisions of the Model Law (see A/CN.9/WG.II/WP.115, remark 14). Article 3 promotes the autonomy of the parties by leaving to them almost all matters that can be set by agreement. Article 2, regarding interpretation of the Model Law and article 7, paragraph 3, concerning fair treatment of the parties, are matters that are not subject to the principle of party autonomy.

References to UNCITRAL documents

A/CN.9/506, paras. 51 and 144

A/CN.9/WG.II/WP.110, para. 87

A/CN.9/WG.II/WP.116, para. 37

Article 4. Commencement of conciliation proceedings³

1. Unless otherwise agreed by the parties, the conciliation proceedings in respect of a particular dispute that has arisen commence on the day on which the parties to the dispute agree to engage in conciliation proceedings.

2. If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

39. Article 4 addresses the question of when a conciliation proceeding can be understood to have commenced. The Commission, in adopting the Model Law, agreed that paragraph 1 of this article should be harmonized with paragraph 7 of article 1. This was done to accommodate the fact that a conciliation might be carried out as a consequence of a direction or request by a dispute settlement body such as

³The following text is suggested for States that might wish to adopt a provision on the suspension of the limitation period:

Article X. Suspension of limitation period

1. When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

2. Where the conciliation proceedings have terminated without a settlement, the limitation period resumes running from the time the conciliation ended without a settlement.

a court or arbitral tribunal. Article 4 provides that a conciliation commences when the parties to a dispute agree to engage in such a proceeding. The effect of this provision is that, even if there exists a provision in a contract requiring parties to engage in conciliation or a court or arbitral tribunal directs parties to engage in conciliation proceedings, such proceedings will not commence until the parties agree to engage in such proceedings. The Model Law does not deal with any such requirement or with the consequences of the parties' or a party's failure to act as required.

40. The general reference to the "day on which the parties to the dispute agree to engage in conciliation proceedings" is designed to cover the different methods by which parties may agree to engage in conciliation proceedings. Such methods may include, for example, the acceptance by one party of an invitation to conciliate made by the other party, or the acceptance by both parties of a direction or suggestion to conciliate made by a court, arbitral tribunal or a competent government entity.

41. By referring in paragraph 1 of article 4 to an "agree[ment] to engage in conciliation proceedings" the Model Law leaves the determination of when exactly this agreement is concluded to laws outside the Model Law. Ultimately, the question of when the parties reached agreement will be a question of evidence (see A/CN.9/506, para. 97).

42. Paragraph 2 provides that a party that has invited another to engage in conciliation may treat this invitation as having been rejected if the other party fails to accept that invitation within thirty days from when the invitation was sent. The time period to reply to an invitation to conciliate has been set at thirty days as provided for in the UNCITRAL Conciliation Rules or any other time as specified in the invitation. This provides maximum flexibility and respects the principle of party autonomy over the procedure to be followed in commencing conciliation.

43. Article 4 does not address the situation where an invitation to conciliate is withdrawn after it has been made. Although a proposal was made during the preparation of the Model Law to include a provision specifying that the party initiating the conciliation is free to withdraw the invitation to conciliate until that invitation has been accepted, it was decided that such a provision would probably be superfluous in view of the possibility offered to both parties to terminate conciliation proceedings at any time under subparagraph (d) of article 12. Also, inclusion of a provision regarding the withdrawal of an invitation to conciliate could unduly interfere with the law of contract formation by introducing new rules as to the conditions under which an offer or an acceptance to conciliate might be withdrawn (see A/CN.9/WG.II/WP.115, remark 17).

44. The footnote to the title of article 4 (footnote 3) includes text for optional use by States that wish to enact it. The Working Group discussed the question of whether it would be desirable to prepare a uniform rule providing that the initiation of conciliation proceedings would interrupt the running of limitation and prescription periods concerning the claims involved in the conciliation. Strong opposition was expressed to the retention of this article in

the main text, principally on the basis that the issue of the limitation period raised complex technical issues and would be difficult to incorporate into national procedural regimes, which took different approaches to the issue. Moreover, it was suggested that the provision was unnecessary since other avenues were available to the parties to protect their rights (for example, by agreeing to extend the limitation period or by commencing arbitral or court proceedings for the purpose of interrupting the running of the limitation period). Equally strong argument was presented in favour of inclusion of the text on the basis that preserving the parties' rights during a conciliation would enhance the attractiveness of conciliation. It was said that an agreed extension of the limitation period was not possible in some legal systems and providing a straightforward and efficient means to protect the rights of the parties was preferable to leaving the parties with the option of commencing arbitral or court proceedings. Ultimately, it was agreed to include the provision as a footnote to article 4 for optional use by States that wished to enact it (A/CN.9/506, paras. 93 and 94).

References to UNCITRAL documents

A/CN.9/485 and Corr.1, paras. 127-132
 A/CN.9/487, paras. 110-115
 A/CN.9/506, paras. 53-56 and 93-100
 A/CN.9/WG.II/WP.110, paras. 95 and 96
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 11-12

Article 5. Number of conciliators

There shall be one conciliator, unless the parties agree that there shall be a panel of conciliators.

45. Unlike in arbitration where the default rule is three arbitrators, conciliation practice shows that parties usually wish to have the dispute handled by one conciliator. For that reason, the default rule in article 6 is one conciliator. A number of private international arbitration rules provide a default rule of one arbitrator.

References to UNCITRAL documents

A/CN.9/487, paras. 116 and 117
 A/CN.9/506, para. 58
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 13

Article 6. Appointment of conciliators

1. In conciliation proceedings with one conciliator, the parties shall endeavour to reach agreement on the name of the sole conciliator.

2. In conciliation proceedings with two conciliators, each party appoints one conciliator.

3. In conciliation proceedings consisting of three or more conciliators, each party appoints one conciliator and shall endeavour to reach agreement on the name of the other conciliators.

4. Parties may seek the assistance of an appropriate institution or person in connection with the appointment of conciliators. In particular:

(a) A party may request such an institution or person to recommend names of suitable persons to act as conciliator; or

(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

5. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, with respect to a sole or third conciliator, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

6. When a person is approached in connection with his or her possible appointment as a conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.

46. The intent of article 6 is to encourage the parties to agree on the selection of a conciliator. The advantage of the parties first endeavouring mutually to agree on a conciliator is that this approach respects the consensual nature of conciliation proceedings and also provides parties with greater control and therefore confidence in the conciliation process. Although a suggestion was made while preparing the Model Law that, where there is more than one conciliator the appointment of each conciliator should be agreed to by both parties, which would thereby avoid the perception of partisanship, the prevailing view was that the solution allowing each party to appoint a conciliator was the more practical approach. This approach allows for speedy commencement of the conciliation process and might foster settlement in the sense that the two party-appointed conciliators, while acting independently and impartially, would be in a better position to clarify the positions of the parties and thereby enhance the likelihood of settlement. When three or more conciliators are to be appointed, the conciliator other than the two party-appointed conciliators should, in principle, be appointed by agreement of the parties. This should foster greater confidence in the conciliation process.

47. When no agreement may be reached on a conciliator, reference has to be had to an institution or a third person. Subparagraphs (a) and (b) of paragraph 4 provide that the institution or person may simply provide names of recommended conciliators or, by agreement of the parties, directly appoint conciliators. Paragraph 5 sets out some guidelines for the person or institution to follow in making recommendations or appointments. These guidelines seek to foster the independence and impartiality of the conciliator.

48. Paragraph 6 obliges a person who is approached to act as a conciliator to disclose any circumstance likely to raise justifiable doubts as to his or her impartiality or independence. This obligation is stated to apply not only from the time that the person is approached but also throughout the

conciliation. A suggestion was made that the provision address the consequences that might result from failure to make such a disclosure, for example by expressly stating that failure to make such disclosure should not result in nullification of the conciliation process. However, the prevailing view was that the consequences of failure to disclose such information should be left to the provisions of law in the enacting State other than the enactment of the Model Law (A/CN.9/506, para. 65).

References to UNCITRAL documents

A/CN.9/487, paras. 118 and 119

A/CN.9/506, paras. 59-66

A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 14

A/CN.9/WG.II/WP.116, paras. 42 and 43

Article 7. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, on the manner in which the conciliation is to be conducted.

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator or the panel of conciliators may conduct the conciliation proceedings in such a manner as the conciliator or the panel of conciliators considers appropriate, taking into account the circumstances of the case, any wishes that the parties may express and the need for a speedy settlement of the dispute.

3. In any case, in conducting the proceedings, the conciliator or the panel of conciliators shall seek to maintain fair treatment of the parties and, in so doing, shall take into account the circumstances of the case.

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

49. Paragraph 1 of article 7 stresses that the parties are free to agree on the manner in which the conciliation is to be conducted. It was derived from article 19 of the UNCITRAL Model Law on International Commercial Arbitration.

50. Paragraph 2 recognizes the role of the conciliator who, while observing the will of the parties, may shape the process as he or she considers appropriate.

51. It should be noted that, while the Model Law does not set out a standard of conduct to be applied by a conciliator, paragraph 3 provides that the conciliator or panel of conciliators seek to maintain fair treatment of the parties by reference to the particular circumstances of the case. Some concern was expressed that the inclusion of a provision governing the conduct of the conciliation could have the unintended effect of inviting parties to seek annulment of the settlement agreement by alleging unfair treatment. However, the prevailing view was that the guiding principles should be retained in the body of the legislative provisions to the effect of providing guidance regarding conciliation, particularly for less experienced conciliators (see

A/CN.9/506, para. 70). The reference in paragraph 3 to maintaining fair treatment of the parties is intended to govern the conciliation process and not the settlement agreement.

52. Conciliation rules often contain principles that should guide the conciliator in conducting the proceedings. For example, article 7 of the UNCITRAL Conciliation Rules states as follows:

“1. The conciliator assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute.

“2. The conciliator will be guided by principles of objectivity, fairness and justice, giving consideration to, among other things, the rights and obligations of the parties, the usages of the trade concerned and the circumstances surrounding the dispute, including any previous business practices between the parties.

“3. The conciliator may conduct the conciliation proceedings in such a manner as he considers appropriate, taking into account the circumstances of the case, the wishes the parties may express, including any request by a party that the conciliator hear oral statements, and the need for a speedy settlement of the dispute.

“4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute. Such proposals need not be in writing and need not be accompanied by a statement of the reasons therefor.”

Some national laws have included some of these guiding principles in their laws on conciliation. Given the different approaches to conciliation, the focus of the process will not always be the same. In order to encompass that variety, the text requires the conciliator to “take into account the circumstances of the case”. The Working Group agreed that, while other provisions of article 7 might be subject to contrary agreement between the parties, paragraph 3 should be regarded as setting a minimum standard. Thus, parties are not allowed to agree on a different standard of conduct to be followed by conciliators. To this end, an exception to the general application of article 3 has been made with respect to paragraph 3 of article 7.

53. Paragraph 4 clarifies that a conciliator may, at any stage, make a proposal for settlement. Whether, to what extent and at which stage the conciliator may make any such proposal will depend on many factors, including the wishes of the parties and the techniques the conciliator considers most conducive to a settlement.

References to UNCITRAL documents

A/CN.9/468 paras. 56-59
A/CN.9/485 and Corr.1, para. 125
A/CN.9/487, paras. 120-127
A/CN.9/506, paras. 67-74
A/CN.9/WG.II/WP.108, paras. 61 and 62
A/CN.9/WG.II/WP.110, paras. 91 and 92
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 15-18
A/CN.9/WG.II/WP.115, remarks 22 and 23

Article 8. Communication between conciliator and parties

Unless otherwise agreed by the parties, the conciliator, the panel of conciliators or a member of the panel may meet or communicate with the parties together or with each of them separately.

54. Separate meetings between the conciliator and the parties are, in practice, so usual that a conciliator is presumed to be free to use this technique, save for any express restriction agreed to by the parties. Some States have included this principle in their national laws on conciliation by providing that a conciliator is allowed to communicate with the parties collectively or separately. The purpose of this provision is to put this issue beyond doubt.

55. The conciliator should afford the parties equal treatment, which, however, is not intended to mean that equal time should necessarily be devoted for separate meetings with each party. The conciliator may explain to the parties in advance that there may be time discrepancies, both real and imagined, which should not be construed as other than the fact that the conciliator is taking time to explore all issues, interests and possibilities for settlement.

References to UNCITRAL documents

A/CN.9/468, paras. 54 and 55
A/CN.9/487, paras. 128 and 129
A/CN.9/506, para. 76
A/CN.9/WG.II/WP.108, paras. 56 and 57
A/CN.9/WG.II/WP.110, para. 93
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 19

Article 9. Disclosure of information between the parties

When the conciliator, the panel of conciliators or a member of the panel receives information concerning the dispute from a party, the conciliator, the panel of conciliators or a member of the panel may disclose the substance of that information to the other party. However, when a party gives any information to the conciliator, the panel of conciliators or a member of the panel subject to a specific condition that it be kept confidential, that information shall not be disclosed to the other party.

56. As its title suggests, article 9 is limited to disclosure of information between the parties. With respect to disclosure of information to third parties, it was widely agreed that the Model Law should include a provision expressing a duty of confidentiality (see article 10). Article 9 expresses the principle that, whatever information a party gives to a conciliator, that information may be disclosed to the other party. It provides an approach consistent with established practice in many countries as reflected in article 10 of the UNCITRAL Conciliation Rules. The intent is to foster open and frank communication of information between parties and, at the same time, to preserve the parties' rights to maintain confidentiality. The role of the conciliator is to cultivate a candid exchange of information regarding the dispute. Such disclosure fosters the confidence of both

parties in the conciliation. However, the principle of disclosure is not absolute, in that the conciliator has the freedom, but not the duty, to disclose such information to the other party. Indeed the conciliator has a duty not to disclose a particular piece of information when the party that gave the information to the conciliator made it subject to a specific condition that it be kept confidential. This approach is justified because the conciliator imposes no binding decision on the parties. An earlier suggestion requiring that the party giving the information give consent before any communication of that information may be given to the other party was rejected. It was considered that this would be overly formalistic, inconsistent with established practice in many countries and likely to inhibit the entire conciliation process.

57. A broad notion of “information” is preferred in the context of this statutory rule. It is intended to cover all relevant information communicated by a party to the conciliator. The notion of “information”, as used in this article, should be understood as not only covering communications that occurred during the conciliation but also communications that took place before the actual commencement of the conciliation.

References to UNCITRAL documents

A/CN.9/468, paras. 54-55
 A/CN.9/487, paras. 130-134
 A/CN.9/506, paras. 77-82
 A/CN.9/WG.II/WP.108, paras. 58-60
 A/CN.9/WG.II/WP.110, para. 94
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 20 and 21

Article 10. Duty of confidentiality

Unless otherwise agreed by the parties, all information relating to the conciliation proceedings shall be kept confidential, except where disclosure is required under the law or for the purposes of implementation or enforcement of a settlement agreement.

58. In keeping with article 14 of the UNCITRAL Conciliation Rules, support was expressed for the inclusion of a general rule of confidentiality applying to the conciliator and to the parties. (see A/CN.9/506, para. 86) A provision on confidentiality is important as the conciliation will be more appealing if parties can have confidence that the conciliator will not take sides or disclose their statements, particularly in the context of other proceedings. The provision is drafted broadly referring to “all information relating to the conciliation proceedings” to cover not only information disclosed during the conciliation proceedings but also to cover the substance and the result of the proceedings as well as matters relating to a conciliation that occurred before the agreement to conciliate was reached, including, for example, discussions concerning the desirability of conciliation, the terms of an agreement to conciliate, the choice of conciliators, an invitation to conciliate and the acceptance or rejection of such an invitation. The phrase “all information relating to the conciliation proceedings” was supported because it reflected a tried and tested formula set out in article 14 of the UNCITRAL Conciliation Rules.

59. Article 10 is expressly subject to party autonomy to meet concerns expressed that it might be inappropriate to impose upon the parties a rule that would not be subject to party autonomy and could be very difficult, if not impossible, to enforce. This reinforces the principle objective of the Model Law, that is, to respect party autonomy and also to provide a clear rule to guide parties in the absence of contrary agreement.

60. The rule is also subject to express exceptions, namely where disclosure is required by law, such as an obligation to disclose evidence of a criminal offence, or where disclosure is required for the purposes of implementation or enforcement of a settlement agreement. Although the Working Group initially considered including a list of specific exceptions it was strongly felt that listing exceptions in the text of the Model Law might raise difficult questions of interpretation, in particular as to whether the list should be regarded as exhaustive. The Working Group agreed that an illustrative and non-exhaustive list of possible exceptions to the general rule on confidentiality would more appropriately be provided in the Guide to Enactment. Examples of such laws may include laws requiring the conciliator or parties to reveal information if there is a reasonable threat that a person will suffer death or substantial bodily harm if the information is not disclosed and laws requiring disclosure if it is in the public interest, for example to alert the public about a health or environmental or safety risk.

References to UNCITRAL documents

A/CN.9/487, paras. 130-134
 A/CN.9/506, paras. 83-86

Article 11. Admissibility of evidence in other proceedings

1. Unless otherwise agreed by the parties, a party that participated in the conciliation proceedings or a third person, including a conciliator, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding, any of the following:

- (a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;
- (b) Views expressed or suggestions made by a party to the conciliation in respect of a possible settlement of the dispute;
- (c) Statements or admissions made by a party in the course of the conciliation proceedings;
- (d) Proposals made by the conciliator;
- (e) The fact that a party to the conciliation had indicated its willingness to accept a proposal for settlement made by the conciliator;
- (f) A document prepared solely for purposes of the conciliation proceedings.

2. Paragraph 1 of this article applies irrespective of the form of the information or evidence referred to therein.

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement.

4. The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.

5. Subject to the limitations of paragraph 1 of this article, evidence that is otherwise admissible in arbitral or court proceedings does not become inadmissible as a consequence of having been used in a conciliation.

61. In conciliation proceedings, the parties may typically express suggestions and views regarding proposals for a possible settlement, make admissions, or indicate their willingness to settle. If, despite such efforts, the conciliation does not result in a settlement and a party initiates judicial or arbitral proceedings, those views, suggestions, admissions or indications of willingness to settle might be used to the detriment of the party who made them. This possibility of such a “spillover” of information may discourage parties from actively trying to reach a settlement during conciliation proceedings, which would reduce the usefulness of conciliation (see A/CN.9/WG.II/WP.108, para. 18). Thus, article 11 is designed to encourage frank and candid discussions in conciliation by prohibiting the use of information listed in paragraph 1 in any later proceedings. The words “or a third person” are used to clarify that persons other than the party (for example, witnesses or experts) who participated in the conciliation proceedings are also bound by paragraph 1.

62. The provision is needed in particular if the parties have not agreed on a provision such as that contained in article 20 of the UNCITRAL Conciliation Rules which provides that the parties must not “rely on or introduce as evidence in arbitral or judicial proceedings . . . :

(a) Views expressed or suggestions made by the other party in respect of a possible settlement of the dispute;

(b) Admissions made by the other party in the course of the conciliation proceedings;

(c) Proposals made by the conciliator;

(d) The fact that the other party had indicated his willingness to accept a proposal for settlement made by the conciliator.”

63. However, even if the parties have agreed on a rule of that type, the legislative provision is useful because, at least under some legal systems, the court may not give full effect to agreements concerning the admissibility of evidence in court proceedings.

64. In view of the general rule contained in article 3, the view was expressed that the opening words of article 11 “Unless otherwise agreed by the parties” were superfluous. However, the prevailing view was that maintaining those words would better reflect the function of the rule in paragraph 1 as a default rule of conduct for the parties (see A/CN.9/506, para. 102).

65. The approach in this article is designed to eliminate any uncertainty as to whether the parties may agree not to use as evidence in arbitral or judicial proceedings certain facts that occurred during the conciliation. The Model Law aims at preventing the use of certain information in subsequent judicial or arbitral proceedings regardless of whether the parties have agreed to a rule such as that contained in article 20 of the UNCITRAL Conciliation Rules. Where the parties have not agreed upon a contrary rule, the Model Law provides that the parties shall not rely in any subsequent arbitral or judicial proceedings on evidence of the types specified in the model provision. The specified evidence would then be inadmissible in evidence and the arbitral tribunal or the court could not order disclosure.

66. Paragraph 2 provides that the prohibition in article 11 is intended to apply to the specified information, for example, regardless of whether they appear in a document or not.

67. Paragraph 3 provides that an arbitral tribunal or court shall not order the disclosure of information referred to in paragraph 1 unless such disclosure is permitted or required under the law governing the arbitral or judicial proceedings. This provision was considered necessary to properly clarify and reinforce paragraph 1. In order to achieve the purpose of promoting candor between the parties engaged in a conciliation, they must be able to enter into the conciliation knowing the scope of the rule and that it will be applied. Paragraph 3 expresses this principle by restricting the rights of courts, arbitral tribunals or government entities from ordering disclosure of such information and by requiring such bodies to treat any such information offered as evidence as being inadmissible. There may be situations, however, where evidence of certain facts would be inadmissible under article 11, but the inadmissibility would have to be overridden by an overwhelming need to accommodate compelling reasons of public policy. For example, the need to disclose threats made by a participant to inflict bodily harm or unlawful loss or damage; where a participant attempts to use the conciliation to plan or commit a crime; where evidence is needed to establish or disprove an allegation of professional misconduct based on the conduct occurring during a conciliation; where evidence is needed in a proceeding in which fraud or duress is at issue regarding the validity or enforceability of an agreement reached by the parties; or where statements made during a conciliation show a significant threat to public health or safety. The final sentence in paragraph 3 of article 11 expresses such exceptions in a general manner and is in similar terms to the exception expressed with respect to the duty of confidentiality in article 10. Paragraph 4 extends the scope of application of paragraphs 1 to 3, inclusive, to apply not only to related subsequent proceedings but also to unrelated subsequent proceedings. Paragraph 5 makes it clear that all information that otherwise would be admissible as

evidence in a subsequent court or arbitral proceeding does not become inadmissible solely by reason of it being raised in an earlier conciliation proceeding (for example, in a dispute concerning a contract of carriage by goods by sea, a bill of lading would be admissible to prove the name of the shipper, notwithstanding its use in a conciliation). It is only certain statements made in conciliation proceedings (that is, views, admissions, proposals and indications of willingness to settle) that are inadmissible, not any underlying evidence that gave rise to the statement. Thus, evidence that is used in conciliation proceedings is admissible in any subsequent proceedings just as it would be if the conciliation had not taken place.

68. In some legal systems a party may not be compelled to produce in court proceedings a document that enjoys a “privilege”, for example, a written communication between a client and his attorney. The privilege may, however, be deemed lost if a party has relied on the privileged document in a proceeding. Privileged documents may be presented in conciliation proceedings with a view to facilitating settlement. In order not to discourage the use of privileged documents in conciliation, the enacting State may wish to consider including a uniform provision stating that the use of a privileged document in conciliation proceedings does not constitute a waiver of the privilege.

References to UNCITRAL documents

A/CN.9/460, paras. 11-13
 A/CN.9/468, paras. 22-30
 A/CN.9/485 and Corr.1, paras. 139-146
 A/CN.9/487, paras. 139-141
 A/CN.9/506, paras. 101-115
 A/CN.9/WG.II/WP.108, paras. 18-28
 A/CN.9/WG.II/WP.110, paras. 98-100
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 25-32

Article 12. Termination of conciliation

The conciliation proceedings are terminated:

(a) By the conclusion of a settlement agreement by the parties, on the date of the agreement;

(b) By a written declaration of the conciliator or the panel of conciliators, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

(c) By a written declaration of the parties addressed to the conciliator or the panel of conciliators to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

(d) By a written declaration of a party to the other party and the conciliator or the panel of conciliators, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

69. The provision enumerates various circumstances in which conciliation proceedings may be terminated. In subparagraph (a) the provision uses the expression “conclusion” instead of “signing” in order better to reflect the possibility of entering into a settlement by electronic communications. Any enacting State that has not enacted the

UNCITRAL Model Law on Electronic Commerce should consider inclusion of a provision along the lines of article 6 of that instrument when enacting this Model Law⁴ (see A/CN.9/506, para. 88). The first circumstance, listed in subparagraph (a), is where the conciliation ends successfully, namely where a settlement agreement is reached. The second circumstance, set out in subparagraph (b), allows the conciliator or panel of conciliators to bring the conciliation proceedings to an end, after consulting with the parties. Subparagraph (c) provides that both parties may declare the conciliation proceedings to be terminated and subparagraph (d) allows one party to give such notice of termination to the other party and the conciliator or panel of conciliators. As noted above in the context of article 4, the parties may be under an obligation to commence and participate in good faith in conciliation proceedings. Such an obligation may arise, for example, from an agreement of the parties entered into before or after the dispute arose, from a statutory provision or from a direction or request by a court. The sources of such an obligation differ from country to country and the Model Law does not deal with them. The Model Law also does not deal with the consequences of failure by a party to comply with such an obligation (see para. 39 above).

References to UNCITRAL documents

A/CN.9/487, paras. 135 and 136
 A/CN.9/506, paras. 87-91
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 22 and 23
 cf article 15 of the UNCITRAL Conciliation Rules

Article 13. Conciliator acting as arbitrator

Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator in respect of a dispute that was or is the subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or any related contract.

70. Article 13 reinforces the effect of article 11 by limiting the possibility of the conciliator acting as an arbitrator in respect of a dispute that was or is the subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or any related contract. The purpose of this article is to provide greater confidence in the conciliator and in conciliation as a method of dispute settlement. A party may be reluctant to strive actively for a settlement in conciliation proceedings if it has to take into account the possibility that, if the conciliation is not successful, the conciliator might be appointed as an arbitrator in subsequent arbitration proceedings.

71. In some cases, the parties might regard prior knowledge on the part of the arbitrator as advantageous, particularly if the parties think that this knowledge would allow the arbitrator to conduct the case more efficiently. In these cases, the parties may actually prefer that the

⁴Article 6 of the Model Law on Electronic Commerce provides in part that “where the law requires information to be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.”

conciliator and not somebody else be appointed as an arbitrator in the subsequent arbitral proceedings. The provision poses no obstacle to the appointment of the former conciliator provided the parties depart from the rule by agreement, for example by a joint appointment of the conciliator to serve as an arbitrator. However, in some cases there may be ethical considerations suggesting that the conciliator should decline to act.

72. The provision applies to either “a dispute that was or is the subject of the conciliation proceedings” or “in respect of another dispute that has arisen from the same contract or any related contract”. The first limb extends the application of the provision to both past and ongoing conciliations. The second limb extends the scope of the article to cover disputes arising under contracts that are distinct but commercially and factually closely related to the subject matter of the conciliation. Whilst the formulation is very broad, determining whether a dispute raises issues relating to the main contract would require an examination of the facts of each case.

73. An earlier draft of the Model Law contained a provision dealing with the situation where an arbitrator acts as a conciliator. It was noted that such a provision would relate to the functions and competence of an arbitrator, and to arbitration practices that differ from country to country and are influenced by legal and social traditions. There is no settled practice on the question of an arbitrator acting as a conciliator and some practice notes suggest that the arbitrator should exercise caution before suggesting or taking part in conciliation proceedings relating to the dispute. It was considered inappropriate to attempt to unify these practices through uniform legislation. Although the provision was deleted, the Commission agreed that the Model Law was not intended to indicate whether or not an arbitrator could act or participate in conciliation proceedings relating to the dispute and that this was a matter left to the discretion of the parties and arbitrators acting within the context of applicable law and rules (see A/CN.9/506, para. 132).

74. An earlier draft also restricted a conciliator from acting as a representative or counsel of either party subject to contrary party agreement. It was suggested that in some jurisdictions, even if the parties agreed to the conciliator acting as a representative or counsel of any party, such an agreement would contravene ethical guidance to be followed by conciliators and could also be perceived as undermining the integrity of conciliation as a method for dispute settlement. A proposal to amend the provision so as not to leave this question to party autonomy was rejected on the basis that it undermined the principle of party autonomy and failed to recognize that, in some jurisdictions where ethical rules required a conciliator not to act as a representative or counsel, the conciliator would always be free to refuse to act in that capacity. On that basis, it was agreed that the provision should be silent on the question of whether a conciliator could act as a representative or counsel of any of the parties (see A/CN.9/506, para. 117).

References to UNCITRAL documents

A/CN.9/468, paras. 31-37
A/CN.9/485 and Corr.1, paras. 148-153

A/CN.9/487, paras. 142-145
A/CN.9/506, paras. 117-123 and 130-132
A/CN.9/WG.II/WP.108, paras. 29-33
A/CN.9/WG.II/WP.110, footnote 30

Article 14. Resort to arbitral or judicial proceedings

1. Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specified period of time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with.

2. A party may nevertheless initiate arbitral or judicial proceedings where, in its sole discretion, it considers such proceedings necessary to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.

75. In the preparation of the Model Law, it was agreed that the text should contain a rule preventing parties from initiating an arbitral or judicial proceeding while conciliation was pending. Paragraph 1 deals with the effect of the agreement of the parties to engage in conciliation. The consequence of that provision is that the court or arbitral tribunal will be obliged to bar litigation or an arbitration from proceeding if that would be in violation of the agreement of the parties.

76. Paragraph 2 of article 14 deals with the issue of whether, and to what extent, the party may initiate court or arbitral proceedings during the course of conciliation proceedings. The idea behind this provision is to allow the parties to initiate arbitral or court proceedings only in circumstances where, in the opinion of the party initiating such proceedings, such action is “necessary for preserving its rights”. Possible circumstances that may require initiation of arbitral or court proceedings may include the necessity to seek interim measures of protection or to avoid the expiration of the limitation period. This provision would need to be integrated with the requirements of existing procedural and substantive law in the enacting State.

References to UNCITRAL documents

A/CN.9/468, paras. 45-49
A/CN.9/485 and Corr.1, paras. 155-158
A/CN.9/487, paras. 147-150
A/CN.9/506, paras. 125-129
A/CN.9/WG.II/WP.108, paras. 49-52
A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnotes 36 and 37

Article 15. Enforceability of settlement agreement⁵

If the parties reach and sign an agreement settling a dispute, that settlement agreement is binding and enforceable . . . [the enacting State inserts a description of the method of enforcing settlement agreements or refers to provisions governing such enforcement].

77. Legislative solutions regarding the enforceability of settlements reached in conciliation proceedings differ widely. Many practitioners have put forward the view that the attractiveness of conciliation would be increased if a settlement reached during a conciliation would, for the purposes of enforcement, be treated as or similarly to an arbitral award. Reasons given for introducing expedited enforcement usually aim to foster the use of conciliation and to avoid situations where a court action to enforce a settlement might take months or years to reach judgement.

78. Some States have no special provisions on the enforceability of such settlements, with the result that they would be enforceable as any contract between the parties. This understanding that conciliation settlements are enforceable as contracts has been restated in some laws on conciliation.

79. In some national legislation, parties that have settled a dispute are empowered to appoint an arbitrator specifically to issue an award based on the agreement of the parties. For example, in China, where conciliation may be conducted by an arbitral tribunal, legislation provides that “if conciliation leads to a settlement agreement, the arbitral tribunal shall make a written conciliation statement or make an arbitration award in accordance with the settlement agreement. A written conciliation statement and a written arbitration award shall have equal legal validity and effect.” (Arbitration Law of the People’s Republic of China, article 51). In some jurisdictions, the status of an agreement reached following conciliation depends on whether or not the conciliation took place within the court system and legal proceedings in relation to the dispute are on foot. For example, under Australian legislation, agreements reached at conciliation held outside the court cannot be registered with the court unless the proceedings are on foot, whereas in court-based conciliation schemes, a court may make orders in accordance with the settlement agreement and these orders have legal force and are enforceable as such.

80. Some legal systems provide for enforcement in a summary fashion if the parties and their attorneys signed the settlement agreement and it contained a statement that the parties may seek summary enforcement of the agreement. Also, settlements might be the subject of expedited enforcement if, for example, the settlement agreement was notarized or formalized by a judge or co-signed by the counsel of the parties. For example, in Bermuda, legislation provides that “If the parties to an arbitration agreement

which provides for the appointment of a conciliator reach agreement in settlement of their differences and sign an agreement containing the terms of settlement . . . the settlement agreement shall, for the purposes of its enforcement, be treated as an award on an arbitration agreement and may, by leave of the Court or a judge thereof, be enforced in the same manner as a judgement or order to the same effect, and where leave is so given, judgement may be entered in terms of the agreement” (Bermuda, Arbitration Act 1986). Similarly, in India, a settlement agreement that has been signed by the parties is final and binding on the parties and persons claiming under them respectively and “shall have the same status and effect as if it is an arbitral award” (India, The Arbitration and Conciliation Ordinance, 1996, articles 73 and 74, respectively). However, in some jurisdictions the enforceability of a settlement agreement reached during conciliation will only apply if the settlement agreement was reached as part of an arbitration process. For example, in Hong Kong Special Administrative Region of China, section 2C of the Arbitration Ordinance provides that “Where conciliation proceedings succeed and the parties make a written settlement agreement (whether prior to or during arbitration proceedings), such agreement may be enforced by the Court of First Instance as if it were an award, provided that the settlement agreement has been made by the parties to an arbitration agreement.” This provision is supported by Order 73, rule 10 of the Rules of the High Court, which applies the procedure for enforcing arbitral awards to the enforcement of settlement agreements so that summary application may be made to the court and judgement may be entered in terms of the agreement.

81. The text of the article is aimed at reflecting the smallest common denominator between the various legal systems. Although the Working Group recognized that the text was ambiguous, since it might be read in different languages and different legal systems either as creating a high degree of enforceability or as merely referring to the obvious fact that a settlement agreement could be made enforceable through appropriate procedures, States were invited to submit official comments on the draft text and the Secretariat held informal consultations regarding the feasibility of improving on the text. [Note by the Secretariat: paragraphs 77 to 81 are expected to require a degree of redrafting as a result of the discussion at the thirty-fifth session of the Commission.]

References to UNCITRAL documents

A/CN.9/460, paras. 16-18
 A/CN.9/468, paras. 38-40
 A/CN.9/485 and Corr.1, para. 159
 A/CN.9/487, paras. 153-159
 A/CN.9/506, paras. 38-48, and 133-139
 A/CN.9/WG.II/WP.108, paras. 34-42
 A/CN.9/WG.II/WP.110, paras. 105-112
 A/CN.9/WG.II/WP.113/Add.1 and Corr.1, footnote 39

⁵When implementing the procedure for enforcement of settlement agreements, an enacting State may consider the possibility of such a procedure being mandatory.

II. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Report of the Working Group on Privately Financed Infrastructure Projects on the work of its fourth session (Vienna, 24-28 September 2001)

(A/CN.9/505) [Original: English]

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I. INTRODUCTION

1. The present report covers the fourth session of the Working Group on Privately Financed Infrastructure Projects (previously named the Working Group on Time-Limits and Limitations (Prescription)).

2. The Working Group, which was composed of all States members of the Commission, held its fourth session in Vienna from 24 to 28 September 2001. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, Honduras, Hungary, Iran (Islamic Republic of), Italy, Japan, Morocco, Russian Federation, Spain, Sweden and United States of America.

3. The session was attended by observers from the following States: Bosnia and Herzegovina, Czech Republic, Ecuador, Indonesia, Lebanon, Namibia, Nigeria, Pakistan, Philippines, Portugal, Republic of Korea, Saudi Arabia, Slovakia, Syrian Arab Republic, Turkey and Venezuela.

4. The session was also attended by observers from the following international organizations: United Nations Industrial Development Organization, Organisation for Economic Cooperation and Development and Southeast European Cooperative Initiative.

5. The Working Group elected the following officers:

Chairman: Tore Wiwen-Nilsson (Sweden)

Rapporteur: Judit Kónia (Hungary)

6. The Working Group had before it the following documents:

(a) Provisional agenda, annotations thereto and scheduling of meetings of the fourth session (A/CN.9/WG.I/WP.27);

(b) UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (with a view to possible use of the legislative recommendations contained therein as a basis for its deliberations);

(c) Note by the Secretariat on possible future work on privately financed infrastructure projects (A/CN.9/488).

7. The Working Group adopted the following agenda:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Possible addendum to the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects.
5. Other business.
6. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

8. The Working Group started its work on the drafting of core model legislative provisions in the field of privately financed infrastructure projects, pursuant to a decision taken by the Commission at its thirty-fourth session (Vienna, 25 June-13 July 2001).¹

9. The Secretariat was requested to prepare draft model legislative provisions in the field of privately financed infrastructure projects, based on the deliberations and decisions of the Working Group, to be presented to the Working Group at its fifth session (Vienna, 9-13 September 2002)² for review and further discussion.

III. POSSIBLE ADDENDUM TO THE UNCITRAL LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

A. General remarks

10. At its thirty-third session (New York, 12 June-7 July 2000), the United Nations Commission on International Trade Law (UNCITRAL) adopted the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects, consisting of the legislative recommendations (A/CN.9/471/Add.9) with the amendments adopted by the Commission at that session and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the Secretariat was authorized to finalize in the light of the deliberations of the Commission.³ The Legislative Guide has since been published in all official languages (available at www.uncitral.org).

11. The Commission also considered a proposal for future work in the area. It was suggested that, although the Legislative Guide would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure, it would nevertheless be desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues.⁴

12. After consideration of that proposal, the Commission decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the Legislative Guide should be considered by the Commission at its thirty-fourth session. In order to assist the Commission in making an informed decision on the matter, the Secretariat was requested to organize a colloquium, in cooperation with other interested

international organizations or international financial institutions, to disseminate knowledge about the Legislative Guide.⁵

13. The Colloquium on Privately Financed Infrastructure: Legal Framework and Technical Assistance was organized with the co-sponsorship and organizational assistance of the Public-Private Infrastructure Advisory Facility, a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. It was held in Vienna from 2 to 4 July 2001.

14. At its thirty-fourth session, the Commission took note with appreciation of the results of the Colloquium as summarized in a note by the Secretariat (A/CN.9/488) and agreed that the proceedings should be published by the United Nations. The Commission further recommended that the Secretariat, in coordination with other organizations, undertake initiatives to ensure widespread knowledge of the Legislative Guide.

15. Various views were expressed as to the desirability and feasibility of further work of the Commission in the field of privately financed infrastructure projects.

16. There was wide support for the view that there was a significant demand for model legislation providing more specific guidance, especially in developing countries and in countries with economies in transition. In that connection, it was suggested that the Legislative Guide should be implemented by way of drafting a set of core model provisions dealing with some of the substantive issues identified and dealt with in the Guide. It was pointed out that, while the Guide was in itself a valuable product to assist domestic legislators in the process of enacting or reviewing legislation in that field, the effectiveness of that process would be significantly increased if model legislative provisions were available. It was also noted that the prompt undertaking of such further work would take advantage of the vast and significant expertise gathered throughout the process that led to the adoption of the Guide and would allow it to be easily and effectively achieved within a reasonable amount of time. Finally, it was further observed that there was no inconsistency between undertaking such further work on the one hand and undertaking efforts to promote knowledge and dissemination of the Legislative Guide on the other.

17. After considering the different views, the Commission agreed that a working group should be entrusted with the task of drafting core model legislative provisions in the field of privately financed infrastructure projects. The Commission was of the view that, if further work in the field of privately financed infrastructure projects was to be accomplished within a reasonable time, it was essential to carve out a specific area from among the many issues dealt with in the Legislative Guide. Accordingly, it was agreed that the first session of such a working group should identify the specific issues on which model legislative provisions, possibly to become an addendum to the Legislative Guide, could be formulated.⁶

¹See *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17)*, para. 369.

²Subject to approval by the Commission at its thirty-fifth session.

³See *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 195-368.

⁴*Ibid.*, para. 375.

⁵*Ibid.*, para. 379.

⁶*Ibid.*, *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, para. 369.

B. Consideration of topics for possible draft model legislative provisions on the basis of the legislative recommendations contained in the Legislative Guide

18. The Working Group noted that the purpose of its work was to review the legislative recommendations contained in the Legislative Guide with a view to formulating more concrete guidance in the form of model legislative provisions dealing with specific issues, with a possible further focus on chapter III, "Selection of the concessionaire". The first task of the Working Group was therefore to identify the issues on which such guidance might be useful.

19. The Working Group heard various suggestions of topics that might usefully be addressed in model legislative provisions, including authority to award concessions in the host country; the nature of the concession (that is, whether exclusive or not) and its duration; measures to ensure effective administrative coordination among the various governmental agencies involved; procedures to select the concessionaire; authority to provide governmental support or guarantees to the project; key provisions dealing with the construction and the operational phases of the project; provisions intended to remove statutory obstacles to the implementation of privately financed infrastructure projects; provisions aimed at facilitating the financing of infrastructure projects; dispute settlement mechanisms for the various phases of the project; governing law of the project agreement, including the issue of which branch of the laws of the host country should govern the agreement (that is, whether administrative law or general contract law); and duration, extension and termination of the project agreement, including compensation arrangements.

20. It was suggested that, when considering topics on which model legislative provisions should be drafted, the Working Group should not aim at formulating provisions that prescribed the contents of the project agreement. Rather, the Working Group should have as its primary objective the formulation of model legislative provisions that enabled the use of private financing for infrastructure development without being overly prescriptive in respect of the contractual arrangements between the various parties concerned.

21. The Working Group welcomed those suggestions and observations. Generally, it was pointed out that most of those topics were already covered in the Legislative Guide. The Working Group agreed that it should use the legislative recommendations as the basis for its deliberations. It also agreed that it should begin its work by considering the legislative recommendations dealing with the selection of the concessionaire and revert thereafter to the other topics covered in the Guide.

Chapter III. Selection of the concessionaire

General considerations

Recommendation 14

22. The text of the recommendation was as follows:

"The law should provide for the selection of the concessionaire through transparent and efficient competitive procedures adapted to the particular needs of privately financed infrastructure projects."

23. The Working Group agreed that it would be useful to formulate a model legislative provision that stated the general principles that should preside over the process leading to the selection of the concessionaire. Whether a substantive provision was needed in that regard, or whether that idea should be expressed in a preambular paragraph to the model legislative provision, was a question to which the Working Group decided to revert at a later stage, once an initial draft had been prepared by the Secretariat.

24. By way of a general comment, it was pointed out that chapter III of the Legislative Guide contained an extensive set of legislative recommendations and detailed notes thereon. In that connection, the question was raised as to whether it was recommended that the host country adopt specific legislation dealing with the procedures for selecting the concessionaire and, if so, how such provisions would relate to general legislation on government procurement.

25. In response, it was noted that the purpose of the legislative recommendations was to assist the host country in developing rules specially suited for the selection of the concessionaire. The recommendations were concerned with the particular needs of privately financed infrastructure projects and differed in many respects from general rules on government procurement, such as those contained in the UNCITRAL Model Law on Procurement of Goods, Construction and Services (the "UNCITRAL Model Procurement Law"). The legislative recommendations were not intended to replace or reproduce such general rules on government procurement and it was for each host country to decide in which manner they could best be implemented. For example, a State might wish to enact special legislation or regulations dealing only with the selection of the concessionaire, or might incorporate some of them into general legislation on privately financed infrastructure projects, with cross-references, as appropriate, to other legislation dealing with matters not covered in the recommendations (such as administrative and practical arrangements for conducting the selection proceedings).

26. In that connection, it was suggested that the Working Group might need to consider carefully the relationship between model provisions on selection procedures and the general procurement regime in the host country. It was also pointed out that two aspects should be borne in mind by the Working Group.

27. The first was that recommendation 14 was based on the assumption that there existed in the host country a general framework for government procurement that

provided for transparent and efficient competitive procedures in a manner that met the standards set forth in the UNCITRAL Model Procurement Law. The Working Group was invited to consider in due course how the model legislative provisions to be drafted should address the needs of countries that lacked such a general framework.

28. The second aspect to which the attention of the Working Group was drawn concerned the particular requirements of the selection procedures for privately financed infrastructure projects. It was pointed out that international experience had revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method, when applied for the award of privately financed infrastructure projects. The model legislative provisions to be developed by the Working Group should make clear the particular nature of the selection procedures to be dealt with by them.

Pre-selection of bidders

29. The text of the relevant recommendations was as follows:

Recommendation 15

“The bidders should demonstrate that they meet the pre-selection criteria that the contracting authority considers appropriate for the particular project, including:

“(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, namely, engineering, construction, operation and maintenance;

“(b) Sufficient ability to manage the financial aspects of the project and capability to sustain the financing requirements for the engineering, construction and operational phases of the project;

“(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating public infrastructure.”

Recommendation 16

“The bidders should be allowed to form consortia to submit proposals, provided that each member of a pre-selected consortium may participate, either directly or through subsidiary companies, in only one bidding consortium.”

Recommendation 17

“The contracting authority should draw up a short list of the pre-selected bidders that will subsequently be invited to submit proposals upon completion of the pre-selection phase.”

30. The Secretariat was requested to draft a model provision reflecting the substance of recommendation 15.

31. In respect of both recommendation 16 and recommendation 17, one view was that they contained provisions of

an operational nature, as such not requiring to be addressed in the form of model legislative provisions.

32. In response, it was observed that pre-selection was a crucial phase within the context of selection of the concessionaire for privately financed infrastructure projects and that, accordingly, model legislative provisions relating thereto should be drafted. As a general remark, it was pointed out that the Working Group should aim at drafting a comprehensive text on the selection process, capable of being used by legislators and government officers as a self-standing, self-sufficient tool for the purpose of enacting new or revising existing legislation in the area of privately financed infrastructure. Accordingly, it was agreed that any and all provisions that were felt to be critical to achieving the goals of privately financed infrastructure projects should be included in the draft text. At the same time, however, the Working Group agreed that the model legislative provisions should refrain from addressing unnecessary details that might impair the flexibility of the text.

33. In respect of recommendation 16, the view was expressed that the issue of submission of proposals by consortia could not be addressed by a single provision, since distinctions had to be drawn depending upon the kind of project at stake. It was clarified that, in the event that model legislative provisions were to be retained, they had to be drafted bearing in mind the general situation of privately financed infrastructure projects, consistent with the approach taken in the Legislative Guide.

34. With respect to recommendation 17, the suggestion to provide for the short list of pre-selected bidders to be published and notified to all parties having submitted an application for the purposes of pre-qualification was widely supported. The view was shared that such publication would enhance the transparency of the process, without prejudice however to the power of the enacting countries to address the issue of publication in the law rather than in regulations. It was recalled that notification of all parties having submitted an application to pre-qualify was also provided by article 7, paragraph 6, of the UNCITRAL Model Procurement Law.

Procedures for requesting proposals

Single-stage and two-stage procedures for requesting proposals

Recommendation 18

35. The text of the recommendation was as follows:

“Upon completion of the pre-selection proceedings, the contracting authority should request the pre-selected bidders to submit final proposals.”

36. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Recommendation 19

37. The text of the recommendation was as follows:

“Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when it is not feasible for it to formulate project specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated. Where a two-stage procedure is used, the following provisions should apply:

(a) The contracting authority should first call upon the pre-selected bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms;

(b) The contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals;

(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial project specifications and contractual terms prior to issuing a final request for proposals.”

38. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Content of the final request for proposals**Recommendation 20*

39. The text of the recommendation was as follows:

“The final request for proposals should include at least the following:

“(a) General information as may be required by the bidders in order to prepare and submit their proposals;

“(b) Project specifications and performance indicators, as appropriate, including the contracting authority’s requirements regarding safety and security standards and environmental protection;

“(c) The contractual terms proposed by the contracting authority;

“(d) The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which the criteria are to be applied in the evaluation of proposals.”

40. It was observed that it was crucial to provide for the contractual terms proposed by the contracting authority to be included in the final request for proposals, as provided by recommendation 20, paragraph c, and that therefore a model provision reflecting that recommendation should be drafted.

*Clarifications and modifications**Recommendation 21*

41. The text of the recommendation was as follows:

“The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the final request for proposals by issuing addenda at a reasonable time prior to the deadline for submission of proposals.”

42. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Evaluation criteria**Recommendation 22*

43. The text of the recommendation was as follows:

“The criteria for the evaluation and comparison of the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

“(a) Technical soundness;

“(b) Operational feasibility;

“(c) Quality of services and measures to ensure their continuity;

“(d) Social and economic development potential offered by the proposals.”

Recommendation 23

44. The text of the recommendation was as follows:

“The criteria for the evaluation and comparison of the financial and commercial proposals may include, as appropriate:

“(a) The present value of the proposed tolls, fees, unit prices and other charges over the concession period;

“(b) The present value of the proposed direct payments by the contracting authority, if any;

“(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

“(d) The extent of financial support, if any, expected from the Government;

“(e) Soundness of the proposed financial arrangements;

“(f) The extent of acceptance of the proposed contractual terms.”

45. The Working Group discussed the issue of the relationship between the evaluation criteria referring to non-financial aspects, as listed in recommendation 22, and the criteria relating to the financial aspects, as listed in recommendation 23.

46. It was felt that the model legislative provisions should recommend avoiding placing excessive emphasis on the financial aspects of a proposal, namely on the price criterion, to the detriment of non-financial aspects, which was felt inappropriate in respect of privately financed infrastructure projects. A similar view was that the model legislative provisions should clarify that price-related criteria could be taken into account only after evaluation of the non-financial aspects of the proposals had been carried out.

47. In response, it was noted that the issue of the relative weight to be given to financial criteria vis-à-vis non-financial aspects had been thoroughly addressed in the notes to the Legislative Guide. It was further noted that it would be inappropriate to address the issue of hierarchy among evaluation criteria at the legislative level. In that connection, it was also recalled that the mandate given to the Working Group was meant to comply with and not to amend the policy decisions underlying the Guide.

48. Concern was raised that departure from the price criterion might result in the overall transparency of the process being impaired. It was suggested that the draft model legislative provisions should provide for parameters capable of ensuring the objectiveness of the procedure. In that connection, it was observed that such problems of transparency and objectiveness might be addressed by the thresholds established by the contracting authority for the purpose of assessing the qualification and the responsiveness of the proposals, as provided in recommendation 24. It was further noted that such thresholds should be established by the contracting authority with a view to ensuring the viability of the project. Another suggestion was that the thresholds established for the purposes of assessing the responsiveness of the proposals should be included in the final request for proposals addressed in recommendation 20.

49. After discussion, the Working Group agreed that the issue of determining the relative weight to be given to the evaluation criteria should be left to the contracting authority, provided however that adequate transparency was ensured. However, it was further agreed that the model legislative provisions might usefully refer to the possibility for the contracting authority to structure the evaluation process in two stages, along the lines of article 42 of the UNCITRAL Model Procurement Law and as reflected in paragraph 81 of chapter III of the Legislative Guide.

50. The suggestion that environmental soundness, though possibly implied in the criteria of "technical soundness" and "quality of services", should be mentioned explicitly among the relevant non-financial evaluation criteria received support.

51. In response to a query as to the relationship between subparagraph (f) of recommendation 23 and recommendation 21, providing for the contracting authority being able to provide clarifications and modifications to the final request for proposals, it was explained that subparagraph (f) was only concerned with contractual terms that had not been qualified as non-negotiable by the contracting authority, in respect of which negotiations were allowed. With a view to enhancing transparency, it was agreed that the point should be clearly spelled out in the model legislative provisions.

Submission, opening, comparison and evaluation of proposals

Recommendation 24

52. The text of the recommendation was as follows:

"The contracting authority may establish thresholds with respect to quality, technical, financial and commercial aspects to be reflected in the proposals in accordance with the criteria as set out in the request for proposals. Proposals that fail to achieve the thresholds should be regarded as non-responsive."

53. Subject to the suggestion made in respect of recommendation 23, subparagraph (f), the Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Recommendation 25

54. The text of the recommendation was as follows:

"Whether or not it has followed a pre-selection process, the contracting authority may retain the right to require the bidders to demonstrate their qualifications again in accordance with criteria and procedures set forth in the request for proposals or the pre-selection documents, as appropriate. Where a pre-selection process has been followed, the criteria should be the same as those used in the pre-selection proceedings."

55. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Final negotiations and project award

Recommendation 26

56. The text of the recommendation was as follows:

"The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating. Final negotiations may not concern those terms of the contract which were stated as non-negotiable in the final request for proposals."

57. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Recommendation 27

58. The text of the recommendation was as follows:

"If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the other bidders on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals."

59. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation. For the purposes of transparency, however, it was suggested that the circumstances under which the contracting authority might consider it “apparent” that negotiations with the perspective bidder would not result in entering into the agreement should be identified explicitly.

Concession award without competitive procedures

Recommendation 28

60. The text of the recommendation was as follows:

“The law should set forth the exceptional circumstances under which the contracting authority may be authorized to award a concession without using competitive procedures, such as:

“(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in a competitive selection procedure would therefore be impractical;

“(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

“(c) Reasons of national defence or national security;

“(d) Cases where there is only one source capable of providing the required service (for example, because it requires the use of patented technology or unique know-how);

“(e) In case of unsolicited proposals of the type referred to in legislative recommendations 34 and 35;

“(f) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals, and if, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award;

“(g) Other cases where the higher authority authorizes such an exception for compelling reasons of public interest.”

61. As a general comment, it was noted that in some countries concessions were not always awarded through structured competitive procedures. Coupled with measures enhancing transparency, the less formal procedures used in those countries produced satisfactory results, a circumstance that was adequately reflected in the notes to legislative recommendation 28.^a It was therefore suggested that the word “exceptional” should not appear in a model provision to implement recommendation 28.

62. There was strong objection to that proposal, since the prevailing view within the Working Group was that the text of recommendation 28 correctly reflected the policy

guidance adopted by the Commission that, in the context of privately financed infrastructure projects, the award of a concession without structured competitive procedures should be used in exceptional circumstances.

63. The Working Group was reminded of the Commission’s understanding that the list of exceptional circumstances authorizing the award of a concession without structured competitive procedures was not exhaustive.⁷ The Working Group was of the view, however, that the flexibility intended by the Commission was already contained in subparagraph (g) of the recommendation and that, as a matter of drafting technique, the words “such as” should not appear in a model provision to implement recommendation 28. The Working Group agreed to consider expanding the scope of subparagraph (g) by adding language along the following lines “or other cases of the same exceptional nature, as defined by the law”.

64. The Working Group agreed that the words “urgent” in subparagraph (a) and “compelling” in subparagraph (g) might not be needed in a model provision to implement recommendation 28.

Recommendation 29

65. The text of the recommendation was as follows:

“The law may require that the following procedures be observed for the award of a concession without competitive procedures:

“(a) The contracting authority should publish a notice of its intention to award a concession for the implementation of the proposed project and should engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit;

“(b) Offers should be evaluated and ranked according to the evaluation criteria established by the contracting authority;

“(c) Except for the situation referred to in recommendation 28 (c), the contracting authority should cause a notice of the concession award to be published, disclosing the specific circumstances and reasons for the award of the concession without competitive procedures.”

66. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

67. The Working Group also agreed that it might be useful to expand the scope of subparagraph (c) so as to align the publicity requirements contained therein with the record-keeping requirements referred to in paragraph 122 of chapter III of the Legislative Guide.

Unsolicited proposals

68. There was general agreement within the Working Group that it would be useful to provide specific legislative guidance, in the form of model legislative provisions, on

^aUNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (United Nations publication, Sales No. E.01.V.4), chap. III, para. 88.

⁷Ibid., Fifty-third Session, Supplement No. 17 (A/53/17), para. 168.

the manner in which contracting authorities might handle unsolicited proposals. It was pointed out in that connection that, whether or not such proposals might give rise to some objections of principle, it would be preferable to offer enacting States a satisfactory system to ensure transparency and fairness in handling unsolicited proposals, rather than simply to ignore them altogether.

69. As a general remark, it was observed that it might be useful for the Working Group to define more clearly the notion of unsolicited proposals. It was also suggested that the Working Group should point out, possibly in notes that might accompany the model legislative provisions, that appropriate administrative procedures should be developed by the contracting authority in order to ensure efficiency and transparency in handling unsolicited proposals.

Recommendation 30

70. The text of the recommendation was as follows:

“By way of exception to the selection procedures described in legislative recommendations 14-27, the contracting authority may be authorized to handle unsolicited proposals pursuant to specific procedures established by the law for handling unsolicited proposals, provided that such proposals do not relate to a project for which selection procedures have been initiated or announced by the contracting authority.”

71. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Procedures for determining the admissibility of unsolicited proposals

Recommendation 31

72. The text of the recommendation was as follows:

“Following receipt and preliminary examination of an unsolicited proposal, the contracting authority should inform the proponent, within a reasonably short period, whether or not there is a potential public interest in the project. If the project is found to be in the public interest, the contracting authority should invite the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to make a proper evaluation of the concept or technology and determine whether the proposal meets the conditions set forth in the law and is likely to be successfully implemented at the scale of the proposed project.”

73. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Recommendation 32

74. The text of the recommendation was as follows:

“The proponent should retain title to all documents submitted throughout the procedure and those documents should be returned to it in the event that the proposal is rejected.”

75. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology

Recommendation 33

76. The text of the recommendation was as follows:

“The contracting authority should initiate competitive selection procedures under recommendations 14-27 above if it is found that the envisaged output of the project can be achieved without the use of a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights or if the proposed concept or technology is not truly unique or new. The author of the unsolicited proposal should be invited to participate in such proceedings and may be given a premium for submitting the proposal.”

77. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation. It was pointed out, however, that the notion of “premium” in the recommendation might need to be clarified by the Working Group at a later stage.

Procedures for handling unsolicited proposals involving proprietary concepts or technology

Recommendation 34

78. The text of the recommendation was as follows:

“If it appears that the envisaged output of the project cannot be achieved without using a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights, the contracting authority should seek to obtain elements of comparison for the unsolicited proposal. For that purpose, the contracting authority should publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period.”

79. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

Recommendation 35

80. The text of the recommendation was as follows:

“The contracting authority may engage in negotiations with the author of the unsolicited proposal if no alternative proposals are received, subject to approval by a higher authority. If alternative proposals are submitted, the contracting authority should invite all the proponents to negotiations in accordance with the provisions of legislative recommendation 29 (a)-(c).”

81. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Confidentiality**Recommendation 36*

82. The text of the recommendation was as follows:

“Negotiations between the contracting authority and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other commercial information relating to the negotiations without the consent of the other party.”

83. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Notice of project award**Recommendation 37*

84. The text of the recommendation was as follows:

“The contracting authority should cause a notice of the award of the project to be published. The notice should identify the concessionaire and include a summary of the essential terms of the project agreement.”

85. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Record of selection and award proceedings**Recommendation 38*

86. The text of the recommendation was as follows:

“The contracting authority should keep an appropriate record of key information pertaining to the selection and award proceedings. The law should set forth the requirements for public access.”

87. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation.

*Review procedures**Recommendation 39*

88. The text of the recommendation was as follows:

“Bidders who claim to have suffered, or who may suffer, loss or injury owing to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority’s acts in accordance with the laws of the host country.”

89. The Secretariat was requested to draft a model provision reflecting the substance of the legislative recommendation. It was observed, in that connection, that the Working Group should, at a later stage, consider whether such a model provision should appear after the provisions dealing with the selection of the concessionaire or whether it would

be best placed together with the provisions dealing with settlement of disputes in the various phases of an infrastructure project.

*Chapter I. General legislative and institutional framework**Constitutional, legislative and institutional framework**Recommendation 1*

90. The text of the recommendation was as follows:

“The constitutional, legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness, and the long-term sustainability of projects. Undesirable restrictions on private sector participation in infrastructure development and operation should be eliminated.”

91. The Working Group acknowledged that both provisions contained in recommendation 1 were of a general nature and as such were not suitable for translation into legislative language. However, it was agreed that the substance of the recommendation might usefully be retained as a reminder of the broad objectives to be pursued in the field of privately financed infrastructure, possibly in a preamble or in explanatory notes to the model legislative provisions that the Working Group might decide to prepare.

Scope of authority to award concessions

92. The text of the relevant recommendations was as follows:

Recommendation 2

“The law should identify the public authorities of the host country (including, as appropriate, national, provincial and local authorities) that are empowered to award concessions and enter into agreements for the implementation of privately financed infrastructure projects.”

Recommendation 3

“Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems.”

Recommendation 4

“The law should identify the sectors or types of infrastructure in respect of which concessions may be granted.”

Recommendation 5

“The law should specify the extent to which a concession might extend to the entire region under the

jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.”

93. The Working Group considered recommendations 2-5, on the scope of authority to award concessions, as a unitary set. As a general remark, it was recalled that all those recommendations served the purpose of recommending legislative clarity both as to the identification of the authorities empowered to award concession agreements and as to the scope of such powers. Accordingly, support was expressed for the view that all the aspects addressed in recommendations 2-5 might be reflected and dealt with in a single model legislative provision.

94. As to the technique by which the identification of the relevant authorities should be made, it was suggested that alternative solutions could be proposed, possibly along the lines of the options provided in article 2, paragraph (b), of the UNCITRAL Model Procurement Law. It was clarified, however, that providing for an exhaustive list of the single relevant bodies or agencies might make it necessary for the law to specify also the sectors in respect of which those bodies or agencies were empowered. Without prejudice to the solution to be given to that issue, the Working Group agreed that the model legislative provisions should have a general scope and not be limited to specific sectors. In that connection, it was also felt that a general definition as to the types of infrastructure projects falling within the scope of those provisions, along the lines of recommendation 3, could be usefully retained.

95. Support was expressed for the view that the issue of possible overlapping of competencies and authorities in respect of privately financed infrastructure projects, depending on the structure of the enacting State or on the nature of the service at stake, should be expressly addressed in a model legislative provision, with a view to ensuring coordination.

96. After discussion, the Working Group requested the Secretariat to draft a model legislative provision addressing that issue, without however delving into excessive details that might result in unnecessary complication of the text. In that connection, it was clarified that the task of providing details as to the structure of the enacting State should be left to national legislators.

Administrative coordination

Recommendation 6

97. The text of the recommendation was as follows:

“Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance

with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.”

98. While recalling that the recommendation had been considered crucial to avoid delays and inefficiencies related to lack of coordination among different public authorities, it was felt that the issue did not necessarily lend itself to be dealt with in legislation. In that connection, it was observed that many countries considered such coordination as a matter of administrative practice.

99. Another view was that the issue of coordination among authorities was crucial in order to ensure the long-term sustainability of infrastructure projects and that, accordingly, it should be reflected in a provision of a legislative nature. Some support was expressed for the suggestion that the policy underlying the recommendation should be retained in the preamble or the notes to the model legislative provisions, as an issue of a general nature. A further suggestion was that the issue should be dealt with within the context of scope of authority.

100. As a general remark, the Working Group agreed that the issue of determining how to reflect principles that, though important, were not felt suitable to be addressed in model legislative provisions should be deferred to a later stage.

Authority to regulate infrastructure services

101. The text of the relevant recommendations was as follows:

Recommendation 7

“The authority to regulate infrastructure services should not be entrusted to entities that directly or indirectly provide infrastructure services.”

Recommendation 8

“Regulatory competence should be entrusted to functionally independent bodies with a level of autonomy sufficient to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.”

Recommendation 9

“The rules governing regulatory procedures should be made public. Regulatory decisions should state the reasons on which they are based and should be accessible to interested parties through publication or other means.”

Recommendation 10

“The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body, which may include court review, and should set forth the grounds on which such a review may be based.”

Recommendation 11

“Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector.”

102. The general view was that recommendations 7-11 were not suitable to be translated into legislative language and that, accordingly, the authority to regulate infrastructure services should remain outside the scope of the model legislative provisions. In that connection, it was pointed out that some issues pertaining to the regulatory authority might be usefully dealt with within the context of other chapters, such as those addressing the operation phase or the settlement of disputes.

Chapter II. Project risks and government support*Project risks and risk allocation**Recommendation 12*

103. The text of the recommendation was as follows:

“No unnecessary statutory or regulatory limitations should be placed upon the contracting authority’s ability to agree on an allocation of risks that is suited to the needs of the project.”

104. While reaffirming its importance for the purpose of making legislators aware of the implications of their policy choices in the field of privately financed infrastructure, the Working Group agreed that the recommendation had an educational rather than a prescriptive character and therefore was not suitable to be transformed into a model legislative provision.

*Government support**Recommendation 13*

105. The text of the recommendation was as follows:

“The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.”

106. One view was that the recommendation was related to the broader issue of the scope of authority to award concessions. Accordingly, it was suggested that its substance should be included in the model legislative provisions related to legislative recommendations 2-5. While that view attracted some support, a concern was that mentioning governmental financial or economic support in a model legislative provision would be tantamount to recommending that support be given by the Government, a result that was considered inappropriate in respect of those Governments whose policy was not to grant any support for privately financed infrastructure projects. In response, it was observed that the purpose of a provision reflecting the substance of recommendation 13 would not consist in

recommending government support to be granted as a policy approach, but rather in ensuring transparency in those systems where a policy decision in favour of such support had been taken.

107. In respect of the last part of the recommendation, suggesting that the law should clearly state the types of support that could be provided by the public authorities, it was feared that its incorporation in a model legislative provision might result in unnecessarily diminishing flexibility in negotiations. A further concern was that the task of drafting a comprehensive list might prove difficult, owing to the variety of forms that such support could take.

108. After discussion, the Working Group requested the Secretariat to draft a model provision reflecting the substance of the recommendation, possibly in square brackets, with a view to drawing the attention of the Group to the need to reconsider the issue at a later stage.

Chapter IV. Construction and operation of infrastructure: legislative framework and project agreement*General provisions on the project agreement**Recommendation 40*

109. The text of the recommendation was as follows:

“The law might identify the core terms to be provided in the project agreement, which may include those terms referred to in recommendations 41-68 below.”

110. The Working Group noted that, as pointed out in the Legislative Guide (chap. IV, “Construction and operation of infrastructure: legislative framework and project agreement”, para. 2), domestic legislation often contained provisions dealing with the content of the project agreement. In some countries, the law merely referred to the need for an agreement between the concessionaire and the contracting authority, while the laws of other countries contained extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach was taken by those laws which listed a number of issues that needed to be addressed in the project agreement without regulating in detail the content of its clauses.

111. The Working Group was mindful of the fact that general legislative provisions on certain essential elements of the project agreement might serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties. They might also be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of project agreements at different levels of government (national, provincial or local). Lastly, legislation might sometimes be required so as to provide the contracting authority with the power to agree on certain types of provisions.

112. However, the Working Group was of the view that general legislative provisions dealing in detail with the rights and obligations of the parties might deprive the

contracting authority and the concessionaire of the necessary flexibility to negotiate an agreement that took into account the needs and particularities of a specific project.

113. Against that background, the Working Group held an extensive exchange of views on whether it would be desirable to formulate a model legislative provision that listed essential issues that needed to be addressed in the project agreement. It was proposed, in that connection, that such a list be based upon the headings that preceded recommendations 41-68, with some adjustments where it was felt that the language used in the headings did not provide a sufficiently clear indication of the subject matter to be dealt with in the project agreement. The Working Group was also reminded of the possible disadvantages of drafting such a list of essential provisions. It was said, for instance, that such a list would give rise to the question as to whether the parties had the power not to include any of the matters listed or whether they might, in turn, include other matters not contained in the list. Another possible disadvantage might be uncertainty as to what might be the legal consequences of failure by the parties to follow a list of provisions established in legislation.

114. Having considered the various views that were expressed, the Working Group agreed that it would be useful to formulate a model legislative provision that listed essential issues that needed to be addressed in the project agreement. The Secretariat was requested to prepare an initial draft of such a model provision on the basis of the headings that preceded recommendations 41-68, with the adjustments that might be required so as to spell out clearly, but without unnecessary details, the various topics that needed to be covered by project agreements.

115. The Working Group proceeded to consider the suggestion that, in addition to the list of core provisions of the project agreement, some of the matters dealt with in recommendations 41-68 related to issues that deserved to be treated separately in specific model legislative provisions. This, it was said, was the case, in particular, of those recommendations which related to matters for which prior legislative authorization might be needed or those which might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement was not admitted in some legal systems.

116. While there were no objections in principle to that proposal, the Working Group decided to revert to it at a later stage once it had completed its review of legislative recommendations 41-68 (see paras. 118-164 below).

Recommendation 41

117. The text of the recommendation was as follows:

“Unless otherwise provided, the project agreement is governed by the law of the host country.”

118. In response to a question as to the meaning of the opening phrase of the recommendation, it was pointed out that the issue of the law governing the project agreement had been the subject of extensive debate at the thirty-second session of the Commission. The flexible wording

eventually agreed upon by the Commission was intended to take into account the fact that, under some legal systems, provisions allowing for the application of a law other than the law of the host country could only be of a statutory nature, whereas in other legal systems the contracting authority might have the power to agree on the applicable law.

119. It was further stated that beyond the question of the choice between domestic or foreign law, the recommendation also related to the issue of which branch of the laws of the host country would govern the project agreement (that is, whether administrative law or general contract law). That question, it was pointed out, had significant practical implications, since administrative law in some legal systems provided for a number of implied or explicit prerogatives of governmental agencies in connection with administrative contracts, such as powers to terminate a contract unilaterally or to amend its terms.

120. It was suggested that legislative recommendation 41 did not lend itself to being transformed into a self-standing model legislative provision. At the most, it was said, the Working Group might wish to consider, at an appropriate stage, including a heading such as “governing law” in a list of core provisions of a project agreement that might be drafted to implement legislative recommendation 40.

121. The countervailing view, however, was that recommendation 41 was important, since it touched upon the sovereignty of host countries. While in practice investors, in particular foreign ones, might have concerns about the overall stability and predictability of the host country’s legal framework for private investment in infrastructure, the model legislative provisions should acknowledge the efforts that had been made in many countries, including developing countries, to improve their investment climate. The Working Group took those views into account and requested the Secretariat to draft a model legislative provision reflecting the substance of recommendation 41.

Organization of the concessionaire

122. The text of the relevant recommendations was as follows:

Recommendation 42

“The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country.”

Recommendation 43

“The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval by the contracting authority of the statutes and by-laws of the project company and fundamental changes therein.”

123. It was observed that on some occasions the requirement of a minimum capital was established by the contracting authority as a prerequisite for entering into the

agreement. The suggestion was made that, in view of the relationship between recommendations 42 and 43 and the governing law of the project agreement, those recommendations were suitable for transformation into model legislative provisions.

The project site, assets and easements

Recommendation 44

124. The text of the recommendation was as follows:

“The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.”

125. It was suggested that the distinction made in recommendation 44 between various categories of project assets reflected well-established principles of law in some legal systems. Therefore, the recommendation was found to be suitable for transformation into a model legislative provision.

Recommendation 45

126. The text of the recommendation was as follows:

“The contracting authority should assist the concessionaire in obtaining such rights related to the project site as necessary for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction, operation and maintenance of the facility.”

127. Strong support was expressed for the view that the issues addressed in recommendation 45 needed to be reflected in model legislative provisions, since they addressed rights and obligations of third parties.

Financial arrangements

128. The text of the relevant recommendations was as follows:

Recommendation 46

“The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees.”

Recommendation 47

“Where the tariffs or fees charged by the concessionaire are subject to external control by a regulatory body, the law should set forth the mechanisms for periodic and extraordinary revisions of the tariff adjustment formulas.”

Recommendation 48

“The contracting authority should have the power, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users or to enter into commitments for the purchase of fixed quantities of goods or services.”

129. The view was expressed that model legislative provisions in respect of recommendations 46-48 should be drafted, since the issue of both collection of fees and other payments to be made to the concessionaire was crucial in respect of the financial balance of the project and the very notion of a concession agreement and therefore needed to be addressed at a legislative rather than at a contractual level. After considering that suggestion, the Working Group decided that a model legislative provision dealing with financial arrangements should be limited to stating the right of the concessionaire to collect tariffs or fees for the use of the facility, as mentioned in the first sentence of recommendation 46.

Security interests

Recommendation 49

130. The text of the recommendation was as follows:

“The concessionaire should be responsible for raising the funds required to construct and operate the infrastructure facility and, for that purpose, should have the right to secure any financing required for the project with a security interest in any of its property, with a pledge of shares of the project company, with a pledge of the proceeds and receivables arising out of the concession, or with other suitable security, without prejudice to any rule of law that might prohibit the creation of security interests in public property.”

131. The Working Group acknowledged that the ability of the concessionaire to grant all those securities which might be required in order to obtain adequate financing (including, when appropriate, securities on the shares of the project company or on the proceeds and the revenues of the concession) was often crucial for the success of the project. While there was consensus as to the importance of the issue, it was also recalled that the issue had proved to be particularly sensitive, owing to the constraints provided in some legal systems in respect of the creation of securities or other liens on public property. It was also pointed out that the creation of security rights was a matter exceeding the scope of concession law and dealt with by the general law on security interests.

132. While the Working Group was aware of the possible difficulty of drafting a model legislative provision that

dealt with the various issues related to security interests in an adequate fashion, it was felt that a model legislative provision in that respect would be desirable.

Assignment of the concession

Recommendation 50

133. The text of the recommendation was as follows:

“The concession should not be assigned to third parties without the consent of the contracting authority. The project agreement should set forth the conditions under which the contracting authority might give its consent to an assignment of the concession, including the acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire’s technical and financial capability as necessary for providing the service.”

134. It was pointed out that recommendation 50 reflected the importance attached by some legal systems to the personal character (*intuitu personae*) of concession contracts, which was found to be crucial for ensuring the long-term sustainability of the project. Accordingly, the Working Group agreed that the essential principles reflected in the recommendation deserved to be addressed in the form of a model legislative provision.

Transfer of controlling interest in the project company

Recommendation 51

135. The text of the recommendation was as follows:

“The transfer of a controlling interest in a concessionaire company may require the consent of the contracting authority, unless otherwise provided.”

136. It was suggested that recommendation 51, like recommendation 50, was crucial in order to preserve the personal character of the project agreement and that, accordingly, its content should be reflected in a model legislative provision.

Construction works

Recommendation 52

137. The text of the recommendation was as follows:

“The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority’s right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances.”

138. The Working Group shared the view that the recommendation dealt with matters of an essentially contractual

nature and that no model legislative provision addressing them was desirable.

Operation of infrastructure

Recommendation 53

139. The text of the recommendation was as follows:

“The project agreement should set forth, as appropriate, the extent of the concessionaire’s obligations to ensure:

“(a) The adaptation of the service so as to meet the actual demand for the service;

“(b) The continuity of the service;

“(c) The availability of the service under essentially the same conditions to all users;

“(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.”

140. It was suggested that the recommendation reflected fundamental principles of law governing the obligations of infrastructure concessionaires in some legal systems and that, therefore, it would be useful to transform it into a model legislative provision.

Recommendation 54

141. The text of the recommendation was as follows:

“The project agreement should set forth:

“(a) The extent of the concessionaire’s obligation to provide the contracting authority or a regulatory body, as appropriate, with reports and other information on its operations;

“(b) The procedures for monitoring the concessionaire’s performance and for taking such reasonable actions as the contracting authority or a regulatory body may find appropriate, to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements.”

142. The Working Group shared the view that the recommendation dealt with matters of an essentially contractual nature and that no model legislative provision addressing them was desirable.

Recommendation 55

143. The text of the recommendation was as follows:

“The concessionaire should have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.”

144. The Working Group did not find it desirable or necessary to formulate a draft model legislative provision on the basis of recommendation 55.

General contractual arrangements

145. The text of the relevant recommendations was as follows:

Recommendation 56

“The contracting authority may reserve the right to review and approve major contracts to be entered into by the concessionaire, in particular contracts with the concessionaire’s own shareholders or related persons. The contracting authority’s approval should not normally be withheld except where the contracts contain provisions inconsistent with the project agreement or manifestly contrary to the public interest or to mandatory rules of a public law nature.”

Recommendation 57

“The concessionaire and its lenders, insurers and other contracting partners should be free to choose the applicable law to govern their contractual relations, except where such a choice would violate the host country’s public policy.”

146. The Working Group was of the view that recommendations 56 and 57 dealt with matters of an essentially contractual nature and that no model legislative provision addressing them was desirable.

Recommendation 58

147. The text of the recommendation was as follows:

“The project agreement should set forth:

“(a) The forms, duration and amounts of the guarantees of performance that the concessionaire may be required to provide in connection with the construction and the operation of the facility;

“(b) The insurance policies that the concessionaire may be required to maintain;

“(c) The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;

“(d) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement owing to circumstances beyond their reasonable control;

“(e) Remedies available to the contracting authority and the concessionaire in the event of default by the other party.”

148. It was suggested that subparagraph (c) reflected fundamental principles of law on infrastructure operation in some legal systems and that, therefore, it was useful to translate it into a model legislative provision. As to the other subparagraphs of the recommendation, however, the Working Group felt that they dealt with matters of an

essentially contractual nature and that no model legislative provision addressing them was desirable.

Recommendation 59

149. The text of the recommendation was as follows:

“The project agreement should set forth the circumstances under which the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations.”

150. It was suggested that the recommendation reflected fundamental principles of law on infrastructure operation in some legal systems and that, therefore, it would be useful to transform it into a model legislative provision.

Recommendation 60

151. The text of the recommendation was as follows:

“The contracting authority should be authorized to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required or if other specified events occur that could justify the termination of the project agreement.”

152. It was suggested that the recommendation contained useful advice in order to facilitate the financing of infrastructure projects and that, therefore, it would be useful to transform it into a model legislative provision.

Chapter V. Duration, extension and termination of the project agreement*Duration and extension of the project agreement**Recommendation 61*

153. The text of the recommendation was as follows:

“The duration of the concession should be specified in the project agreement.”

154. The Working Group was of the view that it would be useful to draft a model legislative provision to implement recommendation 61.

Recommendation 62

155. The text of the recommendation was as follows:

“The term of the concession should not be extended, except for those circumstances specified in the law, such as:

“(a) Completion delay or interruption of operation due to the occurrence of circumstances beyond either party’s reasonable control;

“(b) Project suspension brought about by acts of the contracting authority or other public authorities;

“(c) To allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the project agreement that the concessionaire would not be able to recover during the normal term of the project agreement.”

156. The Working Group was of the view that the recommendation set out an important principle to ensure transparency and avoid abuse in the extension of project agreements and that it was therefore suitable for translation into a model legislative provision.

Termination of the project agreement

157. The text of the relevant recommendations was as follows:

Termination by the contracting authority

Recommendation 63

“The contracting authority should have the right to terminate the project agreement:

“(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

“(b) For reasons of public interest, subject to payment of compensation to the concessionaire.”

Termination by the concessionaire

Recommendation 64

“The concessionaire should have the right to terminate the project agreement under exceptional circumstances specified in the law, such as:

“(a) In the event of serious breach by the contracting authority or other public authority of their obligations under the project agreement;

“(b) In the event that the concessionaire’s performance is rendered substantially more onerous as a result of variation orders or other acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the project agreement.”

Termination by either party

Recommendation 65

“Either party should have the right to terminate the project agreement in the event that the performance of its obligations is rendered impossible by the occurrence of circumstances beyond either party’s reasonable control. The parties should also have the right to terminate the project agreement by mutual consent.”

158. The Working Group was of the view that it would be useful to formulate model legislative provisions to implement recommendations 63-65.

Consequences of expiry or termination of the project agreement

Transfer of assets to the contracting authority or to a new concessionaire

Recommendation 66

159. The text of the recommendation was as follows:

“The project agreement should lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement.”

160. The Working Group was of the view that the recommendation dealt with matters of an essentially contractual nature and that no model legislative provision addressing them was desirable.

Financial arrangements upon termination

Recommendation 67

161. The text of the recommendation was as follows:

“The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement, and for losses, including lost profits.”

162. It was suggested that the recommendation contained useful advice in order to facilitate the financing of infrastructure projects and that, therefore, it could be usefully translated into a model legislative provision. In drafting a model provision, it was said, the Working Group should consider the relationship between recommendation 67 and recommendation 58, subparagraph (c).

Wind-up and transitional measures

Recommendation 68

163. The text of the recommendation was as follows:

“The project agreement should set out, as appropriate, the rights and obligations of the parties with respect to:

“(a) The transfer of technology required for the operation of the facility;

“(b) The training of the contracting authority’s personnel or of a successor concessionaire in the operation and maintenance of the facility;

“(c) The provision, by the concessionaire, of operation and maintenance services and the supply of spare

parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.”

164. It was suggested that recommendation 68 dealt with important follow-up measures that were of particular significance for developing countries and that, therefore, it was desirable to formulate a model legislative provision to address them.

Chapter VI. Settlement of disputes

Disputes between the contracting authority and the concessionaire

Recommendation 69

165. The text of the recommendation was as follows:

“The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as best suited to the needs of the project.”

166. It was generally felt that the principle expressed in recommendation 69, providing the contracting authority with the freedom to agree upon those mechanisms for settling of disputes which the parties deem to be appropriate to the specific needs of the project (including without limitation arbitration), should be reflected in model legislative provisions. It was pointed out that a legislative sanction of that freedom would provide useful guidance not only to the benefit of countries where explicit prohibitions were in place (possibly deriving from the subject matter of the dispute or from the public nature of the contracting authority), but also for those legal systems where no clear enabling provision was available and the implementation of contractual mechanisms for settlement of disputes might be resisted by judiciary or administrative courts. Accordingly, the Secretariat was requested to draft a model provision reflecting the substance of legislative recommendation 69.

167. In that connection, it was suggested that different mechanisms for settlement of disputes might be required in respect of each phase of an infrastructure project. It was clarified that mechanisms that might be suitable in respect of the bidding phase, where the parties had not yet entered into an agreement, might not be appropriate in respect of disputes arising subsequent to the award and the entering into of the project agreement. Similarly, specific mechanisms might be required for the various subsequent phases of development of the project.

168. The prevailing view, however, was that it was not desirable to insert such distinctions in the model legislative provision reflecting the substance of recommendation 69. In that connection, it was clarified that that recommendation was meant to be of a general nature and did not purport to suggest any specific method of resolution of disputes.

169. A query was raised as to the relationship between recommendation 69 and recommendation 10, providing for the right of the concessionaire to request a review of

regulatory decisions by an independent and impartial body. In response, it was recalled that recommendation 10 envisaged primarily situations where the law provided that complaints by public service providers should be filed with an entity other than the contracting authority, such as a regulatory agency or another governmental agency, while recommendation 69 merely covered disputes arising between the concessionaire and the contracting authority.

170. While recognizing the importance of drawing the attention of the host country’s legislators to the need for providing dispute settlement mechanisms for dealing with the situations envisaged in recommendation 10, the Working Group agreed that an attempt to draft model legislative provisions to implement recommendation 10 might prove difficult, in view of the variety of mechanisms that might need to be considered. The Working Group therefore decided that no such model provision was desirable. Nevertheless, an appropriate reference, possibly in a note accompanying the model legislative provisions, should highlight the importance of procedures of review of regulatory decisions to ensure the objective of transparency set forth in the recommendation.

Disputes between the project promoters and between the concessionaire and its lenders, contractors and suppliers

Recommendation 70

171. The text of the recommendation was as follows:

“The concessionaire and the project promoters should be free to choose the appropriate mechanisms for settling commercial disputes among the project promoters, or disputes between the concessionaire and its lenders, contractors, suppliers and other business partners.”

172. It was observed that recommendation 70 usefully spelled out a specific aspect of the general principle of freedom of contract set forth in recommendation 57. Accordingly, it was agreed that it would be useful to draft a model legislative provision reflecting the recommendation, for the purpose of either eliminating existing legal obstacles or to overcoming possible contrary practices of judicial or administrative authorities.

Disputes involving customers or users of the infrastructure facility

Recommendation 71

173. The text of the recommendation was as follows:

“The concessionaire may be required to make available simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.”

174. It was pointed out that recommendation 71 was not concerned with major disputes between the concessionaire and its customers or users of the infrastructure facility, but with claims or disagreements that had not yet reached that stage. Given the variety of mechanisms that might be

established to implement the recommendation and the practical rather than legislative character of the matter, the Working Group agreed that no model legislative provision reflecting the substance of the recommendation was desirable.

C. Relationship between the draft model legislative provisions and the Legislative Guide

175. Having completed its review of the legislative recommendations contained in the Legislative Guide, the Working Group proceeded to consider the relationship between the model legislative provisions and the Legislative Guide.

176. As a general comment, it was noted that the model legislative provisions, in accordance with the mandate given to the Working Group by the Commission, were expected to become an addition to the Legislative Guide, but that such model provisions were not expected to supplant the recommendations contained in the Guide.

177. It was pointed out, in that connection, that the need for legislators to bear in mind the whole of the contents of the Legislative Guide, whether or not expressly dealt with in the model legislative provisions, should be clearly spelled out, possibly in the preamble or in explanatory notes thereto. As a general view, it was reaffirmed that the Legislative Guide should be preserved as a valuable piece of work and that, accordingly, the model legislative provisions should be thought of as a product aimed at supplementing rather than replacing it. As to the technique to be

used in order to achieve that result, several suggestions were made, including establishing a link between the two texts by way of inserting footnotes or cross references to the relevant chapters of the Guide, or drafting a foreword along the lines of the foreword highlighting the relationship between the recommendations and the notes in the Guide.

178. A further proposal was to reproduce the text of the relevant legislative recommendations next to the text of each model legislative provision. While that suggestion attracted some support, concern was expressed that it might prove misleading as to the respective nature and hierarchy of the provisions, especially where only slight differences in language were given. A further concern was that such a technique might result in diminishing the visibility and ultimately the usefulness of the model legislative provisions.

179. After discussion, it was widely felt that a final decision in that respect would be premature. Accordingly, the Working Group decided that it would be advisable to revert to it at a later stage, while bearing in mind all the different suggestions.

180. There was a specific discussion in respect of the relationship between the model legislative provisions on the selection of the concessionaire and the UNCITRAL Model Procurement Law. In that connection, it was suggested (a) that the preamble or the explanatory notes to the model legislative provisions should make clear that the selection proceeding was different from tendering and (b) that there might be more detailed references in footnotes or otherwise to specific provisions of the UNCITRAL Model Procurement Law.

III. INSOLVENCY LAW

A. Report of the Working Group on Insolvency Law on the work of its twenty-fourth session (New York, 23 July-3 August 2001)

(A/CN.9/504) [Original: English]

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I. INTRODUCTION

1. At its thirty-third session, the United Nations Commission on International Trade Law (UNCITRAL) noted the recommendation made by the Working Group on Insolvency Law in the report of the exploratory session held at Vienna from 6 to 17 December 1999 (A/CN.9/469, para. 140) and gave the Working Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

2. At that session, the Commission also recommended that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of the International Bar

Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, it was noted that the UNCITRAL secretariat would organize a colloquium before the next session of the Working Group, in cooperation with INSOL International and IBA, as had been proposed by those organizations.¹

3. That colloquium was organized with the co-sponsorship and organizational assistance of INSOL International and in conjunction with IBA in Vienna from 4 to 6 December 2000, with a view to identifying and discussing the needs of nations in the process of undertaking reform of their domestic laws relating to insolvency and to determine the manner in which the Commission and other organizations could assist that process of reform.

4. Broad support was expressed by participants in the colloquium in favour of the Commission's undertaking work on the key elements of an effective insolvency regime (see the report on the UNCITRAL/INSOL/IBA Global Insolvency Colloquium (A/CN.9/495, para. 34)). The colloquium strongly recommended that approximately six

¹Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 408.

months should be allowed for thorough preparation of drafts for consideration by the Working Group. It was also noted that the Commission had requested the Working Group to bear in mind the work under way or already completed by other international organizations and to commence its work after receipt of the reports currently being prepared by other organizations, including the World Bank.

5. At its thirty-fourth session, in 2001, the Commission took note with satisfaction of the report of the colloquium (A/CN.9/495) and commended the work accomplished thus far, in particular the holding of the colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the colloquium, in particular with respect to the form that future work might take and the interpretation of the mandate given to the Working Group by the Commission at its thirty-third session.

6. In terms of the mandate given to the Working Group, the Commission was generally of the view that it should be interpreted broadly to enable the Working Group to develop a work product that could reflect the elements mentioned in the mandate for inclusion (see para. 1 above and A/CN.9/495, para. 13). As to the possible form of future work, it was reaffirmed that a model law on substantive features of an insolvency regime would be neither desirable nor feasible, given the complexity and variety of issues involved in insolvency law and the disparity of approaches taken within the various legal systems. The view was widely shared that the work should ensure as much flexibility as possible, while at the same time maximizing utility. A concern was that while a legislative guide could provide the necessary flexibility, it might result in a product that was too general and too abstract to provide the required guidance. Accordingly, it was suggested that the Working Group bear in mind the need to be as specific as possible in developing its work and in that connection it was suggested that model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

7. The view was widely shared that the work should take the form of a legislative guide. It was pointed out that a product issued in that form might prove very useful not only for countries that did not have an efficient and effective insolvency regime and needed to develop such a regime, but also for countries that had undertaken or were to undertake the process of modernizing and reviewing their national system. A further view was that in developing the guide the Working Group should be mindful of the goal of furthering trade and promoting commerce, not just of the goal of harmonization of existing laws.

8. It was suggested that the three key areas for organizing the material to be included in the guide, as outlined in paragraphs 30-33 of A/CN.9/495, provided an appropriate format for the essential elements and that work should proceed on that basis. As to the substantive contents of the guide, a number of suggestions were made, including that, in developing the legislative guide, the Working Group should bear in mind a number of key principles and objectives such as respecting issues of public policy; enhancing

the coordination role of courts; establishing a special regime for public claims; the priority of reorganization over liquidation; preserving the operation of the business and employment; guaranteeing salaries; the role of courts in controlling the insolvency representatives; equal treatment of creditors; and transparency of collective proceedings. It was observed that those principles should not be interpreted as limiting the mandate given to the Working Group, but might usefully be taken into account by the Working Group for the purposes of guidance and to avoid the legislative guide being overly general. It was suggested that either banks and financial institutions should remain outside the scope of the work, or that a special regime should be maintained for those entities.

9. Other suggestions that received some support included the need to take account of a number of issues that had proven to be problems in international insolvency, such as the difficulty of collecting and disseminating information on companies that have been the subject of insolvency proceedings, providing access for foreign creditors to make claims, equal treatment of foreign creditors and the treatment of late claims, especially where they may be made by foreign creditors. It was further noted that insufficient care in decisions to grant credit proved, though apparently remote, to be one of the causes of insolvency. It was recalled that the UNCITRAL Model Law on Cross-Border Insolvency already addressed a number of those problems. It was noted that while some of those issues might also be relevant in the context of the current project to develop a legislative guide, there was no intention that the current project should change or amend the Model Law in any way.

10. After discussion, the Commission confirmed that the mandate given to the Working Group at the thirty-third session of the Commission should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide.

11. The Working Group on Insolvency Law, composed of all States members of the Commission, held its twenty-fourth session in New York from 23 July to 3 August 2001. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Cameroon, Canada, Colombia, Fiji, France, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Lithuania, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

12. The session was attended by observers from the following States: Algeria, Australia, Bangladesh, Belarus, Brunei Darussalam, Bulgaria, Denmark, Ecuador, Lao People's Democratic Republic, Guinea, New Zealand, Nigeria, Peru, Philippines, Portugal, Republic of Korea, Saudi Arabia, Slovakia, Switzerland, Turkey, United Arab Emirates, Venezuela and Yugoslavia.

13. The session was also attended by observers from the following international organizations: American Bar Association, Asian Development Bank, Consultative Group on International Economic and Monetary Affairs, Inc. (Group of Thirty), European Bank for Reconstruction and

Development, European Central Bank, Groupe de Reflexion sur l'Insolvabilité et sa Prévention, INSOL International, International Bar Association, International Insolvency Institute, International Working Group on European Insolvency Law, Inter-Pacific Bar Association and World Association of Former United Nations Interns and Fellows. Observers from the International Monetary Fund and the World Bank also attended the session.

14. The Working Group elected the following officers:

Chairman: Wisit WISITSORA-AT (Thailand)

Vice-Chairman: Paul HEATH (New Zealand),
elected in his personal capacity

Rapporteur: Jorge PINZON SANCHEZ
(Colombia)

15. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.V/WP.53);

(b) Report of the Secretary-General on a first draft of a legislative guide on insolvency law (A/CN.9/WG.V/WP.54, A/CN.9/WG.V/WP.54/Add.1 and A/CN.9/WG.V/WP.54/Add.2);

(c) Report of the Secretary-General on alternative approaches to out-of-court insolvency processes (A/CN.9/WG.V/WP.55).

16. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on insolvency law.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

17. The Working Group on Insolvency Law commenced its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third session, in 2000,² and thirty-fourth session, in 2001.³ The decisions and deliberations of the Working Group with respect to the legislative guide are reflected in section III below.

18. The Secretariat was requested to prepare a revised version of the guide, based on the deliberations and decisions, to be presented to the twenty-fifth session of the Working Group on Insolvency Law, to be held in Vienna from 3 to 14 December 2001, for review and further discussion.

III. CONSIDERATION OF THE DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

A. General remarks

19. At the outset of the session, some international organizations presented the status of their work in the field of insolvency law. The Working Group heard that the World Bank report entitled "Principles and guidelines for effective insolvency and creditor rights systems" had been published in April 2001. In that connection, it was observed that a crucial goal of the report was to foster and enhance the availability of credit by increasing certainty and predictability of creditors' rights, so that they could accurately assess the risks and consequences of the loans they made. While counterbalancing policies might be appropriate in some cases, it was suggested that they should not intrude into the insolvency regime unless a balance could be achieved with the goals of certainty and predictability. It was noted that national surveys aimed at refining the principles in respect of the specific needs of different jurisdictions would be carried out as a way of implementing the report. The need for devices capable of increasing the availability and reducing the cost of credit was recognized by various international organizations active in the field of insolvency law.

B. Key objectives of an effective and efficient insolvency regime

20. The Working Group commenced its consideration of the draft legislative guide, contained in documents A/CN.9/WG.V/WP.54 and Add.1 and 2, by considering the statement of key objectives set forth in part one of the draft legislative guide (A/CN.9/WG.V/WP.54, paras. 16-22). The view was expressed that the key objectives necessary for effective and efficient insolvency regimes were reflected and that few additions were required. It was suggested that the need to have an insolvency system anchored within both the legal and commercial regimes of a country should be clearly stated within the key objectives, with the reference to commercial systems intended to include not only commercial law but also commercial practices and usages that were recognized as part of a country's regulatory regime. It was also suggested that the key objectives should be developed in parallel with the discussions in the Working Group on the substance of the draft guide. In particular, it was pointed out that the words in square brackets in paragraph 19, referring to sanctions for failure to commence insolvency proceedings at an early stage, raised issues of substance that would need to be considered in the context of initiation and commencement of proceedings, in part two of the draft guide. Because of the importance to an effective and efficient insolvency regime of provisions addressing cross-border issues, it was suggested that the relationship between the draft guide and the Model Law on Cross-Border Insolvency should be borne in mind in the discussions, with a view to determining at a later stage whether the Model Law should form part of the final work product.

²Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17, (A/55/17), paras. 400-409.

³Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3), paras. 296-308.

C. Core provisions of an effective and efficient insolvency regime

1. Relationship between liquidation and reorganization proceedings

21. The general view was that the draft guide should point out, in a complementary manner, the advantages and disadvantages of the different types of proceedings available, in order to ensure flexibility and that the choice of proceedings in any given case was focused upon the most efficient solution. It was agreed that both liquidation and reorganization proceedings should be included as options and that the draft guide should reflect both unitary proceedings (where the decision as to whether liquidation or reorganization was the most appropriate process was made at some time after the application for commencement, when there had been an opportunity to assess what was most appropriate for the enterprise in question) and dual proceedings (where the party commencing the proceedings was given the choice of liquidation or reorganization).

22. While noting that maximization of value was a key objective, it was pointed out that there were cases that should be mentioned in the draft guide where that objective should be balanced against more important social interests that might suggest the adoption of a different approach. It was suggested that the draft guide should point out the implications of the choice of unitary or dual processes in terms of other components of the insolvency regime, rather than recommending the adoption of one or the other approach. For example, in dual proceedings, the insolvency regime should provide for conversion between them and the draft guide should indicate the circumstances in which that conversion would be most likely to be relevant, such as in reorganization proceedings commenced by the debtor or the creditors and liquidation proceedings commenced by the creditors. While it was suggested that it might also be appropriate for the draft guide to consider which party could seek conversion, whether based upon an approach that reflected the interests of creditors or balanced the interests of all stakeholders, some concern was expressed that that involved matters that should be left to national law. Where a unitary proceeding was preferred, it was suggested there would need to be a period of assessment protected by a stay, in order to allow the entity to stabilize its situation and determine the most efficient ways of addressing its financial difficulties.

2. Initiation and commencement of insolvency proceedings

(a) Scope

23. Concern was expressed related to the reference in paragraph 24 to the presence of assets as a basis for commencement of insolvency proceedings. It was suggested that, while that connection might be a sufficient basis for the commencement of liquidation proceedings, it was too tenuous for the commencement of reorganization proceedings. A further concern related to the inclusion within the insolvency regime of state-owned enterprises, whether acting in a commercial capacity or not.

(b) Initiation of insolvency proceedings

24. The Working Group discussed the need to achieve a balance between incentives for early initiation of proceedings and sanctions to compel early initiation. The view was expressed that the imposition of sanctions, such as those aimed at the liability of directors for trading whilst insolvent, had proven to be successful in a number of countries and had led to increased applications for reorganization. In other countries, however, while the sanctions were available, they were not consistently applied and were therefore ineffective as a means of compelling the initiation of proceedings. It was suggested that the imposition of such sanctions needed to be carefully considered to avoid situations where directors might take defensive decisions to avoid liability or, in the context of out-of-court processes, where directors might need to have immunity from liability in order to achieve a successful result. It was pointed out that the issue of liability was closely related to the extent to which management retained control and had an exclusive period to prepare a reorganization plan.

25. As a general recommendation, it was suggested that the draft guide should consider each of the topic areas not only in terms of the key objectives set forth in part one, but also in terms of the impact of each area upon other topics and policies.

26. Different views were expressed with respect to initiation of proceedings and the party that should be able to apply. There was general agreement that debtors should have available to them both liquidation and reorganization procedures. As to initiation by creditors, although different views were expressed as to the relevant criteria, there was general agreement that creditors should be permitted to initiate both liquidation and reorganization proceedings.

27. In the case of initiation by creditors, support was expressed in favour of an application being made by one or more creditors, without specifying a particular number, while there was also support for the number to be specified. A concern was expressed that allowing an application by a single creditor might lead to the insolvency procedure being used as an alternative to ordinary debt enforcement procedures, since the debt might more appropriately be pursued elsewhere. Another view was that a criterion addressing the value of outstanding debts could be relevant so that a single creditor could apply in circumstances where the value of that creditor's debt was significant, or a number of creditors could apply where the composite of their debt exceeded a certain specified amount. It was also suggested that the application criteria should specifically refer to unsecured creditors who had undisputed debts. On the question of the criteria for initiation of proceedings, one view was that the same criteria should apply to initiation by both the debtor and by creditors. Another view was that different tests should apply. In the case of a debtor, the application could be made on the basis of a general cessation of payments or the likelihood that the debtor would become unable to pay its debts in the future as and when they fell due. It was suggested that that test might be reflected in the draft guide along the lines of the debtor having "no reasonable prospect of being able to pay its debts".

28. In the case of creditor initiation, a view was expressed that, as noted in paragraph 51(b) of document A/CN.9/WG.V/WP.54/Add.1, creditors should be able to show that they held mature claims that had not been paid by the debtor. A preliminary issue raised was the need to define clearly the meaning of the term “maturity” to avoid disputes. A question was raised as to whether the debts really needed to be mature and due and whether the adoption of such a test might not limit access to insolvency proceedings unnecessarily and impact broadly upon the cost and availability of credit. That was stated to be the case in particular in situations where even though the debt was not mature, it was clear that the debtor’s situation would result in it not being able to pay when the debt became mature. It was pointed out, however, that providing no restriction on access could result in insolvency proceedings being used as an alternative to debt enforcement mechanisms. A related question was whether the mature debts needed to be held by applying creditors, or whether it might be possible for other creditors holding immature debts to apply on the basis that the debtor had mature, outstanding debts. It was suggested that where the criterion of maturity was included, there might need to be an exception to cover situations such as where the debtor was acting fraudulently, where there was evidence of preferential treatment of some creditors, or where proceedings were being commenced to implement a pre-negotiated reorganization.

29. On the question of whether the entry criteria for creditor applications should be the same for both liquidation and reorganization, different views were expressed. One view was that to achieve the goal of timely, efficient and impartial access to insolvency proceedings, which was one of the key objectives noted in part one of the draft guide, the criteria should be the same and should be broadly formulated. To reflect that suggestion and the need to accommodate both unitary and dual processes, it was proposed that an approach along the following lines should be considered:

“An application to open or commence insolvency proceedings may be made by:

“(a) A debtor, in which case the debtor should show actual or prospective inability to pay debts or that the liabilities exceed the value of the assets of the debtor;

“(b) One or more creditors that are owed a matured debt, in which case the creditor(s) should show that the debt has matured and is unpaid.”

30. It was noted that that proposal was intended to establish minimum agreed entry criteria and that the draft guide could note and discuss potential variations, such as a requirement for a minimum amount of debt or that the debt need not be mature. While there was agreement for taking that general approach, some support was expressed in favour of the test being that the debtor “is unable or will be unable to pay its debts as and when they fall due”.

31. A view was also expressed that entry criteria for creditor applications for reorganization should be more restrictive than for liquidation applications, with criteria such as a requirement for the creditors to be able to show that the business could continue to trade and could be

successfully reorganized, being added. If those criteria were to be included, the view was expressed that clear guidance would need to be provided as to what was required to be demonstrated, such as the availability of ongoing cash to pay debts for day-to-day running of the business, that the value of assets would support reorganization and that the return to creditors would be greater than in liquidation. Concern was expressed that additional criteria could operate as a barrier to entry and it was suggested that they could only be considered in terms of the consequences of commencement and how the proceedings continued. It was noted, for example, that in systems where a stay applied automatically on commencement, the ability of the business to continue trading and be successfully reorganized could be assessed after commencement. In other systems, that information might be needed before commencement of reorganization, since the choice of that proceeding presupposed that it would lead to a greater return. It was also observed that the choice of entry criteria for reorganization depended upon the objective of the insolvency regime; if it was maximization of value the requirements would be different to those applicable where the objective was recycling of assets. The need to discuss those policy issues in the draft guide was reaffirmed.

32. On the issue of the role that courts should play in commencement of proceedings, the view was expressed that while the court did not necessarily need to play a central supervisory role (which could perhaps be played by an administrative agency) parties should always have recourse to the courts to resolve disputes. It was pointed out that too much involvement of the court as the supervisory body might lead to delay and might render reorganization proceedings cost ineffective, particularly in the case of small and medium enterprises. It was also suggested that in some countries, such as those where the judiciary was very small, it was neither efficient nor effective to expect the courts to play a central role. Another view was that the role of the courts was central to supervision of the insolvency process and that that function could not be given to another body, however constituted.

33. The Working Group considered the proposal contained in paragraph 51 (c) of document A/CN.9/WG.V/WP.54/Add.1, concerning applications for insolvency proceedings made by governmental authorities. Wide support was expressed in favour of possible initiation of insolvency proceedings by such an authority. However, a shared concern was that vesting such an authority with a general power to initiate insolvency proceedings might create uncertainty and therefore be inappropriate.

34. The suggestion that the explanatory section of the draft guide should be expanded to mention specific violations of laws other than criminal laws (for example, administrative or environmental laws) as factors possibly triggering initiation by the governmental authority was not supported. Furthermore, it was also noted that excessive expansion of situations enabling the public authority to file an application would exceed the scope of insolvency law.

35. Accordingly, the Working Group agreed that some criteria providing guidance as to the situations triggering that power and the manner in which it should be exercised,

with a view to restricting the discretion of the relevant authority, should be provided.

36. Another suggestion was that the power of the governmental authority to initiate should apply not only to liquidation but also to reorganization proceedings, with a view to ensuring that the public interest was preserved in those situations when reorganization was possible but the debtor and the creditors failed to apply.

(c) *Commencement*

37. The Working Group considered a number of issues relevant to commencement of the insolvency proceedings. On the question of the need to ensure a speedy consideration of the application to commence proceedings, the general view was that that decision should be made promptly to avoid dilution of value and ensure certainty and transparency for creditors, particularly where commencement would affect their ability to exercise their rights. It was noted that entry criteria that were designed to facilitate early and easy access to the process would also facilitate the court's consideration of the application for commencement and that the question of timeliness was thus closely linked to what the court was being requested to do in making that commencement decision.

38. One view was that the decision for commencement should flow more or less directly from the simplicity of the entry criteria, avoiding the likelihood of delay and dispute. It was noted that in some systems, a voluntary application by a debtor was an acknowledgement of insolvency and would function as an automatic commencement, unless it could be suggested that the debtor was abusing the process to evade its creditors. With respect to reorganization, it was pointed out that the purpose of the entry criteria was to derive a standard that could create a presumption or *prima facie* case of insolvency. In such cases, unless the debtor's application was disputed, there should be no delay in commencing the proceedings, although commencement would not be automatic and some formal decision from the court was required. Another view was that the entry criteria was only the start of the process and the court would be required to carefully consider a number of related issues, such as whether the proceedings sought were the most appropriate for the debtor, before making a decision to commence the process. It was noted in response to that view that questions of assessment of the debtor and of the proceeding most appropriate to the debtor could be addressed through provision for conversion between liquidation and reorganization. There was support for the view that, while a debtor application could operate to effect almost automatic commencement, that was not the case with an application by creditors, which would be required to be determined in a timely manner.

39. The view was expressed that although a quick decision was desirable, the time period within which a decision could be made in practice differed from case to case and therefore it would be impractical to set time limits. Where laws did set time limits, it was pointed out that they were often ignored and it was difficult to establish effective sanctions to enforce such limits, particularly where it was

a court (as opposed to an administrative authority) that was not observing the limit. It was observed that sanctions might be more appropriate to ensure that the debtor or creditor pursued its application in a timely manner. Another view was that a fixed time limit should be set to ensure certainty and transparency for both creditors and the debtor.

40. After discussion, the general view was that a flexible approach was required that would emphasize the desirability of speed and provide guidance as to what was reasonable, but also recognize that countries needed to fit their insolvency regime within the overall constraints and resources of their judicial systems and local needs for determining priority.

(d) *Notice requirements*

41. The Working Group considered the proposal contained in paragraph 54 of A/CN.9/WG.V/WP.54/Add.1 that notice of the application should be provided to the debtor (in the case of a creditor application) and to the creditors (in the case of a debtor application).

42. The Working Group agreed that notification of the insolvency proceedings was not only appropriate, but also crucial in order to ensure transparency of the insolvency system, in accordance with one of the major objectives pursued by the UNCITRAL Model Law on Cross-Border Insolvency, and to ensure equality of information for creditors in the case of voluntary proceedings.

43. As to the time at which notification should occur, the prevailing view was that notification to the debtor and, respectively, to creditors should be treated differently. The concern was widely shared that immediate notification of an application filed by either creditors or a governmental authority (that is, of involuntary proceedings) to the debtor would be appropriate. Notification to the creditors prior to commencement on a debtor application, however, might be counterproductive as it could unnecessarily affect the position of the debtor in the event that the application was rejected and might encourage last minute actions by creditors to enforce their claims. The suggestion that such prejudice to the debtor would not be relevant in the case of a voluntary proceeding because the debtor had already made an assessment as to its insolvency did not receive support. It was noted that those issues would not arise in legal systems where commencement was an automatic effect of application.

44. After discussion, the Working Group agreed that notification of involuntary proceedings should not occur prior to commencement. It was noted that that solution was also consistent with the approach taken in article 14 of the UNCITRAL Model Law on Cross-Border Insolvency, which clearly referred to commencement as the basis of notification. The Working Group also welcomed the suggestion that the draft guide should provide some guidance both as to the party required to give notice (for example, the debtor or the court) and to the ways to ensure that the notification was effective.

3. *Consequences of commencement of insolvency proceedings*

(a) *The insolvency estate*

45. A general view was that the importance for national laws to provide clear rules as to the assets to be included in the insolvency estate needed to be stressed, to the benefit of both domestic and foreign creditors.

46. As to the specific assets that should be included, the general view was that all the assets in which the debtor had an interest as of the date of the commencement of the insolvency proceedings should be included, whether tangible or intangible and irrespective of whether those assets were in the actual possession of the debtor. The view was also shared that the insolvency estate should also include any assets acquired by the insolvency representative after the commencement of the insolvency proceedings. It was further suggested that specific contractual arrangements, such as transfers created for the purpose of security, trusts or fiduciary arrangements and consigned goods, needed to be addressed. It was also observed that it would be useful if the draft guide would expand the explanation of the notion of tangible and intangible assets.

47. Various views were expressed as to whether assets subject to a security interest in favour of a creditor should also be included. Some support was expressed for the view that as a general rule those assets should be excluded, unless one or more of them proved to be essential to the possibility of successful reorganization. It was pointed out that such a principle would significantly enhance the availability of credit, since it would reassure secured creditors that their interests would not be adversely affected by the opening of an insolvency proceeding.

48. However, support was expressed in favour of the view that secured assets should be included in the insolvency estate. It was observed that allowing secured creditors to enforce their rights on secured assets might not only impair the principle of equal treatment of creditors, but also the possibility of carrying out a successful reorganization. It was explained that retention of essentially all assets pertaining to the debtor at the outset of the procedure was crucial to achieve reorganization of the business. In that connection, it was also clarified that including secured assets in the insolvency estate would not be tantamount to saying that secured creditors would be deprived of adequate devices to preserve their rights. The view was also expressed that the emphasis should not be so much upon inclusion or not in the estate but whether the secured assets would be subject to the insolvency proceedings.

49. A proposal that secured assets should be subject to a different regime in liquidation as opposed to reorganization did not receive support.

50. A further view was that all assets pertaining to the debtor should be included in the insolvency estate irrespective of their geographical location, since that would be consistent with the approach taken in the UNCITRAL Model Law on Cross-Border Insolvency. In response, it was noted that the draft guide was not intended to address

questions of relevance to cross-border aspects of insolvency law, since those matters were addressed in the Model Law, which the current work was not intended to in any way modify or amend.

51. Wide support was expressed for the idea that when the debtor was a natural person, some assets might be excluded from the insolvency estate. As to the identification of exempted assets, a suggestion was that exclusion should apply to claims for personal damages. After discussion, the Working Group agreed that given the different approaches taken in various legal systems, it would be inappropriate for the draft guide to include excessive details and that specific listing of exempted assets should be left to national laws. In that connection, the Working Group agreed that the draft guide should recommend to national legislators to identify clearly those exemptions and to limit their number to the minimum necessary to preserve the personal rights of the debtor. It was further suggested that the text should identify and discuss the various policy options possibly underlying the different approaches taken in different countries.

52. The issue of the treatment of third-party-owned assets was also discussed. A concern was that, if those assets were to be excluded from the scope of the insolvency estate, the possibility to achieve reorganization would be significantly impaired. It was noted that in most cases at least some of the assets used for the operation of the business were in the ownership of a party other than the debtor and were retained by the latter on the basis of contractual agreements, including leases and the like. A suggestion was to include in the draft guide the principle that third-party assets were not included in the insolvency estate, unless those assets were necessary to continue or maintain the operation of the business and provided that adequate provision was made for protection of the lessor to the extent that those assets were utilized in the insolvency proceeding. That suggestion was supported.

53. Another view was that third-party assets should be treated differently depending on whether liquidation or reorganization was at stake. It was observed that, while in reorganization retention of assets in the possession of the debtor might prove crucial to the very possibility of rescuing the business, those needs did not arise in respect of liquidation. A different view was that preventing dismemberment of the estate at the outset of the procedure might prove crucial also for the purposes of ensuring the maximization of value within the context of liquidation.

54. A further view was that the issue of treatment of assets retained by the debtor pursuant to a contractual agreement should be addressed in the context of treatment of contracts rather than in the insolvency estate. In that connection, the view was widely shared that the rights of the owner under the contract should be restrained in order to ensure that the asset remained at the disposal of the insolvency proceeding. In that connection, it was clarified that insolvency law would not affect title to the assets, but only limit the way in which those rights were exercised, with a view to preserving the needs of an insolvency proceeding.

55. The discussion showed that the notion of insolvency estate varied among the different legal systems; some laws appeared to consider the issue of third-party assets as pertaining to the rights of property, while some others appeared to address it within the context of treatment of contracts. However, the prevailing view was that the insolvency law should provide some mechanism to ensure that third-party assets used in the operation of the business remained available to the insolvency proceeding, both for the purposes of reorganization and with a view to maximizing the value of the assets subject to the proceedings.

56. General support was expressed for the right of the insolvency representative to recover property of the debtor that was improperly transferred in violation of the principle of equal treatment of creditors. Support was also expressed for the suggestion that the draft guide should clearly state the policy reasons that would justify such a right of recovery. A number of suggestions were made as to the kind of acts that would be subject to recovery and to the time periods in which recovery would be possible. A view was that, while the proposed text seemed to adopt an approach relying on the intention of the party, many legal systems relied rather on the detrimental effect of the transaction subject to avoidance and that in that respect a policy decision was needed. In response, it was noted that, given the variety of approaches taken by different legal systems in that field, the draft guide should not include excessive details as to the conditions upon which that right of recovery could be exercised. It was also noted that detailed distinctions as to both the type of transactions and the relevant time periods were presented in the section of the draft guide specifically devoted to avoidance actions. Accordingly, the Working Group agreed to defer further detailed discussion of that issue to a later stage.

(b) Stay of proceedings

57. In considering whether the application of the stay should be automatic or discretionary and whether it should apply on application for, or commencement of, insolvency proceedings, the Working Group agreed on the need to distinguish between applications for liquidation and reorganization proceedings and the parties that may make the application. It was observed that, while the reasons for automatic application of the stay were clearly set forth in the draft guide, the discussion of the advantages of a discretionary application needed to be expanded. It was recalled that the UNCITRAL Model Law on Cross-Border Insolvency addressed the issue of application of a stay and suggested that the approach adopted in the draft guide should be consistent with the Model Law.

58. With respect to unsecured creditors, it was suggested that the stay should apply automatically to all creditors on an application for both liquidation and reorganization proceedings, irrespective of whether the debtor or creditors applied. Where the application was one for liquidation, continuation of the stay after commencement could be discretionary, but in cases of reorganization, the automatic stay would continue to apply after commencement. It was noted that a distinction might need to be drawn between those cases where the business was to be sold as an

operating entity in liquidation proceedings and straightforward liquidation of the enterprise. A different suggestion, which received some support, was that the stay (which should apply automatically in both liquidation and reorganization proceedings, irrespective of whether those proceedings were initiated by the debtor or by creditors) should apply on commencement of the proceedings. To address the period between application and commencement, it was agreed that provisional measures should be available. Support was also expressed for the stay to apply automatically from the time of application where it was the debtor that applied, in order to avoid potential abuse by creditors. It was pointed out that such automatic application was of particular relevance in legal systems where an application made by the debtor led to automatic commencement without the need for any formal decision by the court.

59. As to the question of application of the stay to secured creditors, the general view was that if the secured interests were to be included within the scope of the stay, it should be emphasized in the draft guide that such inclusion should not be seen as a negation of the secured rights. The view was expressed that restricting the exercise of secured rights was necessary in both liquidation and reorganization proceedings to ensure that the goals of those proceedings could be realized, but that that had to be balanced by the maintenance and protection of secured rights. A contrary view was that secured creditors should not be included within the scope of the stay. It was suggested that to do so could undermine party autonomy and the bargain reached between the debtor and the secured creditor. In support of that view, it was suggested that a system which applied the stay to secured creditors and sought to balance any negative impact by protecting the value of the secured interest was likely to be complex, costly and require the court to be able to make difficult commercial decisions on the question of appropriate protection. Where the stay did not apply to secured creditors, the matter was appropriately left to negotiation between the interested parties. On that point it was noted that there was a clear balance in many systems between the need for a stay and the availability and effectiveness of pre-commencement negotiations to achieve agreement between the debtor and creditors on how to proceed. It was pointed out that in a number of legal systems, pre-commencement negotiation was effective in achieving agreement between the debtor and its creditors so that a stay was not required. An alternative approach, which received some support, was to combine the automatic application of the stay on commencement for a short period to enable the financial situation of the debtor to be evaluated with a view to determining how the proceedings should continue, with provision for the stay to be lifted on application to the court where it could be shown that the value of the collateral was being adversely affected.

60. On the question of preferential or priority creditors, it was noted that there were different uses of those terms in different legal systems and that the draft guide needed to explain those differences clearly. For example, in some systems priority creditors were creditors with possessory interests, while in others they had only a distribution priority. A related issue was the different rights that might be held by those different types of creditors and whether or

not they were within the scope of rights to be affected by the stay. A general view was that a number of those types of creditors would be within the category of unsecured creditors affected by the stay, but it was suggested that the draft guide should address the issues clearly.

(c) Treatment of contracts

61. The Working Group addressed the issues of termination, continuation and assignment by the insolvency representative of contracts that were outstanding at the time of commencement. As to termination, a general view was that there was a direct link between the ability of the insolvency representative to terminate contracts, on the one hand, and the level of availability of credit, on the other hand. It was observed that the wider the right of the insolvency representative to terminate, the higher the cost and the lower the availability of credit would be and that a careful balance needed to be struck between those two conflicting needs.

62. The issue of possible automatic termination of a contract in the absence of a decision to continue by the insolvency representative within a specified period was discussed by the Working Group. A view was that providing for such automatic termination might prove useful to avoid costs of litigation in respect of situations where it was clear that the debtor was not in the position to perform the contract. Furthermore, it was noted that failure to provide a mechanism for automatic termination would result in imposing on the insolvency representative the burden to notify the decisions in respect of all outstanding contracts, increasing the costs of the procedure.

63. However, the prevailing view was that the provision contained in the summary section (paragraph 113 (b) of document A/CN.9/WG.V/WP.54/Add.1), stating that termination might be automatically effective in the absence of a decision to continue within a specified period of time, was too broad. Several views were expressed as to how the scope could be more focussed. One suggestion was that the text should clarify that automatic termination would only be possible when expressly provided by the contract. In that connection, it was pointed out that allowing automatic termination as a general principle might expose the debtor to the risk of being deprived of some supplies that might be essential to the continuing operation of the business (such as electricity, water and the like). In response, it was noted that the rule was not aimed at giving the power to terminate the contract to the other contracting party, but rather at enabling the insolvency representative to avoid having to give notice of the decision to terminate. It was further clarified that the provision was not aimed at amending the rights that the other contracting party had under the contract. Another suggestion was to specify the period of time after which automatic termination would apply.

64. Another view was that automatic termination should be limited to some categories of contracts, as expressly identified by national laws. It was observed that, while supported by sound economic considerations, that mechanism might create an excessive amount of uncertainty, thus impairing the key objective of predictability of the insolvency system. A further concern was that automatic

termination might give rise to uncertainties when the insolvency representative was not adequately informed on the outstanding contracts.

65. It was pointed out that automatic termination was aimed at ensuring certainty: on the one hand, the mechanism forced the insolvency representative to make a timely decision in respect of the contracts outstanding at the time of commencement of the proceeding; on the other hand, it also offered the other party a way to eliminate uncertainties as to the continued existence of the contract within a reasonable period of time.

66. Another view was that the issue of automatic termination of contracts needed to be treated differently depending on whether liquidation or reorganization was at stake, given the different policies respectively underlying each proceeding. In that respect, it was observed that, while in liquidation it would be reasonable to assume that failure of the insolvency representative to take a decision in respect of a contract would most likely imply a decision to terminate, that assumption might not always be appropriate in reorganization.

67. The prevailing view was that the mechanism of automatic termination should be retained, subject to some limitations to its scope. Support was expressed for establishing in the draft guide criteria that would guide the insolvency representative in making the decision as to whether to terminate the contract, bearing in mind that those criteria would be different for liquidation and reorganization. Furthermore, it was observed that outlining the policy reasons that might justify automatic termination would be most useful for those legal systems where the impairment of contractual rights required a specific justification.

68. In addition to the right to terminate contracts, it was suggested that the insolvency representative should have the power to disclaim other property included in the insolvency estate, whenever that property happened to be burdened in such a way that retention would require excessive expenditure. While some support was expressed for that view, it was observed that such a power would need to be accompanied by devices allowing disclaimed property to be vested in another person.

69. Support was also expressed in favour of the insolvency representative being able to ensure continuation of contracts. However, the Working Group agreed that that right should be limited in scope by excluding those contracts in respect of which continuation would be impossible: namely, contracts where the personal characteristics of the debtor were essential for performance of the contract. A suggestion was that examples (along the lines of those outlined in paragraph 106 of document A/CN.9/WG.V/WP.54/Add.1) should be included in the summary. Another view was that reference to the possible intervention of the court (as contained in the chapeau of paragraph 116 and in paragraph 116 (a) of document A/CN.9/WG.V/WP.54/Add.1) was inconsistent with the approach taken in respect of termination (where no reference to the court was made) and was therefore inappropriate.

70. Support was expressed in favour of mentioning the reasons underlying the right of the insolvency representative to continue the contract, as suggested in respect of termination. It was clarified that the right of the insolvency representative to continue the contract irrespective of the agreement of the other party should be balanced against the interests of the other party by some mechanism for compensation. It was also suggested that the other party should be given the right to be heard or consulted by the insolvency representative prior to his or her decision, as well as means to contest that decision.

71. As to the issue of assignment of contracts, one view was that the scope of the provision should be limited, as in the case of continuation. In that connection, it was pointed out that the possibility of assignment should be excluded in respect of those contracts in which the specific characteristics of the debtor were essential to performance. In that respect, it was suggested that the insolvency representative could not be vested with rights wider than those pertaining to the debtor under the contract.

72. After discussion, the prevailing view was that the right of the insolvency representative to assign the contracts outstanding at the time of commencement should be retained, subject to adequate limitations to its scope. In support of that view, it was also observed that under some circumstances termination might result in a windfall for the other contracting party (for example, where the contract lease price was lower than the market price) and that providing for a contract to be continued and assigned may enable the insolvency estate to benefit from the difference between the contract and the market price.

73. As to the issue of non-assignment clauses, support was expressed in favour of enabling the insolvency representative to treat such clauses as null and void, but that the draft guide should point out the consequences of such treatment vis-à-vis the other party. It was further noted that that solution was consistent with the approach taken in the draft United Nations Convention on the Assignment of Receivables in International Trade. Another suggestion was that the bracketed reference to "all parties" appearing in paragraph 118 (b) of document A/CN.9/WG.V/WP.54/Add.1 should be clarified to make it clear that the reference was to the parties of the original contract and not to the parties of the assignment.

74. A general view was that the draft guide should point out the need for excluding financial contracts (including currency swaps, interest rate swaps, derivatives and the like) from the scope of the provisions enabling the insolvency representative to interfere with contracts. It was observed that preserving the rights of financial investors (in particular, the right to net their positions, the right to terminate the contract and the right to claim for collateral in accordance with the rules and arrangements governing those contracts) was crucial in order to ensure the stability of the financial market as a whole. It was further noted that such special treatment appeared appropriate in the light of the peculiarities of those contracts and that such peculiarities had similarly led to their exclusion from the scope of application of the draft Convention on the Assignment of Receivables in International Trade. While that view was

supported, it was also agreed that the reasons supporting a special regime for those contracts, entailing a significant exception to the principle of equal treatment of creditors, should be pointed out in the draft guide.

75. Wide support was expressed in favour of the view that employment contracts should be subject to a special regime, given the strong social implications of their treatment within the context of insolvency. A suggestion was that the draft guide should mention the social policy considerations underlying the issue and the reasons justifying their exclusion from the scope of the general rules. A further suggestion was that the draft guide should recommend that the limited power of the insolvency representative to terminate those contracts should also be expressly mentioned in the insolvency law, for the purpose of transparency.

76. The prevailing view was that the issue of set-off should be dealt with in the draft guide. The suggestion that that issue should not be addressed in the context of treatment of contracts, being rather an issue of general private law, was not supported.

(d) Avoidance actions

77. At the outset of the discussion in the Working Group it was observed that avoidance actions were potentially very expensive to run and it was suggested that the Working Group should direct its attention towards devising criteria that would assist in simplifying those actions. It was noted that in some legal systems an individualized approach that considered in some detail questions such as the intent of the parties to the transaction and what might constitute the normal course of their business arrangements had led to excessive litigation. That subjective approach had now been changed to a more simple objective approach, which combined a short time limit for the suspect period (three to four months) with an arbitrary rule that all transactions occurring within that period would be suspect unless there was a roughly contemporaneous exchange of value between the parties to the transaction.

78. It was noted that the potential expense of avoidance actions had led some legal systems to consider how those costs might be funded. Possible approaches included allowing individual creditors to pursue the action where the insolvency representative chose not to pursue it, provided other creditors agreed; permitting the insolvency representative to assign the action for value to a third party; and allowing the insolvency representative to approach a lender to advance funds with which to commence the avoidance action. It was noted that some of those approaches would result in the creditor taking the action being able to cover its claim out of the funds recovered or at least some part of it. In other systems, it was noted that the Government would provide funds for the insolvency representative to take not only avoidance actions to recover funds, but also actions against directors. Some concern was expressed with regard to approaches that might serve the interests of individual creditors and depart from the collective nature of the insolvency proceeding. In support of mechanisms that allowed private funding, it was pointed out that there were

vast differences between countries in the availability of public resources for funding avoidance actions. An additional difficulty could arise where such actions were required to be funded from the assets of the estate, particularly as that might operate to prevent the recovery of assets that had been removed from the estate with the specific intention of hindering avoidance actions. After discussion, support was expressed in favour of a mechanism that would allow creditors to pursue recovery where the insolvency representative was unwilling to do so or to obtain external funding where no other option was available.

79. The Working Group discussed the types of transactions that might be subject to avoidance actions, as set forth in paragraphs 125-129 of document A/CN.9/WG.V/WP.54/Add.1. As a preliminary point it was noted that the power to take avoidance actions should be available in both liquidation and reorganization. It was pointed out that reorganization, like liquidation, involved allocation on the basis of priorities. Accordingly, where a creditor had obtained a benefit shortly before commencement that would affect its priority it should not be able to retain that benefit.

80. On the issue of the scope of avoidance powers, it was suggested that the draft guide should refer to transactions rather than to payments or to transfers, as the latter two terms were too narrow. It was also suggested that the principal categories of avoidable transactions should be fraudulent, undervalued and preferential transactions, with other categories such as invalid security interests, gifts, set-offs, unauthorized transfers occurring after initiation of insolvency proceedings and transactions seriously inconsistent with normal commercial transactions included as specific examples of those three categories. In discussing those various categories, the draft guide should indicate the categories of transactions that would be void and not merely suggest which transactions might be avoidable. A further suggestion was that the draft guide should focus not simply upon the types of transactions as described above, but also upon the consequences of the transaction and the relationship between the parties involved in the transaction. In terms of the consequences, the example was given that directors might seek to pay off all the liabilities which they had guaranteed in the period before insolvency. While the payments in themselves might be acceptable, the effect of such payments needed to be considered. As to the relationship between the parties, it was noted that transactions with insiders might require special attention. It was recalled that the Working Group had agreed to the exclusion of financial transactions from the power of the insolvency representative to interfere with contracts and that therefore they should not be subject to avoidance.

81. As a general point with regard to the suspect period, one view was that the periods should be set forth in the law and not left to retrospective determination by the courts, since that approach did not assist clarity and predictability of the law. Another view was that a degree of flexibility could be added to the law by allowing the court to extend the fixed periods in certain circumstances. It was noted that some countries adopted such a combination of objective and subjective criteria. In response, it was pointed out that such an approach might not serve the goals of

predictability and certainty, which were key objectives as noted in part one of the draft guide. It was nevertheless suggested that there might be circumstances in which extension of the suspect period might be appropriate, for example, where a transaction that had been concealed had the effect of diminishing the estate. It was also pointed out that the draft guide needed to be clear on when suspect periods commenced, that is, whether on application or commencement (where that meant the making of the insolvency decision) of the insolvency proceedings.

82. In respect of fraudulent transfers, the Working Group agreed that they should be subject to avoidance. In terms of a suspect period, one view was that avoidance of transactions on the basis of fraud should not be restricted to a particular time. Another view was that a time period was required but that it should be long.

83. On the issue of burden of proof, it was suggested that the question to be considered was whether the transaction was intended to, or had the effect of, hindering, delaying or depriving creditors of value. It was observed that since intent was the essential element of fraud, it would not be sufficient for the transaction to have the effect of defeating or delaying creditors unless that effect was intended. In addition, it was suggested that the fraudulent intent must be recognizable to the other party to the transaction. As a practical matter, it was observed that if a party could not explain the commercial purpose of a particular transaction that extracted value from the estate, it would be relatively easy to show that the transaction was fraudulent. The Working Group's attention was drawn to the need to bear in mind that many transactions that were perfectly valid under non-insolvency law were potentially fraudulent under insolvency law.

84. With respect to the question of whether the transaction should be automatically avoided by operation of the law or voidable on the application of the insolvency representative, it was noted that a distinction had to be made between fraudulent transactions, which could not be automatically avoided, and the other types of transactions, which could be automatically avoided by reference to a fixed suspect period.

85. In discussing transactions at an undervalue, it was pointed out that there was a need to distinguish between those transactions involving creditors and those involving third parties, as the latter could also be classified as gifts. It was suggested that a long suspect period was required for transactions at an undervalue.

86. In relation to preferential transactions, it was noted that the criterion was whether the transaction involved a contemporaneous exchange of value. Examples could include irregular payments made in respect of debts not yet mature. It was suggested that such transactions were broader than just payments to creditors and should include not only transactions for the benefit of creditors, but also transactions with third parties. In response, it was pointed out that the preferential nature of the transaction would be hard to define in the context of third parties and that transactions involving a preference to third parties could be classified as transactions at an undervalue or as gifts

(although it was noted that some legal systems might permit certain gifts to be made). It was suggested that transactions involving payment in kind could also be included. As to the suspect period required, it was suggested that it should be shorter than that applicable in the case of fraudulent or undervalued transactions.

87. Some concern was expressed as to what invalid security interests as a category of avoidable transaction referred to. It was generally agreed that that category would cover security provided on the basis of past consideration. It was suggested, however, that it might also include securities such as liens that were not properly perfected and could be avoided under non-insolvency law. The Working Group added that, as a general matter, the issues relating to the validity or invalidity of secured interests should properly be the province of the relevant secured transactions law and should be the subject of cooperation between the Working Group on Insolvency Law and the Working Group that would commence its work on secured transactions in May 2002.

88. The view was expressed that set-off was not avoidable as such, but that it might be where the effect of the set-off was to alter the balance of the debt between the parties to the set-off in such a way as to create a preference, or where the set-off occurred in irregular circumstances, such as where there was no contract.

89. Where unauthorized transactions occurred after the application for the proceedings and before commencement, the transaction should be void, not voidable to avoid disputes. In respect of a further category, that of transactions inconsistent with normal commercial practice, the view was expressed that it was more in the nature of a defence to an allegation of a preferential transaction where it could be shown that the transaction was consistent with normal practice or consistent with the normal course of dealings with the particular creditor. A contrary view was that those types of transactions should be included as a separate category. It was suggested, however, that the criteria of "inconsistent with normal commercial practice" would be difficult to determine, particularly where the transaction appeared on the surface to be in the ordinary course of business, but only on close examination was revealed not to be. It was also noted that such criteria raised an issue of who should be charged with making that determination.

4. Administration of proceedings

(a) Debtor's rights and obligations

90. It was generally felt that the issue of the rights and obligations of the debtor were different in liquidation and reorganization. Where the business was to be continued (either for sale as a trading entity or reorganization) a greater need for debtor involvement arose.

91. General support was expressed for the obligation of the debtor to disclose in a timely manner full information as to the financial and economic situation of the business, with a view to preserving confidence and allowing proper evaluation of the business by the insolvency representative.

In respect of reorganization, it was noted that prompt submission of information by the debtor might be useful to enhance the confidence of the creditors in the ability of the debtor to continue managing the business. A suggestion was that that duty should extend to all relevant information and include information also in respect of the years prior to the initiation of the proceedings.

92. In respect of reorganization, the Working Group agreed that continuing involvement of the debtor in the management of the business was desirable and appropriate. The possible advantages of that approach, especially in respect of individual businesses or small partnerships, were pointed out. Where the debtor retained a significant role in management, such as in the debtor-in-possession approach, supervision by the court was necessary (and might include the appointment of an insolvency representative). It was generally felt that the powers given to the debtor within the context of reorganization should be balanced by providing efficient mechanisms enabling creditors to take appropriate action. In that connection, it was observed that the primary responsibility of the debtor after the commencement of the proceeding would be vis-à-vis the creditors rather than to the shareholders. It was further observed that the power of the court to appoint an officer to act as mediator would be useful to address situations where the apathy of creditors might hinder the preparation and approval of the reorganization plan. Another suggestion was that differences in treatment of rights and obligations of the debtor might be introduced, depending on the size of the enterprise.

93. Support was expressed in favour of an approach that relied on sharing of rights and responsibilities between the debtor, on the one hand, and the insolvency representative appointed by the court, on the other hand. Under that approach, the debtor would continue to run the business on a day-by-day basis while the insolvency representative would supervise relevant transactions and be responsible for the implementation of the plan.

94. After discussion, the Working Group agreed that it would be advisable to draw a distinction between the period between initiation of the insolvency proceedings and the approval of the reorganization plan, on the one hand, and the period following that approval, on the other hand. It was felt that, while in the first time span it would be appropriate for legislation to set out specific rules and provide for an independent representative to be involved, a more flexible approach, giving a wider scope to party autonomy, might be advisable during the period following the approval of the plan and throughout its implementation, with a view to enhancing the chances for successful reorganization.

95. The Working Group discussed the issue of the right of the debtor to be heard. A concern was that, if stated as a general principle, that right might lead to formalities and costs unnecessarily impeding the course of the proceeding, especially in the context of a liquidation proceeding. It was therefore suggested that that right should be limited to situations where the debtor had an interest, in respect of both its financial situation and its personal rights. In response, it was noted that some systems considered the right to be heard as a fundamental right of a constitutional nature and

that restrictions thereto might result in making it more difficult to grant recognition of procedures carried out in systems allowing those restrictions. It was further noted that providing for the debtor to be involved in decisions as a general rule might ultimately enhance the confidence in the insolvency system. Accordingly, it was agreed that the draft guide should emphasize the need to avoid the exercise of that right resulting in abuse which would adversely affect the expeditious carrying out of the procedure.

96. A further suggestion was that issues such as the release from restrictions imposed on an individual debtor as a consequence of commencement, as well as discharge from all or some debts following termination of the procedure, should be addressed in the draft guide.

(b) Insolvency representative's rights and obligations

97. As to who should appoint the insolvency representative, it was suggested that any solution should foster the selection of an independent and impartial person; the appointment by the court or creditors was generally considered as more conducive to independence and impartiality than leaving the appointment to the debtor. In that regard, it was noted that debtor appointments had the potential to lead to substantial disputes concerning creditor claims and discrimination towards creditors. It was further noted that there was a trend towards appointment of the insolvency representative by an independent appointing authority that could draw upon professionals with experience and knowledge of relevant sectors.

98. Statements were made regarding procedures that governed the selection of insolvency representatives in various countries; the statements were made by way of information or as suggestions to be taken into account in formulating recommendations for the draft guide. They included that the prospective insolvency representative should be required to disclose circumstance that might indicate a conflict of interest or lack of independence; that candidates for the office had to undergo training by specified institutions and be licensed; that representatives were chosen from a roster under systems that were designed to be fair to representatives (in terms of distributing cases in which assets did not allow for a full remuneration of the representative) but did not necessarily guarantee the choice of the most appropriate person in each case. It was observed that in establishing such procedures and requirements, one should be mindful that overly stringent requirements had the disadvantage of raising the costs of proceedings, while requirements that were too low would not guarantee the quality of the service required.

99. On the question of the qualifications required of an insolvency representative, the view was expressed that paragraph 145 of document A/CN.9/WG.V/WP.54/Add.1 adequately reflected the issues to be considered. It was suggested that a reference could be added to the need for the insolvency representative to be a "fit and proper" person and the fact that it performed different fiduciary roles. It was also suggested that the draft guide might make mention of the need for a public officer to be appointed in cases where an insolvency case could not be assigned to a

private insolvency representative where, for example, there were no assets to fund the administration of the insolvency.

100. It was recognized that the insolvency representative was to be subject to standards of responsibility, but that those standards should be in line with the circumstances in which the representative took decisions; in that light, suggestions were made that the standard of responsibility was not to be more stringent than that of a manager of a company, that it should be along the lines of a standard expected of a prudent person in his or her position, or that the standard should be based on the expectation that he or she would act in good faith for proper purposes; it was stated that the standard of care should not be too stringent (in particular it should not be the standard of care applied in tort cases) so as not to invite law suits against the representative and thereby raise the costs of the service.

101. It was suggested that the provisions on replacement or removal of the representative should be linked to the representative's failure to act according to the required standard, with the reservation that, depending on the role and prerogatives of creditors in the proceedings, it might be appropriate to leave the creditors free to remove the representative without having to give any justification therefor. In that respect it was suggested that where the draft guide dealt with removal, whether or not for cause, it should also discuss the need for the insolvency law to provide for substitution and succession in title to the assets of the estate. It was noted that insolvency representatives were regarded in some countries as officers of the court, which determined their level of responsibility and grounds for removal.

102. As to the need for liability insurance of insolvency practitioners or an obligation to provide a guarantee to cover any breach of their duties (such as a bond by a surety company), it was suggested that those obligations should be in line with the proper distribution of risks among the participants in insolvency proceedings and should be balanced against the need to control the costs of the service.

(c) Creditor claims

103. The Working Group discussed the issue of submission of claims by creditors. One view was that a specified period of time within which such a submission should occur was advisable for the purpose of certainty. A related view was that sanctions for late filing should be provided. However, the concern was raised that providing a specified time limit for submission of claims might result in discrimination against foreign creditors, who in many cases might not be able to meet the time limit. It was observed that that result would entail a violation of the principle of equal treatment of domestic and foreign creditors, as set forth in article 13 of the UNCITRAL Model Law on Cross-Border Insolvency. It was further pointed out that that result would be inconsistent with the international trend in insolvency law reform, which was clearly towards the abolition of any discrimination based upon nationality of the creditor. It was also clarified that the absence of a specified term would be of no detriment to the insolvency estate, provided that the claim was lodged prior to distribution of the assets and provided that any cost arising in connection with the late

filing was borne by the creditor. Another view was that, if a time limit was to be introduced, it should not have a preclusive effect.

104. In response, it was observed that such a concern could be adequately addressed either by introducing longer timer limits, or by providing a specific time limit for foreign creditors as was already the case in some legal systems, or allowing the court to extend the time period upon evidence of serious impediment. It was also suggested that that option should also be open to domestic creditors. It was further noted that the question of late filing of claims by foreign creditors was closely related to provision of adequate notice to those creditors and that the draft guide should refer to the obligation to adequately inform foreign creditors set forth in the UNCITRAL Model Law on Cross-Border Insolvency. It was also observed that the establishment of an international database containing information drawn from national commercial registries would be useful in order to provide timely information to creditors and to assist in ensuring their equal treatment.

105. With regard to foreign creditors, the issue was raised as to whether claims could be submitted in a language other than the one of the insolvency proceedings. The Working Group agreed that allowing a creditor to submit the claims in its own language might significantly facilitate access of foreign creditors. Accordingly, it was suggested that the draft guide recommend that national laws reduce the constraints deriving from documents having to be submitted in a specific language or subject to specific formalities such as translation and notarization required by national law.

106. It was pointed out that equal treatment of foreign creditors was linked to the issue of conversion of claims expressed in a currency other than the one of the country of the insolvency proceeding, namely in respect of the time at which that conversion was to take place. It was noted that, owing to the continuous fluctuations of currency rates, establishing the conversion at the commencement of the proceeding, rather than at the time of filing or of distribution, might result in significant variations in the amount of the claim. The view that conversion should occur at the same time as when interests on claims ceased to accrue, that is, at the time of commencement, was not supported. The Working Group agreed that the draft guide should draw attention to that issue, outlining the various options available without, however, suggesting a specific approach.

107. The idea that the statement of claims should be prepared by the insolvency representative rather than by the court received wide support, since it was felt to be consistent with the desirable objective of reducing the formalities encumbering the process of verification of claims. It was pointed out that those formalities could be further reduced if admission of claims on the basis of appropriate declarations (such as affidavits) entailing penal sanctions in the event of fraud, as well as inclusion of claims evidenced by properly kept accounting books, were allowed. Notwithstanding general support for the goal of ensuring effectiveness and simplicity, it was, however, pointed out that the draft guide should clarify that the decisions of the insolvency representative to either admit or reject a claim would be subject to appeal to the court.

108. A concern was that such a solution relied heavily on the discretionary powers of the insolvency representative and might therefore easily lend itself to delays or even collusion with the debtor, thus undermining the predictability of the system. Therefore, it was suggested that claims outstanding at the time of commencement should be admitted on an automatic basis, without prejudice to the possibility to resort to the court in order to contest admission or exclusion of a specific claim. It was observed that such a system would need to be accompanied by a mechanism aimed at ensuring that adequate information as to the claims included on an automatic basis was available to all interested parties.

109. The advantages of a system providing for automatic admission of claims were recognized by the Working Group. It was observed that admission of claims on an automatic basis would avoid most of the difficulties linked with the insolvency representative having to make a precise assessment of the situation at the outset of the proceeding to enable creditors to participate in and vote at meetings held at an early stage of the proceedings. After discussion, it was agreed that both options should be retained in the draft guide and presented as possible alternatives for adoption.

110. Various views were expressed in respect of the types of claims that should be excluded. It was observed that, while many countries currently took the approach of excluding foreign tax claims, there was no reason why national legislators would not be free to admit them, if they so wished. While it was suggested that foreign tax claims should be given the same treatment as domestic tax claims, the prevailing view was that the draft guide should set forth the various alternatives available to national laws without recommending a specific approach. It was also stressed that the draft guide should remain consistent with the approach reflected in article 13, footnote 2, of the UNCITRAL Model Law on Cross-Border Insolvency, providing that the equal treatment of foreign creditors did not affect the exclusion of foreign tax and social security claims from the insolvency proceeding.

111. With respect to the exclusion of fines and penalties, support was expressed in favour of providing a different treatment for, respectively, fines and penalties of a strict administrative or punitive nature (such as fines imposed as a result of an administrative or a criminal violation) and fines and penalties having a compensatory nature. While exclusions of claims of the first nature was generally deemed justified, it was felt that there would be no reason to exclude claims belonging to the second category. A further view was that there was no sound policy reason supporting exclusion of fines and penalties, since unless they were provable, they could not be collected unless they were not subject to the stay. In response, it was observed that that exclusion might be justified with a view to increasing the assets available for unsecured creditors.

112. As to gambling debts, it was pointed out that the reason why in most systems those debts were excluded from admission was that they arose from activities not permitted by the law. Accordingly, it was agreed that the draft guide should rather focus on the general principle that

claims arising in connection with activities which national law considered unlawful, and thus unenforceable, could not be admitted. Furthermore, it was observed that exclusions based upon public policy reasons should also remain unaffected by the insolvency law.

113. Given the different policy options that might support each of those exclusions, it was suggested that the draft guide should bring examples as to the types of claims that national law might wish to exclude and the different approaches that might be taken from the standpoint of the insolvency law.

114. A suggestion was that claims held by persons connected to the debtor should be subject to a special regime, where they would be subordinated to all other claims and excluded from voting. In response, it was observed that the draft guide should not suggest a specific treatment for those claims, but only remind national legislators of the need to address them.

115. As to the submission of claims by secured creditors, one view was that those claims should be admitted on a provisional basis, owing to the difficulties to make a precise assessment of the value of the collateral at the outset of the proceeding. In that respect, it was noted that providing for submission of secured claims, even on a provisional basis, would be useful for the purpose of informing the insolvency representative of their existence.

116. General support was expressed for the suggestion that the draft guide should clearly point out the existence of different classes of creditors, each of which was characterized by its own rights and prerogatives. While it was felt inappropriate for the draft guide to suggest which classes should be given priority or what treatment should be reserved to each of them, the prevailing view was that clear identification of the admitted classes, as well as of the prerogatives respectively pertaining to each of them, should be recommended to national legislators. It was also felt that any difference in treatment depending on whether liquidation or reorganization was at stake should also be clearly pointed out by national laws. The view was shared that, as a matter of general policy, the draft guide should recommend that equality of treatment among creditors should be pursued and that any exceptions had to be supported by clearly identified policy reasons. Support was also expressed for the suggestion to include in the draft guide reference to the financial and economic impact of the various approaches that could be taken at the legislative level.

117. With respect to the treatment of loans granted by shareholders, a view was that those loans deserved a regime that took into account the specific reasons usually underlying their issuance, which would not necessarily be the same as in the case of loans by other entities. As a general remark, it was pointed out that the draft guide should make national legislators mindful of the possible implications of legislative choices at a corporate governance level.

118. The suggestion that the draft guide should address the issue of the treatment of joint obligations under

insolvency law received significant support. In particular, it was suggested that it should address whether and to what extent the commencement of the insolvency proceedings would affect the right of a creditor to enforce the claim against one or more joint debtors other than the one subject to the proceedings. In that respect, a further view was that treatment of guarantors should be included in the draft guide and that the situation where the guarantor was also insolvent should be addressed.

119. A further view was that the draft guide should recommend that the issue of treatment of unsecured claims acquired after commencement of the insolvency proceedings should be specifically addressed by outlining the different approaches available under various legal systems. Another suggestion was that the issue of set-off was critical to ensure equal treatment of creditors and should therefore be dealt with by the law as a specific issue of creditors' claims.

120. Finally, the Working Group discussed whether the insolvency law should provide for a mechanism of what was, in some legal systems, known as "equitable subordination". It was pointed out that in those systems that allowed it, that mechanism was aimed at ensuring equality of treatment of creditors by undoing or off-setting inequity in a specific claim that would produce injustice or unfairness to other creditors within the context of an insolvency proceeding. It was further clarified that that mechanism was deemed to be exceptional in nature and therefore available under specific circumstances and upon demand of the interested party to the court only. It was pointed out that the remedy would require that the inequitable conduct of the claimant had resulted in harming other creditors or conferring an unfair advantage on the claimant and that the granting of the remedy would not be inconsistent with insolvency law. Some situations usually allowing the remedy to be granted were mentioned, including a fiduciary of the debtor misusing its position to the disadvantage of other creditors; a third party controlling the debtor to the disadvantage of other creditors (for instance, by way of threatening to withdraw financing so as to force the business to be closed); or a third party defrauding other creditors (for instance, by way of submitting misleading information). Finally, it was noted that equitable subordination would be granted only up to the amount of the harm resulting from inequitable conduct and that it would not be available in respect of the exercise of normal rights conferred upon the creditor by either statute or contract, unless misconduct was shown.

(d) Creditor committees

121. Different views were expressed as to the role that a creditor committee could perform. One view was that creditor committees could perform a useful consultative role, assisting the insolvency representative by discussing difficult issues and providing advice but not participating directly in decision-making. It might also have a role to play in checking upon the insolvency representative or the debtor's management where it retained a significant role in the day-to-day management of the business. Another view was that the creditor committee could play a more active

role in decision-making. In relation to how the committee might operate, it was suggested that there was a need for the powers of the creditor committee to be clearly stated and, in order to avoid disputes and in particular to ensure confidentiality, for the committee to operate on the basis of agreed rules.

122. It was suggested that whether or not a committee was needed might depend upon the nature and size of the case and whether it was a liquidation or reorganization. In liquidation, it was observed that a committee was not always needed, but that there might be exemptions such as in the case of the sale of the business, where the creditor committee could be a source of expert advice. On that basis, it was suggested that the committee should have a consultative role in liquidation. In reorganization, it was noted that the input of a creditor committee was generally useful and necessary, but that a flexible approach should be adopted as to what functions the committee should perform. It was suggested that, as a general proposition, the committee should perform an advisory function with some clearly defined exceptions. Those would include the committee playing a central role in the development of the reorganization plan, in the sale of significant assets and when requested by the insolvency representative or directed by the court. With respect to those four instances, but not where its function was only advisory, it was suggested that the committee should have the ability to appoint financial, legal and other advisers as required.

123. In terms of the creditors to be represented on the committee, one view was that it should be limited to the largest unsecured creditors and not include priority or secured creditors. Another view was that representation should be determined on the basis of the size and type of debt, where the type of debt was to be determined by reference to criteria other than the secured or unsecured nature of the claim. A further view was that the insolvency regime did not have to specify which creditors should be represented, but should adopt a flexible approach which would allow creditors to choose their own representatives on the basis of willingness to serve and would provide for enlargement or reduction of the size of the committee as required. Where the different types of creditors requiring representation was too diverse, it was suggested that different committees could be established to represent different interests, but that that approach should be taken only in the case of special interests such as tort claimants and shareholders. It was also suggested that the insolvency law could stipulate which parties could not participate in the committee, such as the debtor or a party related to the debtor.

124. With respect to the liability of creditor committees, it was observed that the fact that members of the committee were not remunerated for participating in the committee would suggest a low level of responsibility. While it was noted that establishing liability for creditor committees was likely to promote creditor apathy, support was expressed for an approach based upon good faith which provided immunity for members in respect of actions taken by them in their capacity as members of the committee unless they were found to have acted improperly or to have breached a fiduciary duty to the creditors.

(e) Post-commencement finance

125. It was generally noted that it was essential for a business in reorganization to have access to cash flow if it was to be able to continue to trade and reorganize successfully. It was observed that in situations where it was permitted by the law, the debtor could use its cash collateral to secure finance, but where this was not available, post-commencement funding would have to be obtained in some other way. Examples were given of a “super-priority” (a priority that ranked in advance of administration expenses) and a “priming lien” (which ranked ahead of existing security interests but were rarely granted without the consent of the secured creditor). It was noted that post-commencement finance was likely to come from two types of lenders. The first was pre-insolvency lenders who had an ongoing relationship with the business and were likely to advance further funds in order to protect their existing claims and perhaps gain additional value through the higher rates charged for new lending. It was noted that that source of post-commencement finance was the most common. The second type of lender had no pre-insolvency connection with the business and was likely to be motivated only by the possibility of high returns. It was observed that the inducement for both types of lender was the predictability of the recognition accorded to post-petition lending and, in respect of existing lenders, confidence that their relationship to the debtor and the terms of their pre-commencement lending would not be changed.

126. Some concern was expressed with respect to the two forms of priority mentioned. It was suggested that the possibility of establishing priming liens might negatively affect the availability of credit to businesses in general. Only secured creditors who would be affected by the priming could agree to be displaced by such forms of security. The decision to obtain such finance therefore was not one that could be taken solely by the court, the insolvency representative or the general creditors. A further concern was how such a priority would be treated in the event that the reorganization failed and the proceedings were converted to liquidation, particularly as it might relate to the established priority for administration expenses. It was noted that a distinction needed to be drawn, in terms of the provision of finance, between the different stages of the reorganization process, such as the post-application, pre-plan and post-plan periods, with only the latter period being addressed by the plan. A question was raised as to whether the issue of post-commencement finance might not also be relevant in the case of the sale of a business in liquidation.

(f) Reorganization

127. At the outset of the discussion it was suggested that the draft guide should include a discussion of why reorganization was desirable and the need in some countries to remove legal obstacles to the development of flexible procedures for reorganization that could take account of the advantages and disadvantages of different procedures in combinations that would enable the goal of maximizing value to be achieved.

128. The Working Group discussed the development of secondary debt markets. Those markets had increased trading in debt, which, in turn, had had an impact on the way in which relevant participants approached reorganization procedures. It was noted that banking practice had changed significantly in some countries over the last 20 years, so that banks were increasingly selling their claims better to manage their risks and create liquidity, rather than waiting for long periods to receive a dividend from insolvency proceedings. It was observed that that trend had the potential to complicate insolvency proceedings significantly, because the parties negotiating a reorganization arrangement could change throughout the duration of the negotiations and because the objectives and interests of those secondary debt purchasers might differ from those of the original creditors, in particular in terms of their interest in returning a profit from their acquired debt rather than in the rescue of the business and the importance of ongoing business and commercial relationships.

129. Although it was apparent that insolvency law did not necessarily need to be changed to address that trend, and no examples of such changes were given, it was noted that there were implications for the insolvency process in terms of membership of creditor committees and the relationship of the parties that might purchase the debt to the debtor. With respect to creditor committees, it was noted that allowing debt traders to participate raised a potential problem of access to sensitive information that could assist their business. There was also a potential for debt traders to misstate the likely value of dividends to encourage creditors to sell at a discount at an early stage of the proceedings. A further issue was whether parties related to the debtor could purchase claims and if so, what mechanisms might need to be adopted to address possible problems. It was suggested, as an example, that a claim against the estate by such a purchaser could be limited to the amount actually paid for the debt, rather than the face value of the debt, where an unrelated third party could claim the face value of the debt. A further mechanism would be to exclude the votes on a reorganization plan of those related parties.

130. The Working Group considered the ways in which insolvency systems dealing with reorganization differed in terms of essential framework. Two principal models were identified, although it was pointed out that some issues were treated similarly in the different models. It was noted that one model relied upon the notion of providing adequate protection for secured creditors. Under that model, governance issues would require greater involvement of the courts; there was a requirement for a stay to be applied, with different approaches being adopted as to the period of application of the stay and the period over which the business could be assessed and there was provision for dissenting creditors to be bound to the plan where the secured claim was appropriately provided for and it was in the interests of all participants in the proceedings to do so (a “cram-down” provision).

131. The other model, used in systems with a strong secured creditor tradition, generally had no, or a limited, application of the stay of proceedings, with the period of the stay being used to evaluate whether a greater return

could be expected from reorganization than from liquidation. Governance issues were normally dealt with by an insolvency representative; there was less court involvement than in the first model, as the question of adequate protection for secured creditors did not arise and there was a reluctance to provide for a cram-down of secured creditors. An underlying assumption of the secured creditor model was that the creditors would generally agree where it was demonstrated that the return in reorganization would be greater than in liquidation.

132. The question was raised of how the sale of a business as an operating entity should be treated and, in particular, whether it should be treated in the context of liquidation or reorganization. That question was one of a number of questions posed to the Working Group in the report of the Secretary-General on the draft legislative guide (see A/CN.9/WG.V/WP.54/Add.1, text following para. 189). It was suggested that the sale of a business as an operating entity was not incompatible with liquidation and also would be a viable option in reorganization. It was agreed that, for the purposes of discussion, there should not be a strict delimitation drawn between the two procedures and that whatever was an appropriate procedure for the purpose of maximizing value should be available.

(i) Preparation of a plan

133. A number of options for preparation of the reorganization plan were considered. One suggestion was that preparation could be undertaken by the insolvency representative who was usually independent and would bring an objective viewpoint to the task, one that was not necessarily dictated by the debtor or by the creditors. It was noted, however, that preparation of the plan by the insolvency representative would rarely occur without consultation with interested parties. Another view was that a distinction needed to be drawn between the secured-creditor model, where an insolvency representative was appointed and could prepare the plan, and the debtor-in-possession model, where there would be an allocation of responsibility between the debtor and the creditors. What was required, it was suggested, was a balance between the freedom accorded to the parties to prepare the plan and the restraints that necessarily attached to the process in the form of voting requirements, time limits for preparation of the plan, amendment of the plan and other procedural considerations.

134. After discussion, the Working Group agreed that a flexible approach should be adopted on the question of who should prepare the plan. In some cases it might be appropriate for the debtor or its representative to prepare the plan and be given an exclusive period to do so on the basis that that might operate as an incentive to the debtor to commence proceedings at an early stage. That incentive would have to be balanced against the need to ensure creditor confidence in the debtor and its proposal. In other cases, the creditor committee or an individual creditor could prepare the plan, while a third option would be to allow an insolvency representative to prepare the plan.

135. On the issue of the time at which the plan should be prepared, one view was that it should not be at

commencement as that was not likely to be a plan of substance and might operate to pre-empt proceedings and cause delay. Another view was that it should occur in the observation period after commencement. A further view was that preparation of the plan might take place before the insolvency application. After discussion, it was agreed that the Guide should reflect an approach where there was no requirement for the plan to be prepared before commencement, but that that option should be available.

(ii) *Content*

136. The general view was that the plan needed to provide certain minimum information in order to ensure transparency and confidence in the process. It was suggested that there was a need for the goal of transparency to be weighed against confidentiality concerns arising from creditor access to potentially sensitive commercial information; it was noted that in cases where the plan was approved by the court, that information would generally be on the public record at some stage of the proceedings, but that consideration should be given by the court to protecting confidential information. It was suggested that the information to be included in the plan should include statements on the financial situation of the debtor, including both asset and liability and cash flow statements; details of the precise proposals included in the plan; details of what creditors would receive and how that would be more than they would otherwise receive in liquidation; and the basis on which the business would be able to keep trading and could be successfully reorganized. It was observed that the plan could not provide for any action that would be illegal or contrary to law (see A/CN.9/WG.V/WP.54/Add.1, para. 176), with an additional example being cited of tax laws. However, it was also noted that there might be laws that could impede implementation of the proposals that might potentially be contained in the plan, with one example being laws on foreign direct investment or foreign exchange limitations. Since some insolvency laws allowed those provisions to be overruled in certain circumstances, or provided for fast-track approvals, it was suggested that the draft guide should raise that issue for consideration. A further suggestion was that a number of the procedural issues set forth in the report of the Secretary-General (see A/CN.9/WG.V/WP.54/Add.1, text following para. 189) were issues that could be addressed in the plan to ensure that the procedures to be followed in order to achieve approval and implementation of the plan were clear.

137. It was noted that permitting secured creditor rights to be affected by the plan could have a negative impact upon the availability of credit and that that effect should be clearly stated in the draft guide.

138. In terms of protection of minority interests, a question was raised as to whether that issue should be addressed in the plan or in the insolvency law. It was suggested that in order to ensure that the proceedings would be respected, it was important that the majority creditors should not be able to affect unfairly the rights of the minority.

(iii) *Approval and effect of the plan*

139. On the issue of voting on the plan, a view was expressed that in order to encourage cross-border flows of capital, clear rules were required as to the rights of the different classes of creditors, particularly with regard to the ability of creditors to vote on a plan and to refuse to agree to a plan. It was suggested that voting should be based only upon economic interest in the outcome of the process and that only those parties having such an interest should be permitted to vote. Support was expressed in favour of voting on the basis of both the value of the claims and the number of creditors, as well as for the requirement of a supermajority to ensure that the support for the plan was sufficient to ensure its implementation. That was considered to be particularly important where dissenting creditors could be bound to the plan.

140. With regard to the reasons that creditors could put forward for challenging a plan, it was noted that since all creditors would be prejudiced by the proceedings, a level of prejudice or harm that exceeded the prejudice or harm suffered by other creditors or classes of creditors was required.

141. In terms of dividing creditors into classes and the criteria that should be taken into account, it was suggested that in the absence of a compelling reason for creating special classes, all general unsecured creditors should be treated in one class. It was noted, however, that in one country the law provided criteria for including secured claims in the same class if the interests of the creditors holding those claims were sufficiently similar to give them a commonality of interest, taking into account factors that included the nature of the debts giving rise to the claims; the nature and priority of the security in respect of the claims; the remedies available to the creditors in the absence of the proposal and the extent to which the creditors could recover their claims by exercising those remedies; the treatment of the claims under the proposal and the extent to which the claims would be paid under it; and other criteria as might be prescribed.

142. It was suggested that the draft guide should address the question of what would occur in situations where a plan was not approved and whether that would lead to other parties being able to propose an alternative plan, automatic commencement of liquidation proceedings, individual actions by creditors or some other result. One view was that a result of automatic liquidation might have the effect of discouraging the debtor from proposing a plan, an outcome that was directly opposed to one of the key objectives of an insolvency regime. Another view was that allowing individual creditors to take action could result in the race for assets that the commencement of collective proceedings was intended to avoid and was incompatible with the goal of maximization of value. A different view was that once a plan was rejected, anything other than automatic liquidation might simply lead to delay, further diminution of value and no predictable end to the proceedings. Automatic liquidation would provide a procedure for equality of distribution in accordance with the insolvency regime. It was suggested that a compromise might be to allow the proposal of a different plan by creditors within a specified

deadline and only in situations where no plan could be prepared should liquidation follow.

143. With respect to the approval procedure, it was noted that not all countries required court confirmation of a plan approved by creditors; some insolvency regimes provided that where the requisite majority of creditors had approved the plan nothing further was required. It was noted also that in some countries the role of the court was performed by an administrative authority. Minority creditors could be protected by allowing them to dispute the plan in court, with some laws establishing criteria against which the dissent of those creditors could be judged.

5. Liquidation and distribution

Distribution priorities

144. A general view was that the draft guide should recommend that priorities in distribution should be not only clearly identified but also reduced to the minimum possible, with a view to both preserving the predictability and the efficiency of the insolvency system and to fostering the availability of credit. It was pointed out that the greater the number of priorities recognized by the law, the wider the scope of the debates which were likely to arise in assessing the privileges pertaining to the different privileged categories. Nevertheless, it was also suggested that the treatment of priorities should distinguish between those that might arise in respect of secured creditors as a result of a bargain or after commencement (such as would relate to provision of post-commencement finance) and those that were related to general unsecured creditors.

145. The Working Group agreed that the draft guide should recommend that any priority should be specifically mentioned in the insolvency law, irrespective of whether the policy reason underlying that priority was to be found in the insolvency system or in other legislation. It was also agreed that it would be inappropriate for the draft guide to suggest which priorities should be retained or excluded. It was further agreed that the financial and economic impact of introducing priorities (namely, the reduction of the amount of the estate available to unsecured debt) should be expressly mentioned.

146. With respect to the provision of a general super-priority, as such prevailing on both secured and unsecured creditors, the view was shared that such a priority would entail a major interference with the rights of secured creditors and therefore needed to be supported by sound public policy considerations.

147. The Working Group discussed the treatment of the expenses incurred during the insolvency proceeding. It was pointed out that most legal systems gave those claims a top priority by considering them to be administrative claims, often resulting in a significant impact on the insolvency estate. While it was recognized that the specific treatment of that issue had links to the underlying infrastructure of the system, various views to the effect of reducing the impact of those claims on the insolvency estate were expressed. The suggestion to introduce a ceiling to the

amount of those expenses was not supported. Instead, the prevailing view was that precise, though flexible, criteria supporting allowance of those expenses should be outlined. In particular, it was suggested that their allowance should be conditional upon the utility of the expense for the purpose of increasing the estate in the general interest of all constituents. A similar suggestion was that those expenses should be allowed only when they appeared not only reasonable and necessary, but also consistent with the objectives of the procedure. A further suggestion was that the reasonableness of the expense should be assessed against both the amount of resources available to, and the possible effect on, the procedure.

148. As to the authority that should be entrusted with the task of assessing the appropriateness and reasonableness of the expenditure, one view was that those expenses needed to be subject to prior authorization by the court. According to a similar view, prior authorization by the court should be required in respect of actions falling outside the scope of the ordinary course of business. However, the prevailing view was that that assessment should be made by the creditors, with a view also to ensuring the transparency of the proceeding, provided however that the decision of the creditors would be subject to recourse to court.

149. In response to those suggestions, it was clarified that a distinction should be drawn between the fees of the insolvency representative and of other professionals involved in the procedure, on the one hand, and the expenses incurred for the purposes of operating the business and carrying out the procedure, on the other hand.

150. As a general suggestion, it was noted that the draft guide should address the treatment of situations where limited or no assets were available. It was observed that different approaches were available: while some systems provided for immediate termination of the procedure upon assessment of absence of assets by the court, others provided that no action should be taken and others for a state liquidator to be appointed. It was suggested that in those cases the fees of the insolvency representative might be paid by way of a deduction on its personal tax account. In response, it was noted that that suggestion would result in the fees of the insolvency representative being borne by the State rather than by the insolvency estate. The view that, when a relevant tax credit was at stake, the tax authorities should be entrusted with the task of administering the insolvency proceeding was equally not supported.

151. As to the order in which issues were dealt with in the draft guide, it was suggested that administrative claims should be addressed prior to secured creditors, given the status of priority widely recognized as applicable to those claims. In response, it was observed that some legal systems might take a different view and that therefore the order of the text should not be amended.

152. Another suggestion was that reference to the “owners”, as appearing in paragraph 195 of document A/CN.9/WG.V/WP.54/Add.1, should be replaced by reference to the “shareholders”. In response, it was observed that reference to shareholders would only reflect the situation of a debtor established in the form of a limited liability

company and that a broader, more neutral term was needed to encompass all situations of financing granted by insiders.

153. In respect of the privilege granted to employee salaries and benefits, it was observed that providing for a system of social guarantee would result in a benefit for the insolvency estate, since that would allow those claims to be excluded from the distribution of the assets. It was however clarified that that would require that the social institution guaranteeing those claims would not be allowed to have the same priority *vis-à-vis* the insolvency estate as the employees. Another view was that the draft guide should draw attention to solutions available in different legal systems.

154. A view was that priority of secured creditors, though established by substantive law, should be mentioned in the section of the insolvency law devoted to priority issues, since that would provide clarification for those legal systems where stability and confidence of the credit industry needed to be enhanced.

155. General support was expressed for the suggestion that the draft guide should specifically address the issue of the termination of the proceedings, in respect of determining both the time at which it would occur and its effects.

IV. ALTERNATIVE INFORMAL INSOLVENCY PROCESSES

156. The Working Group considered the report of the Secretary-General on alternative approaches to out-of-court insolvency processes (A/CN.9/WG.V/WP.55) and what further work it might undertake in the area of informal insolvency procedures, taking into account the work of other organizations on that topic and international trends in the development of informal procedures that provided alternatives to formal procedures and were particularly useful in international insolvencies.

157. The Working Group generally agreed on the desirability of undertaking work on informal insolvency procedures, noting that while such procedures relied upon the formal insolvency framework they could provide a means of introducing flexibility into insolvency systems, reduce reliance on judicial infrastructure, facilitate an earlier proactive response from creditors than would normally be possible under formal regimes and avoid the stigma that was often attached to insolvency. It was noted that the increasing globalization of markets and the growth in debt trading had resulted in a more diverse range of creditors being involved in international reorganizations than previously. Those diverse creditors had different interests and objectives in the insolvency of the debtor, which did not always coincide with the interests and objectives of other major credit providers or support the achievement of reorganization.

158. The Working Group discussed the various forms that informal proceedings could take. It was pointed out that

there was a continuum of processes ranging from non-binding principles that supported a collective negotiating framework and did not involve the judicial system (although relying on the existence of an efficient and effective formal system for leverage), to others that utilized a judicial administration mechanism to enforce a plan reached by informal negotiations and bind creditors to that plan. It was suggested that where the negotiations took place out of court and the debtor and the majority of creditors agreed to the plan, a fast track mechanism could be used for the approval process.

159. With respect to the completely informal processes, it was suggested that the Working Group should consider the work being undertaken by other organizations, such as the International Federation of Insolvency Professionals (INSOL International) Lenders Group's Statement of Principles for a global approach to multi-creditor workouts (see A/CN.9/WG.V/WP.55, paras. 10-21) and other similar types of guidelines. In regard to those processes, which combined informal and formal elements, the Working Group might consider how those processes had been developed around the world and in particular examine the role that was taken by judicial and administrative authorities and the point at which intervention occurred.

160. With regard to administrative frameworks, three types of experience were noted and it was suggested that the draft guide should consider the relevant examples and the circumstances in which they had proven to be useful and where they might appropriately be used in the future. In particular, it was pointed out that administrative frameworks had been of assistance in situations where the courts were inadequate to deal with the issues or simply overwhelmed by the extent of systemic failure.

161. It was noted that some of those considerations intersected with the Working Group's development of a legislative guide on a formal insolvency regime and consideration would need to be given to how that intersection could be achieved. In particular, it was suggested that the draft guide should consider the different options, offering a discussion of the advantages and disadvantages of each and indicating how they could be integrated into a reorganization regime. It was noted in that regard that there was a correlation between the degree of financial difficulty being experienced by the debtor and the difficulty of the appropriate solution. Where, for example, a single bank was involved, it was likely that the debtor could negotiate informally with that bank and resolve its difficulties without involving trade creditors. Where the financial situation was more complex and required the involvement of a large number of different types of creditors, a greater degree of formality might be needed. It was suggested that that approach might be a way of presenting the different procedures to legislators. It was agreed that those considerations should be taken into account in the Working Group's consideration of the sections of the draft guide on reorganization, and in particular that the subject of expedited reorganization procedures to implement restructuring of the type addressed in document A/CN.9/WG.V/WP.55 (including both cross-border and domestic arrangements) should be addressed in the draft guide.

A/CN.9/WG.V/WP.54

**B. Report of the Secretary-General on the draft legislative guide
on insolvency law, working paper submitted to the Working Group
on Insolvency Law at its twenty-fourth session**

(A/CN.9/WG.V/WP.54 and Add.1 and 2) [Original: English]

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*[Part two of the draft legislative guide appears in
document A/CN.9/WG.V/WP.54/Add.1 and
part three in document A/CN.9/WG.V/WP.54/Add.2.]*

BACKGROUND REMARKS

1. The United Nations Commission on International Trade Law (UNCITRAL), at its thirty-second session, in 1999, had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas: transparency; accountability; and management of international financial crises by domestic legal systems. According to the reports, strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and for facilitating rapid and orderly workouts from excessive indebtedness. The proposal recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum to put insolvency law on its agenda.

2. The Commission expressed its appreciation for the proposal. It noted that different projects had been undertaken by other international organizations, such as the International Monetary Fund (IMF), the World Bank and the International Bar Association (IBA), on the development of standards and principles for insolvency regimes. It noted that the broad objectives of those organizations, while differing in scope and working methods as a consequence of their respective mandates and membership, was to modernize insolvency practices and laws. The initiatives taken in them were proof of the necessity of assisting States to reassess their insolvency laws and practices. The various initiatives, however, were also in need of strengthened coordination, where appropriate, so as to avoid inefficient duplication of work and to achieve consistent results.

3. Recognition was expressed in the Commission of the importance to all countries of strong insolvency regimes, as a “front line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work at an international level on insolvency legislation, which involved sensitive and potentially diverging

socio-political choices. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

4. To facilitate that further study, the Commission decided that an exploratory session of a working group should be convened to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That exploratory session of the Working Group on Insolvency Law was held at Vienna from 6 to 17 December 1999.

5. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had made in the report on its exploratory session (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches that were possible and the perceived benefits and detriments of such approaches. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, IMF, the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of IBA. Accordingly, in order to obtain the views and benefit from the expertise of those organizations, the UNCITRAL secretariat was asked to organize a colloquium before the subsequent session of the Working Group, in cooperation with INSOL International and IBA.¹

6. The colloquium was organized with the co-sponsorship and organizational assistance of INSOL International and in conjunction with IBA at Vienna, from 4 to 6 December 2000. The approximately 150 participants from 40 countries included lawyers, accountants, bankers, judges and insolvency practitioners, as well as representatives of Governments and international organizations such as ADB, the European Bank for Reconstruction and Development, IBA, IMF, INSOL International and the World Bank. The speakers included insolvency officials, judges, practitioners and representatives of organizations who had had significant experience in insolvency law and law reform initiatives.

7. Broad support was expressed in favour of the Commission undertaking work on the key elements of an effective insolvency regime (see A/CN.9/495, para. 34). The Colloquium strongly recommended that approximately six

months should be allowed for thorough preparation of drafts for consideration by the Working Group. It was noted that the mandate given by the Commission to the Working Group referred to the work under way or already completed by other international organizations and required the Working Group to commence its work after receipt of the reports currently being prepared by other organizations, including the World Bank. The Colloquium heard that the World Bank report was expected to be finalized in early 2001.

8. In light of those factors, the meeting of the Working Group scheduled for 26 March to 6 April 2001 in New York was rescheduled for 23 July to 3 August 2001, also in New York. Subject to approval by the Commission, a further Working Group meeting might take place from 3-14 December 2001 at Vienna.

9. The present report sets forth the introduction, definitions and part one of the draft legislative guide on insolvency law. Part two, Core provision of an effective and efficient insolvency regime, appears in document A/CN.9/WG.V/WP.54/Add.1 and part three, Draft legislative provisions, appears in document A/CN.9/WG.V/WP.54/Add.2.

DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

Introduction

1. *Organization and scope of the Guide*

10. The purpose of the present Guide is to assist in the development of efficient and effective legal frameworks for insolvency. The advice provided in the Guide aims at achieving a balance between provisions necessary to encourage the early use of and access to an insolvency regime in order to maximize the utility of the tangible and intangible assets of an enterprise on a fair and balanced basis to the stakeholders and avoid the erosion of value through delay, on the one hand, and various public interest concerns, on the other.

11. The Guide is arranged in three parts.² Part one establishes the key objectives of an efficient and effective insolvency regime. Part two addresses the core provisions of an efficient and effective insolvency regime. Part two is arranged in two sections. The first section offers an analytical introduction to the issues raised by a particular subject area and sets forth policy considerations and options. The second section provides a summary of the different approaches that may be taken to the issues discussed in the first section [and includes recommended approaches]. Part three sets forth legislative provisions implementing some of the approaches from part two. Those provisions are intended to form the essential elements of an effective and efficient insolvency framework. The user is advised to read

¹See *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, para. 408.

²Matters included in the text between square brackets are intended only to assist the Working Group by raising issues for consideration and indicating alternative drafting. They would not appear in the final version of the Guide.

the legislative provisions together with the introductory notes, which provide background information to enhance the understanding of the legislative provisions.

12. The legislative provisions deal with matters that it is important to address in legislation specifically concerned with insolvency, be it liquidation or reorganization. They do not deal specifically with other areas of law, such as [foreign investment law, labour law and others] that may have an impact on insolvency law, but where relevant those other areas of law are identified and discussed. The successful implementation of an insolvency regime typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise and training of professionals. Although some of those matters may be mentioned in the analytical introduction, they are not addressed in the legislative provisions. [*References to material on these issues, such as that of the Asian Development Bank and the World Bank, may be included here.*]

13. The Guide does not address questions of relevance to cross-border aspects of insolvency law, such as the treatment of foreign creditors. Those matters are addressed in the UNCITRAL Model Law on Cross-Border Insolvency and it is recommended that that text should be considered in addition to the present Guide. The Guide is not intended to modify or amend any provision of the Model Law in any way.

2. Terminology used in the Guide and role of definitions

14. The following definitions are intended only to provide orientation to the reader of the Guide. Many terms such as “secured creditor”, “liquidation” and “reorganization” may have fundamentally different meanings in different jurisdictions and the inclusion of a definition in the Guide may assist in ensuring that the concepts as included in the Guide are clear and widely understood. [When alternative definitions are proposed, they appear between square brackets. Possible additional conditions or wording are also included in square brackets.]

15. [Reference in the Guide to the “court” might need to be further qualified. The draft provisions of the Guide assume that there is reliance on court supervision throughout the insolvency proceedings, which might include the power to commence insolvency proceedings, to appoint the insolvency representative, to supervise its activities and to take decisions in the course of the proceedings. Although this reliance may be appropriate as a general principle, alternatives may be considered where, for example, the courts are unable to handle insolvency work or supervision by an administrative agency is preferred.]

3. Definitions

Avoidance action: Action which allows transactions to be cancelled or otherwise rendered ineffective. Transactions

that may be avoided include those (a) between a debtor and a creditor having the effect of creating a preference in favour of that creditor to the prejudice of the general body of creditors [other than in the normal course of trade], having taken place within [a specified period of time] before the commencement of the proceedings or (b) in which a debtor’s assets were transferred for unfair value or (c) in which a debtor’s assets were transferred in fraud of creditors.

Centre of main interests: The place where the debtor conducts the administration of its interests on a regular basis, as such ascertainable by third parties.

Claim: Enforceable right to money or property.

Collateral: Property subject to a security interest to the benefit of one or more creditors, who are entitled to sell it in the event of default (see secured claim).

Commencement of proceedings: [Date as of which the effects of insolvency are applicable] or [Date as of which the judicial decision commencing insolvency proceedings becomes effective, whether it is a final decision or not].

Composition: [Within the context of reorganization,] agreement between the debtor and the [majority of] creditors whereby the creditors accept reduction or postponement of debts or the redefinition of payment terms.

Creditor committee: Representative body appointed by [the court] [the insolvency representative] [creditors as a whole] qualified to act on behalf and in the interests of the creditors and possessing consultative powers [and supervising the insolvency representative].

Debtor: Person or entity engaged in a business enterprise and which meets the criteria for, and is subject to, insolvency proceedings, with the exception of entities subject to a special insolvency regime [including banking and financial institutions, insurance companies and *[other]*].

Establishment: Any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.

Initiation of proceedings: The making of an application for commencement of insolvency proceedings by: the debtor; one or more creditors; the general public attorney; the insolvency court of its own motion.

Insolvency: [When the debtor is [likely to become] unable or is no longer able to pay its debts and other liabilities as they fall due] or [When the value of debts and liabilities of the debtor exceeds the value of assets] or [When the debtor generally ceases to pay or suspends payment of its debts and other liabilities as they fall due, the cash assets being insufficient] or [When the debtor ceases to pay important and sensitive debts, such as rent, wages and social security payments].

Insolvency estate: [Goods and rights pertaining to the debtor as of and after the commencement of the proceedings which can be evaluated in money [and all of which

form the debtor's property and constitute assets available for payment of creditors' claims] or [Goods and rights pertaining to the debtor which can be evaluated in money [and are available for creditors as their security]].

Insolvency proceedings: Collective proceedings that involve the [partial or total] divestment of the debtor and the appointment of an insolvency representative [for the purpose of either liquidation or reorganization of the business] [including both liquidation and reorganization proceedings].

Insolvency representative: [Person [or entity] appointed by the court that is in charge of administering the debtor's estate [and assisting and watching over the management of the business] with a view to either liquidation or reorganization of the business; or Person [or entity] appointed by the insolvency court to whom the powers of the debtor's management] to administer, sell or dispose of [assets included in] the insolvency estate are transferred as of the commencement of the proceeding, acting under the supervision of the court. Such powers include without limitation the following: determining or assisting in determination of creditors' claims; realizing the [assets pertaining to the] insolvency estate; making distributions of proceeds among creditors; taking avoidance actions.

Insolvency decision: Decision of the court to commence an insolvency proceeding [and to appoint an insolvency representative].

Involuntary proceedings: Insolvency proceedings initiated by creditors or by the general public attorney's office or [other].

Liquidation: Process whereby a debtor has its assets assembled, disposed of and distributed to the benefit of [the insolvency estate and] the creditors, including shareholders [followed by the dissolution of the legal entity], either by way of a piecemeal sale or a sale of all or most of the debtor's assets in productive operating units or as a going concern.

Netting: In one form it can consist of set-off (see "set-off") of non-monetary fungibles (such as securities or commodities deliverable on the same day, known as settlement netting) and in its more important form it consists of a cancellation by a counterparty of open contracts with the insolvent, followed by a set-off of losses and gains either way (close-out netting).

Observation period: [Within the context of a unitary (see part two, A/CN.9/WG.V/WP.54/Add.1, para. 18) insolvency proceeding], the possibility or otherwise of successful reorganization must be established.

Pari passu: Principle according to which creditors of the same class are treated equally [and are paid proportionately out of the assets of the estate].

Pending contracts: Contracts outstanding [and not fully performed] as of the commencement of the proceedings.

Post-commencement creditor: Creditor whose claim has arisen after commencement of the insolvency proceedings.

Preferential claims: Claims which are to be paid from assets available to pay unsecured debt before payment of general creditors.

Preliminary insolvency representative: Person or entity appointed by the insolvency court in case of a serious crisis of the debtor that prevents the normal operation of its business, required to ensure temporarily further carrying on the business in connection with suspension of the debtor or of the debtor's management (possibly in connection with reorganization).

Reorganization: Process of restructuring an insolvent enterprise in order to [rescue the debtor and] restore the financial well-being and the viability of the business, by way of various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions [and sale of the business as a going concern].

Reorganization plan: Plan to reorganize the business [and redress the debtor] submitted by [the debtor] [the creditors] [the insolvency representative] and approved by the court, addressing issues such as timing of the process, commitments to be undertaken, terms of payment and securities to be offered to creditors, avoidance actions to be filed and treatment of pending contracts, including employment contracts.

Secured claim: Claim assisted by a security taken as a guarantee for a debt enforceable in case of the debtor's default when the debt falls due.

Secured creditor: Creditor holding either a security covering all or part of the debtor's assets or a security over a specific asset entitling the creditor to preference ahead of other creditors with respect to the encumbered assets.

Secured debt: [Aggregate amount of secured claims] or [Claims pertaining to secured creditors].

Set-off: Where a claim for a sum of money owed to a person is "set-off" (balanced) against a claim by the other party for a sum of money owed by that first person. May operate as a defence in whole or part to a claim for a sum of money.

Stay of proceedings: Suspension of the power of the creditors to commence or continue judicial, administrative or other individual actions for enforcement and recovery of their claims, or for obtaining possession of property pertaining to the insolvency estate, or for creating, perfecting or enforcing any security over property pertaining to the insolvency estate.

Unsecured debt: Aggregate amount of claims not supported by security.

Voluntary proceedings: Insolvency proceedings initiated by the debtor.

Part One. Key objectives of an effective and efficient insolvency regime

1. Maximize value of assets

16. Insolvency law should provide for the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized by allowing it to continue. The maximum value for creditors can often be obtained through reorganization rather than liquidation. A broadly phrased “arrangement” or “method” aimed at maximizing the return and minimizing the effects of insolvency would include a range of possible insolvency techniques and avoid implied preference for one technique over the other.

2. Strike a balance between liquidation and reorganization

17. An insolvency regime needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against maintaining the debtor as a viable business through reorganization (often the preference of unsecured creditors). Goals other than maximum recovery for creditors, such as encouraging the development of an entrepreneurial class and protecting employment, are relevant to achievement of this balance.

3. Equitable treatment

18. An insolvency regime should treat similarly situated creditors, including both foreign and domestic creditors, equitably. Equitable treatment recognizes that creditors do not need to be treated equally, but in a manner that reflects the different bargains that they have struck with the debtor, as well as the prerogatives pertaining to holders of claims or interests that arise by operation of law. The insolvency regime should address problems of fraud and favouritism that may arise in cases of financial distress, by providing that acts detrimental to equitable treatment of creditors can be avoided.

4. Provide for timely, efficient and impartial commencement of proceedings and for resolution of insolvency

19. Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business and the activities of

the debtor and to minimizing the cost of the proceedings. To facilitate this, it may be useful to establish time limits in the law for the completion of certain matters (such as providing a deadline for preparing the reorganization plan or in respect of the duration of the stay upon creditors) and for the proceedings as a whole. It might also be useful to allocate responsibility for the process to the entity administering the debtor’s assets, as well as to establish specialized courts or administrative organs or bodies to supervise and direct the process. [Sanctions for failure to commence at an early stage might also be provided].

5. Prevent premature dismemberment of the debtor’s assets by creditors

20. Creditors should be restrained from prematurely dismembering the debtor’s assets by the imposition of a stay. Such a stay would be aimed at enabling a proper examination of the debtor’s situation and would facilitate both maximization of the value of the estate and equitable treatment of creditors.

6. Provide for a procedure that is predictable and transparent

21. Relevant risk allocation rules should be clearly specified in the law and consistently applied to ensure that there is confidence in the process and that all participants are able to adopt appropriate measures to manage risk. Transparency is closely related to the objective of predictability and requires that participants in the process are given sufficient information. In order to ensure that adequate information is available in respect of the debtor’s situation, incentives encouraging the debtor to reveal its positions or sanctions for failure to do so could be provided. In addition, where the law provides for the exercise of discretion, it should also provide adequate guidance as to how that should be exercised.

7. Establish a framework for cross-border insolvency

22. To promote coordination among jurisdictions, insolvency laws should provide rules on cross-border insolvencies with recognition of foreign proceedings, possibly by way of adoption of the UNCITRAL Model Law on Cross-Border Insolvency.

A/CN.9/WG.V/WP.54/Add.1

**Report of the Secretary-General on the draft legislative guide on
insolvency law, working paper submitted to the Working Group on
Insolvency Law at its twenty-fourth session**

ADDENDUM

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GENERAL REMARKS

1. The present note sets forth part two of the draft legislative guide on insolvency law, which deals with core provisions of an effective and efficient insolvency regime. Each subject area is divided into two sections. The first section offers an analytical introduction to the issues raised by each core subject area and discusses policy issues and comparative approaches. The second section provides a summary of the approaches discussed in the first section. Some of the approaches indicated in the summary are reflected in the draft provisions included in part three of the guide (see A/CN.9/WG.V/WP.54/Add.2).

2. Where possible, treatment of each subject area is divided into liquidation and reorganization, to distinguish the different issues applicable to each procedure. The paragraphs entitled “General remarks” are applicable to insolvency proceedings generally and are intended to provide an introduction to the paragraphs that follow.

3. The material in part two is largely based on the work of the International Monetary Fund, the Asian Development Bank and the World Bank. The Working Group may wish to consider what different approaches and examples could be added for each subject area to expand the comparative analysis of different insolvency regimes. The Working Group may also wish to consider whether there are any subject areas and issues that should be addressed in the guide in addition to those already discussed. Some additional issues that it may be desirable to include in the guide are noted within square brackets (for example, under “Treatment of contracts” references are made to set-off and financial contracts and netting, which are yet to be completed). Specific questions and issues for consideration by the Working Group are noted throughout the text. Section B has been completed in respect of a number of subject areas to assist the Working Group in considering what approaches it may wish to recommend and how those recommendations might be reflected in the guide.

DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

Part Two. Core provisions of an effective and efficient insolvency regime

I. Relationship between liquidation and reorganization proceedings

1. General remarks

4. When a debtor is unable to discharge its debts and liabilities as they become due, the need arises to provide for a legal mechanism to address the collective satisfaction of the outstanding claims on all tangible and intangible assets pertaining to that debtor. Most legal systems contain rules on various types of proceedings that may be initiated to address such a situation, which may be referred to by the generic term “insolvency proceedings”. Two types of insolvency proceedings may be distinguished, for which uniform terminology is not always used.

5. The type of proceedings referred to as “liquidation” provides for a public authority (typically, although not necessarily, a judicial court acting through an officer appointed for the purpose) to take charge of the debtor’s assets, with a view to transforming non-monetary assets into monetary form and subsequently distributing the proceeds proportionately to creditors. Such proceedings usually result in liquidation or disappearance of the debtor as a commercial legal entity, although in some instances the assets may be sold together as an operating business.

6. The Asian Development Bank¹ notes that liquidation tends to be close to “universal” in its concept, acceptance

¹Law and policy reform at the Asian Development Bank, report on RETA 5795: Insolvency law reforms in the Asian and Pacific region, April 2000, p. 15.

and application. It normally follows a pattern that includes the following:

- (a) An application to a court or other competent body either by the entity or the creditors;
- (b) An order or judgement that the entity be liquidated;
- (c) Appointment of an independent person to conduct and administer the liquidation;
- (d) Closure of the business activities of the entity;
- (e) Termination of the powers of directors and employment of employees;
- (f) Sale of the entity's assets;
- (g) Adjudication of claims of creditors;
- (h) Distribution of available funds to creditors (under some form of priority); and
- (i) Dissolution of the entity.

7. Wider uncertainties arise as to the meaning of the second type of proceedings, which are often referred to as "reorganization", "rescue", "restructuring" or "rehabilitation". For the purposes of the present Guide, and for the sake of simplicity, the term "reorganization" is used to refer to proceedings whose ultimate purpose is to allow the debtor to overcome its financial difficulties and resume or continue normal commercial operations. That result may be achieved by changing the organization of the business entity or by rescheduling or rearranging the debt. Distinctions as to the way in which reorganization is carried out might depend on the size of the business and the degree of complexity of the specific situation. [Note to the Working Group: it may be desirable to include a more detailed comparative analysis of alternative forms of the processes discussed above.]

8. The Asian Development Bank² points out that, despite the fact that the reorganization process has not been as universal as that of liquidation, and may not therefore follow such a common pattern, there are a number of key or essential elements that can be determined:

- (a) Voluntary submission by an entity to the process, which may or may not involve judicial proceedings and judicial control or supervision;
- (b) Automatic and mandatory stay or suspension of actions and proceedings against the property of the entity affecting all creditors for a limited period of time;
- (c) Continuation of the business of the entity, either by existing management, an independent manager or a combination of both;
- (d) Formulation of a plan which proposes the manner in which creditors, equity holders and the entity itself will be treated;
- (e) Consideration of, and voting on, acceptance of the plan by creditors;
- (f) Possibly, the judicial sanction of an accepted plan; and
- (g) Implementation of the plan.

²Ibid., note 1, pp. 16 and 17.

9. A further difficulty might arise from the fact that the distinction between conventional liquidation and reorganization procedures is not always clear-cut. The term "reorganization" is sometimes used in order to refer to a particular way of ensuring preservation and possible enhancement of the value of the insolvency estate within the context of liquidation proceedings. This is the case, for instance, whenever the law provides for liquidation to be carried out by way of transferring the business to another entity as a going concern. Although such a procedure might seem to evoke the idea of "rescue", as usually associated with reorganization, no actual reorganization occurs. In those situations, the term "reorganization" merely points to a technique other than traditional liquidation (that is, straightforward sale of the assets), being used in order to obtain as much value as possible out of the insolvency estate.³

2. Relationship between liquidation and reorganization proceedings

10. Under certain circumstances, the needs arising in connection with the insolvency of a debtor are best addressed by the liquidation of all of the debtor's assets and the subsequent distribution of proceeds among creditors. Under other circumstances, however, liquidation might not be the best way to maximize the value of the resources of the insolvent enterprise. In reality, straight liquidation of the assets often results in creditors receiving only a portion of the nominal value of their claims. In those cases, the reorganization of the business to preserve the human resources and the goodwill of the enterprise may prove more effective in maximizing the value of the creditors' claims, allowing them to receive more favourable treatment or even to be paid in full. This may be especially true when, for example, the value of the business relies on intangibles (such as intellectual property rights) rather than tangible assets.

11. Reasons for preferring reorganization as opposed to liquidation might also arise in connection with the political and social background of a legal system. Protection of the employees of a troubled enterprise might be regarded as a crucial objective. Furthermore, some countries might consider reorganization proceedings as serving a broad social interest, not only encouraging debtors to resort to reorganization before their financial difficulties become too severe, but also offering them a "second chance", thus ultimately enhancing economic development and growth. Accordingly, many countries recognize that a functioning and effective insolvency regime needs to include both liquidation and reorganization procedures.

³The World Bank report submitted to the Working Group in April 2001 defines rehabilitation as follows: "The process of reorganizing (restructuring) an enterprises' financial relationships to restore its financial well being and render it financially viable. This process may include organizational measures and the restructuring of business and market relationships through debt forgiveness, debt rescheduling, debt-equity conversions and other means. It can also involve selling the business as a going concern, in which case the procedure may be equivalent to similar sales under a liquidation proceeding."

12. Although most countries provide for both liquidation and reorganization proceedings, approaches differ widely as to the structure of the procedure possibly leading to one of those outcomes. Some countries provide for a unitary, flexible insolvency proceeding, alternatively resulting in liquidation or reorganization depending on the characteristics of the case. Some other laws provide for two distinct proceedings, each setting forth its own access and commencement requirements, with different possibilities for conversion between the two proceedings.

13. Those laws which treat liquidation and reorganization procedures as distinct from each other do so on the basis of different social and commercial policy considerations and with a view to achieving different objectives (see part one of the Guide). However, a significant number of issues are common to both liquidation and reorganization, resulting in considerable overlaps and linkages between them, in terms of both procedural steps and substantive issues, as will become evident from the discussion which follows below.

14. When the approach of two distinct procedures is followed, the determination of whether the enterprise of the insolvent debtor is viable should, at least in theory, determine which procedure should be used. As a matter of practice, however, at the time of commencement of either procedure, it is often impossible to make a final evaluation as to the financial viability of the business. Hence the need for the law to provide linkages between the proceedings, with a view to allowing the conversion between the two. It is desirable that devices capable of preventing the abuse of reorganization proceedings as a means of avoiding or delaying liquidation are provided, for example [. . .].

15. Whenever both liquidation and reorganization are provided, the issue of the relationship between the two is addressed in many different ways. In some countries, the party applying for the insolvency proceedings is given the initial choice between liquidation and reorganization. When liquidation proceedings are initiated by one or more creditors, the law will often provide a mechanism that enables the debtor to request conversion into reorganization proceedings.

16. When the debtor applies for reorganization proceedings, whether on its own motion or as a consequence of an application for liquidation by a creditor, the application for reorganization should logically be decided first. With a view to protecting creditors, however, some insolvency laws will provide for a mechanism enabling reorganization to be converted into liquidation upon a determination that reorganization is not likely to succeed. Another mechanism of protection for creditors might consist of setting forth the maximum period for which reorganization against the will of the creditors might be granted.

17. As a general principle, although usually presented as separate procedures, liquidation and reorganization procedures are normally carried out sequentially, that is, a liquidation procedure will only run its course if reorganization is unlikely to be successful or if reorganization efforts have failed. In some insolvency systems, the general presumption is that an enterprise should be reorganized and liquidation procedures may be commenced only upon failure of all

attempts to reorganize. In insolvency systems providing for conversion, a request for reorganization to be converted into liquidation may be made by the debtor, the creditors or the insolvency representative, depending upon the circumstances set forth by the law. These circumstances might include the debtor being unable to pay post-petition debts as they fall due; failure of approval of the reorganization plan; and failure by the debtor to fulfil its obligations under an approved plan or the debtor attempting to defraud creditors. Whilst it is often possible for reorganization proceedings to be converted to liquidation proceedings, most insolvency systems do not allow reconversion to reorganization once conversion of reorganization to liquidation has already occurred.

18. Difficulties of determining at the very outset whether the debtor should be liquidated rather than reorganized have led some countries to revise their insolvency laws by replacing separate proceedings with “unitary” proceedings. Under the “unitary” approach, the same proceeding applies whenever a situation of insolvency occurs; accordingly, for an initial period (usually referred to as an “observation period”, which in existing examples of unitary laws might last up to three months), there is no presumption as to whether the enterprise will be eventually reorganized or liquidated. The choice between liquidation or reorganization proceedings only occurs once a determination as to whether reorganization is actually possible has been made. The basic advantage offered by this approach relies on its procedural simplicity. A simple, unitary procedure, allowing both reorganization and rehabilitation, might result also in encouraging early recourse to the proceedings by debtors facing financial difficulties, thus enhancing the chances of successful rehabilitation.

II. Initiation and commencement of insolvency proceedings

A. Scope

1. General remarks

19. An important threshold issue in designing an insolvency regime is determining which entities, as debtors, can be subjected to a general insolvency law. To the extent that any entity is excluded from the process, it will not enjoy the protections offered by the process, nor be subject to the discipline of the process. The eligibility provisions will identify those forms of legal person and those natural persons whose businesses may be liquidated or reorganized and any businesses that are to be excluded from the application of the law.

20. A general insolvency regime can apply to all forms of enterprise engaged in business activities, both private and state-owned, especially those state-owned enterprises which compete in the market place as distinct commercial or business entities and are otherwise subject to the same commercial and economic processes as privately owned entities. An exception may be where the Government has adopted, for example, a policy of excluding the liability of such enterprises or extending an explicit guarantee. Government ownership of an enterprise may not, in and of

itself, provide a sufficient basis for excluding an enterprise from the coverage of the general insolvency law.

21. While it may be desirable to extend the protections and discipline of an insolvency regime to as wide a range of entities as possible, separate treatment may be provided for certain entities. This separate treatment may arise for a number of reasons, including public policy concerns regarding, for example, consumers or concerns related to the specialized nature of such entities and the often detailed regulatory legal regimes to which they are subject. Such entities might include banking and insurance institutions, utility companies and stock or commodity brokers.

22. *Centre of main interests.* In addition to embodying the necessary business attributes, a debtor must have a sufficient connection to the host State to be subject to its insolvency laws. Although some laws use tests such as principal place of business, UNCITRAL has adopted in the Model Law on Cross-Border Insolvency what is termed the “centre of main interests” of the debtor. In addition to the Model Law, that term is used in the draft United Nations Convention on Assignment of Receivables and in European Council regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. The Model Law does not define the term; while the European Council regulation (13th recital) indicates that the term should correspond to “the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.” As provided in article 16, paragraph 3, of the UNCITRAL Model Law on Cross-Border Insolvency, in the absence of proof to the contrary, the debtor’s registered office, or habitual residence in the case of an individual, should be presumed to be the centre of main interests.

23. *Establishment.* Some laws provide that insolvency proceedings may be commenced in a jurisdiction where the debtor has an establishment. The term “establishment” is defined in article 2 of the Model Law on Cross-Border Insolvency to mean “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.” The European Council regulation includes a similar definition but omits the reference to “services”. The definition is important to the structure of the Model Law as it determines those proceedings that may only be recognized as non-main proceedings; main proceedings require the presence of a centre of main interests. The regulation similarly provides that insolvency proceedings may be opened in a jurisdiction where a debtor has an establishment, but that those proceedings will be restricted in their application to the assets of the debtor situated in the territory of that State.

24. *Presence of assets.* Some laws provide that insolvency proceedings may be commenced against a debtor that has assets within the jurisdiction or has had assets within the jurisdiction without requiring an establishment or centre of main interests within the jurisdiction. The existence of assets raises multi-jurisdictional issues, including multiple proceedings and questions of coordination and cooperation, which might implicate the UNCITRAL Model Law on Cross-Border Insolvency. Accordingly, where a test of presence of assets is used it might be appropriate to include the protections offered by the Model Law in terms of coordination and cooperation.

2. *Summary: scope*

25. An insolvency law should apply to all debtors engaged in a business enterprise, including State-owned enterprises, with limited exceptions. These may include highly regulated entities such as banks and insurance companies.

26. Insolvency proceedings can be commenced against a debtor if it has its centre of main interests in the enacting State. In the absence of proof to the contrary, a legal person would be presumed to have its centre of main interests in the enacting State if it had its registered office in that State and, in the case of a natural person, the presumption would make reference to its habitual residence.

B. *Initiation and commencement criteria*

1. *General remarks*

27. Initiation and commencement criteria are instrumental in delineating which entities are brought within the protective and disciplinary mechanisms of the insolvency process and by whom. The present section addresses the criteria that must be met before proceedings can be initiated and commenced and, in the case of involuntary (see under “liquidation” below) proceedings, specifies the party that may make an application for insolvency against the debtor.

28. As a general principle, and subject to proper and adequate safeguards to prevent abuse of the process, it is desirable that access to the insolvency process be convenient, inexpensive and quick in order to encourage financially distressed or insolvent enterprises to submit themselves voluntarily to the process. Restrictive access can deter both debtors and creditors, while delay can be harmful in terms of the dissipation of assets and the possibility of reorganization.

29. Commencement criteria are a central element of the design of an insolvency law. How those criteria are set determines what is required in order to initiate proceedings, how proceedings are commenced, the period between initiation and commencement of insolvency and what has to occur in that period.

(a) *Liquidation*

30. Insolvency laws generally provide for liquidation proceedings to be initiated by one or more creditors (often described as involuntary proceedings) or the debtor (often described as voluntary) or by operation of the law where failure by the debtor to meet some statutory requirement automatically triggers insolvency proceedings (also described as involuntary).

31. Laws differ on the specific criteria that must be satisfied before the proceedings can commence. A number of laws include alternative criteria and also distinguish between the commencement criteria applicable to liquidation and to reorganization.

32. A criterion that is used extensively for commencement of liquidation proceedings is the liquidity or cash flow standard, which requires a general cessation of payment of liabilities as they become due. However, the way in which countries use this criterion varies. In some countries, it provides the basis for commencement of either a liquidation or reorganization procedure and, where liquidation is chosen, it can later be converted to reorganization. In other countries, only a reorganization procedure may be commenced on the basis of this criterion and the procedure may be converted only when it is shown that the enterprise cannot be reorganized. Under a third approach, this criterion is relied upon to commence a unitary procedure, and the choice between liquidation and reorganization is only made later (see chap. I above).

33. Reliance on the general cessation of payments standard is designed to activate proceedings sufficiently early in the period of the debtor's financial distress to avoid a race by creditors to grab assets, causing dismemberment of the debtor to the collective disadvantage of creditors. An alternative approach would be to adopt the balance sheet approach of excess of liabilities over assets as an indication of greater financial distress. However this approach often leads to proceedings being commenced after the possibilities of reorganization have disappeared. In addition, it suffers from disadvantages of proof and may circumvent the goal of maximization of value. It may also be an inaccurate measure of insolvency where accounting standards and valuation techniques give rise to distorted values that do not reflect fair market value or where markets are not sufficiently developed or stable to establish that value. It would generally require an expert to review books, records and financial data to reach a determination of the enterprise's fair market value. This is especially difficult where those records are not properly maintained or readily available. Such a test is not necessarily meaningful to the debtor's ability to deal collectively with its creditors when the debtor maintains an operating business. The balance sheet approach may be used to assist in defining insolvency, but may not be sufficiently reliable to constitute the sole basis of that definition.

34. Problems associated with the approach of general cessation of payments, such as the commencement of liquidation proceedings of a financially troubled but nevertheless financially viable enterprise, may be resolved by providing for the proceedings to be dismissed or converted to another proceeding (for example, liquidation to reorganization, see chap. I above) at the request of either the debtor or a creditor or the insolvency representative. Other problems may involve abuse of the process, such as where a debtor uses insolvency as a shield against a single creditor, or an insolvency application is used as a substitute for debt enforcement procedures (which may not be well developed), or creditors use insolvency to attempt to force viable businesses out of the market place or to obtain preferential payments.

(i) Debtor initiation

35. While the general cessation of payments requirement technically may be applied to both debtor and creditor applications, as a matter of practice an application by a

debtor will generally be a last resort where it is unable to pay its debts. Thus, although the laws of most countries may, in theory, apply a similar criterion for both debtor- and creditor-initiated liquidation proceedings, in practice the application of the criterion will not be scrutinized in the case of debtor-initiated applications. In some laws debtor applications may be initiated without relying on any particular test of financial difficulty. In view of these considerations, it may be desirable for a debtor to be able to make an application under the insolvency regime on the basis of a simple declaration of its financial condition. In the case of a legal person, the directors or other members of a governing body would make the declaration.

36. It may be suggested that the application of such a standard could result in the process being abused by a debtor to prevaricate and deprive creditors of prompt payment of debts in full. In that event, one remedy may be for the law to provide that the relevant court can declare that the debtor is no longer subject to the insolvency law. [*Note to the Working Group: are there other remedies?*] In some countries, denial of access is based upon a determination that the debtor's application is motivated by an attempt to abuse the system by using it to circumvent other legitimate laws and obligations.

37. A matter related to debtor-initiated insolvency proceedings is the possible imposition of a duty on a debtor to make an application for commencement of proceedings at a certain stage of financial difficulty. There may be advantages in establishing an obligation to take early action. In the case of reorganization, the chances of it being successful are increased by early action and in the case of liquidation, creditors' interests would be protected by preventing further dissipation of the debtor's assets. Provisions that establish a duty to make an application, however, may discourage management from pursuing an out-of-court reorganization agreement (which may be the more appropriate alternative in a particular case) on the basis that delay in applying for formal proceedings could lead to personal liability. The adoption of incentives (such as protection from enforcement actions) to encourage debtors to initiate proceedings at an early stage may be preferable to reliance upon penalties aimed at forcing a debtor to take early action.

(ii) Creditor initiation

38. In the case of an application by creditors, while they may be able to show that the debtor has failed to pay their own claim or claims, providing evidence of a general cessation of payments may not be so easy. There is a practical need for a creditor to be able to present proof, in a relatively simple form, that establishes a presumption of insolvency on the part of the debtor, without placing an unreasonably heavy burden of proof on creditors.

39. Insolvency laws address the issue of creditor initiation in a number of ways. These include a requirement that the application is to be made by more than one creditor (to minimize possible abuse of the process by a single creditor who may seek to use the insolvency process as a substitute for a debt enforcement mechanism), a requirement that the creditors represent a certain value of matured claims (or

both a number and a value), or a requirement that the debtor is to furnish information to the court to enable a determination of a general cessation of payments to be made (see chap. IV, below). Specifying a particular value of claims may not be an optimal drafting technique as the value of currencies change, possibly necessitating amendment of the law. A reasonably convenient and objective test may be the failure of a debtor to pay a matured debt within a specified period of time after a written demand for payment has been made.

(iii) *Initiation by governmental authority*

40. In addition to (i) and (ii) above, an insolvency law may give a governmental agency (normally the public prosecutor's office or the equivalent) non-exclusive authority to initiate liquidation proceedings against any enterprise if it ceases to make payments or, more broadly in some countries, if initiation is considered to be in the public interest. In the latter case, a demonstration of illiquidity may not be necessary, thus enabling the Government to terminate the operations of otherwise healthy enterprises that have been engaged in certain activities, for example, of a fraudulent or criminal nature. While the exercise of such a police power may be appropriate in certain circumstances, it is clearly desirable that those powers are not abused and are exercised in accordance with clear guidelines.

(b) *Reorganization*

41. Although insolvency laws generally provide for liquidation proceedings to be initiated by either a creditor or a debtor, there is no consensus as to whether reorganization proceedings can also be initiated by a creditor. Given that one of the objectives of such proceedings is to provide an opportunity for creditors to enhance the value of their claims through reorganization of the enterprise, it may be desirable that the debtor not be given exclusive authority to initiate reorganization proceedings. The ability of creditors to initiate reorganization is also central to the question of whether creditors can propose a reorganization plan (see chap. IV, below). A number of countries take the position that, since in many cases creditors are the primary beneficiaries of a successful reorganization, creditors should have an opportunity to propose the plan. If that approach is followed, it seems reasonable to provide also that creditors can initiate reorganization proceedings.

(i) *Debtor initiation*

42. A commencement criterion that is consistent with the objective of encouraging debtors to address their financial difficulties at an early stage might be one that does not require the debtor to wait until it has ceased to make payments generally (that is, wait until it is illiquid) before making an application. The merit of this approach of prospective illiquidity is recognized by a number of countries, albeit in different ways. In some laws, the reorganization procedure does not actually involve the application of a substantive criterion: the debtor may make an application whenever it wishes. Other laws specify that the debtor may make an application if it envisages that, in the future, it will not be in a position to pay its debts when they come due. Even among countries that have adopted unitary

proceedings, such a prospective illiquidity test has been introduced for applications made by debtors.

43. Such a relaxation of the commencement criteria could invite debtors to abuse the procedure. For example, a debtor that is not in financial difficulty may attempt to initiate proceedings and submit a reorganization plan that would enable it to shed onerous obligations, such as labour contracts. Whether such abuse could arise is a question of how the elements of the reorganization procedure are designed, such as the degree of control over the enterprise that the law permits the debtor to retain once the proceedings commence. One means of addressing an application by a debtor that is an abuse of the process may be to permit the proceedings to be dismissed by the court on application of a party in interest, provided dismissal would be in the best interest of the creditors.

(ii) *Creditor initiation*

44. Applying the same lower standard to initiation of reorganization proceedings by creditors may be more difficult to justify. If the law allows a debtor to initiate a proceeding on the basis of prospective illiquidity, it would be difficult to envisage how the creditors would have adequate information to assess whether that standard has been met. As a general matter, it would seem unreasonable for any form of insolvency proceeding to be commenced against the debtor's will, unless the creditors can demonstrate that their rights have been impaired.

45. For those reasons, it may be appropriate to apply the same commencement criterion to initiation of both liquidation and reorganization by creditors (that is, general cessation of payments, see sect. II.B above). Such a criterion would appear to be consistent with both the two-track approach and the unitary approach (discussed above in section I), where the application of a different criterion is not so much a function of the proceedings being initiated, but rather whether the applicant is the debtor or a creditor. The exception to this approach would be where either a debtor or a creditor is precluded from initiating liquidation proceedings until it has been determined that reorganization is impossible. In that case, the commencement criterion for liquidation would not be general cessation of payments, but a determination that reorganization cannot succeed.

46. As in the case of liquidation, the criteria applicable to creditor applications for reorganization may include a requirement for the application to be made by a certain number of creditors or by creditors holding a certain value of matured claims, or both.

(c) *Procedural issues*

47. Insolvency proceedings raise a number of procedural issues. A preliminary point is the manner in which the process may be initiated. In many countries the normal practice is for a court of competent jurisdiction to determine, on the basis of the application for commencement, if the requisite conditions for commencement have been met. Some laws take different approaches, such as allowing a voluntary reorganization process to be initiated by lodging

a declaration with an administrative authority. [*Note to the Working Group: Are there other examples?*]

48. Where a court is required to make the decision as to commencement, there may be a practical need to ensure that the proceedings continue without delay. One means of achieving that may be to provide a specified period of time after the making of an application within which that decision as to commencement must be made.

49. In the event of a voluntary application by a debtor, creditors or other interested persons have a direct interest in receiving notice of the application and an opportunity to dispute the presumptions of eligibility and insolvency, perhaps within a specified time period to prevent the proceedings from being prolonged unnecessarily. While notice may be provided directly to known creditors, the need to inform unknown creditors has led legislators to include a provision requiring publication in an official government publication or a commercial or widely circulated national newspaper. In the event of creditor-initiated proceedings, the debtor may need to be given notice and an opportunity to dispute the presumptions that the creditors' claims are of a determined value, matured and unpaid. Provisions requiring the debtor to supply necessary information and enabling the creditors to seek such information are addressed under chapter IV below.

(d) Costs

50. Applications by both debtors and creditors for insolvency proceedings may be subject to the payment of fees, which may be used to help defray the costs of the insolvency system. In determining the level of fees to be imposed, a balance needs to be struck between a level that does not discourage debtors from making an application and a level that might help to defray a significant part of the cost of the proceedings. [*Note to the Working Group: To what extent is it desirable to include issues relating to costs in the guide?*]

2. Summary: initiation and commencement

51. An application for liquidation may be made by:

(a) A debtor, on the basis of a general cessation of payments [an inability to pay its debts as and when they fall due];

(b) One or more creditors, on the basis of that a specified number of creditors are able to show that they hold claims that are mature and that have not been paid by the debtor.

(c) By a [prescribed] [government] authority.

52. An application for reorganization may be made by:

(a) A debtor, on the basis of actual or prospective inability to pay its debts as they become due;

(b) One or more of its creditors, on the basis that a specified number of creditors are able to show that they hold claims that are mature and that have not been paid by the debtor.

53. The application for commencement of proceedings should be made to the court and the court should make a decision on that application within a specified period of time.

54. Notice of the application should be provided to the debtor (in the case of creditor application) and to the creditors (in the case of a debtor application).

III. Consequences of commencement of insolvency proceedings

A. The insolvency estate

1. General remarks

55. Fundamental to the insolvency process, be it liquidation or reorganization, are identification, collection, preservation, protection and disposition of the assets that comprise the estate to be administered. All systems have some concept of the insolvency estate or the assets that will be subject to the insolvency proceedings. Some laws totally exclude certain types of property or property subject to certain interests from the administration of the insolvency process. Where property is subject to a security interest in favour of a creditor, some insolvency laws provide that it is subject to the insolvency proceedings (and therefore to the application of a stay and other effects of commencement), while others provide that it is unaffected by the insolvency and creditors may proceed to enforce their legal and contractual rights (see sect. III.B, Stay of proceedings). Other laws require all property to be subject to the proceedings in the first instance, subject to the proof of harm or prejudice. The question of what is or is not subject to the proceedings (and therefore included or not within the concept of the "estate" where that term is used) will affect the scope and conduct of the proceedings and, particularly in reorganization, will have a significant bearing on the likely success of those proceedings.

(a) Property to be included

56. The assets of the estate may be expected to include the property of the debtor as of the date of commencement of the insolvency proceedings as well as assets acquired by the insolvency representative after that date, whether in the exercise of avoidance powers (see sect. III.D, Avoidance actions) or in the normal course of operating the debtor's business. In the case of a natural person, the estate might exclude property which relates, for example, to post-application earnings from the provision of personal services, property that is necessary for the debtor to earn a living and personal and household property.

57. The property of the debtor may be expected to include all assets in which the debtor has an interest, whether or not they are in the possession of the debtor at the time of commencement, including all tangible and intangible assets. Tangible assets should be readily found on the debtor's balance sheets, such as cash, equipment, inventory and real estate. Assets to be included within the category of intangible assets [to the extent of the debtor's interest] varies from State to State, depending upon the law. In the case of

natural persons, the estate might also include assets such as inheritance rights in which the debtor has an interest or to which the debtor is entitled at the commencement of the insolvency or which come into existence during the insolvency proceedings.

(b) *Third-party-owned property*

58. Complex issues may be raised in determining whether an asset is owned by the enterprise or owned by another party but in the debtor's possession subject to use, lease or licensing arrangements. Those assets owned by a third party but in the possession of the debtor at the time of commencement would not generally be included in the estate. Those assets being used by the debtor, but which are subject to a lease agreement where the lessor retains legal title, may require special attention. In countries where title financing (where the provider of finance has title or ownership of the asset as opposed to a mortgage or security interest) is of considerable importance, there may be a need to respect the creditor's legal title in the asset and allow it to be separated from the estate (subject to the rules in sect. III.C, Treatment of contracts: the right to separate might be limited if the insolvency representative ratifies the lease contract). Other countries may choose to scrutinize such financing arrangements to determine whether the lease is, in fact, a disguised secured lending arrangement, in which case the lessor would be subject to the same restrictions as the secured lender.

(c) *Recovery of property*

59. Identifying the assets that will be subject to the proceedings may require action by the insolvency representative to recover property of the estate that was improperly transferred or transferred at a time of insolvency with the result that the *pari passu* principle (that is, that creditors of the same class are treated equally and are paid in proportion to their claim out of the assets of the estate) has been violated. Most legal systems provide a means of setting aside and recovering the value of antecedent transactions that result in preferential treatment to some creditors or were fraudulent in nature or made in an effort to defeat the rights of creditors (see sect. III.D, Avoidance actions).

2. *Summary: the insolvency estate*

[...]

B. *Stay of proceedings*

1. *General remarks*

60. The imposition of a suspension or "stay" on actions and proceedings by creditors against the property of the debtor recognizes the collective nature of insolvency proceedings. By preventing creditors from dismembering the debtor's business enterprise in an attempt to advance their specific interests, imposition of a stay can ensure a fair and orderly administration of the insolvency proceedings. One of the key issues in the design of an effective insolvency regime is how to balance the immediate benefits that accrue to the entity by having a broad stay to limit the actions of

creditors and the longer-term benefits that are derived from limiting the degree to which the stay interferes with contractual relations with creditors.

61. The scope of rights that are affected by the stay varies considerably among countries. There is little debate regarding the need for the suspension of actions by unsecured creditors against the debtor or its assets. The application of the stay to secured creditors, however, is potentially more difficult and requires a number of competing interests to be balanced. These include, for example, upholding contracts; ensuring that creditors are paid in proportion to their claim out of the assets of the estate; maximizing asset values for all creditors; and, in cases of reorganization, the successful reorganization of a viable enterprise.

(a) *Application of the stay*

62. A preliminary question is whether the stay applies automatically or at the discretion of the court. While local policy concerns and factors such as the availability of reliable financial information and the ability of the debtor and creditors to have access to an independent judiciary with insolvency experience may affect the decision as to whether the stay is applied automatically or granted by the courts on a discretionary basis, the automatic stay is a feature of many modern insolvency law regimes.

(i) *Liquidation*

63. In a liquidation proceeding, a stay of proceedings allows creditors of the same rank to participate in a fair and orderly realization and distribution of the debtor's assets, conducted for the benefit of all creditors. The emphasis is on selling the assets, in whole or in part, so that the creditors can be repaid from the proceeds, as quickly as possible. Maximizing value is the overriding objective.

64. Despite that objective, the interests of secured creditors need to be balanced against the interests of the general unsecured creditors. Arguably, where there is no interest in preserving the enterprise as a whole for possible sale as a going concern, the balance in liquidation should tilt in favour of upholding the contractual rights of secured creditors. At the same time, protection of those secured rights may need to be balanced against the possibility that maximization of value might require the assets of the business to be sold collectively, rather than in a piecemeal fashion. This is particularly so where the collective value of the assets is higher than the break-up value and the result would be of greater benefit to creditors generally. More often than not, the secured creditors will hold security over the most important assets of the business.

65. Some countries adopt the approach that to ensure the effectiveness of the stay, it must be very wide, apply to all remedies and proceedings against the debtor and its assets, whether administrative, judicial or self-help, and restrain both unsecured and secured creditors from exercising enforcement rights as well as Governments from exercising priority rights. Legal proceedings against the debtor are often included within the scope of the stay, with provision for those proceedings to be continued if necessary. In some countries, employee actions against the debtor are not

included within the stay, but any enforcement action resulting from those proceedings will be included.

66. The creditors to be included within the categories of those subject to the stay needs to be clearly specified. For example, if any categories of creditors, such as preferential creditors (including employees), legislative lien holders, government claimants and officials and their respective agents and employees are to be excluded from the scope of the stay, it is desirable that that exclusion be clearly stated. The need for other exemptions, such as for set-off rights and netting of financial contracts, assets that are generally not needed to sell the business as a going concern, such as cash collateral, or exemptions to protect public policy interests or to prevent abuse, such as the use of insolvency proceedings as a shield for illegal activities, may also need to be considered.

67. Any negative impact of the stay on the interests of secured creditors can be addressed in terms of the duration of the stay, protection of the value of the collateral and by providing secured creditors with the possibility of removing the stay where the collateral interests are not sufficiently protected or where the collateral is not necessary to the sale of the entire business or a productive part of it.

(ii) Reorganization

68. In reorganization proceedings, the stay of proceedings allows the debtor a breathing space to reorganize its affairs and for preparation of a reorganization plan and other steps necessary to ensure success of the reorganization. As such, the impact of the stay is greater and therefore more crucial in reorganization than in liquidation and it can provide an important incentive to encourage debtors to initiate reorganization proceedings. A number of the considerations discussed above in respect of application of a stay in liquidation proceedings are also relevant to reorganization proceedings, such as time of application of the stay, whether the stay applies automatically or at the discretion of the court and the scope of the stay in reorganization proceedings.

69. To protect the assets that may be used to reorganize the business, a stay would need to be imposed on all creditors upon formal commencement of the reorganization proceedings. In contrast to liquidation proceedings, some insolvency laws exclude legal proceedings from the scope of the stay.

(b) Provisional measures of protection/time at which stay is applicable

70. A question arises as to the time at which the stay will be effective in both liquidation and reorganization proceedings. In many jurisdictions, there may be a gap between the time at which the application is made and the commencement of insolvency proceedings. During that time there is the potential for the debtor's assets to be dissipated; the debtor may transfer assets out of the business or creditors may take remedial action to pre-empt the effect of the stay that may be imposed later. One approach might be to apply the stay on the making of an application by a debtor and, in the case of a creditor application, after commencement

of the proceedings. If the stay is to apply on commencement of proceedings, another approach may be to allow protective or interim measures to be issued during the period between initiation and commencement. These might include appointing a preliminary insolvency representative; prohibiting the debtor from disposing of assets; sequestering some or all of the debtor's assets; and suspending enforcement of security interests against the debtor. In some jurisdictions, transactions entered into by the debtor during this period are void. Since these are provisional measures that are provided before the decision that the commencement criteria have been met, applying creditors may be required to provide evidence that the measure is necessary and, in some cases, a bond.

(c) Duration of the stay

(i) Unsecured creditors: liquidation and reorganization

71. In both liquidation and reorganization proceedings, many laws provide that the stay applies to unsecured creditors for the duration of the proceedings.

(ii) Secured creditors: liquidation

72. Different approaches are taken to the application of the stay to secured creditors. Some legal systems exclude secured creditors from the scope of the stay, while others adopt the approach that the stay automatically applies upon commencement of proceedings to secured creditors for a brief period, such as 30 or 60 days, except where the collateral is not essential for the sale of the business as a whole. Another approach extends the stay to secured creditors for the duration of the proceedings, subject to a court order for relief. Where the stay is limited to a specified period, the law can include provision for extension of the stay on application by the insolvency representative when it can be demonstrated that the extension is required in order to maximize value. This might, for example, include demonstrating that there is a reasonable possibility that the enterprise, or units of the enterprise, can be sold as a going concern. To provide additional protection, there might be a need for the law to set a limit on the period for which the stay could be extended.

(iii) Secured creditors: reorganization

73. In reorganization proceedings, there may be a need for the stay to apply to secured creditors for the duration of the proceedings to ensure that the reorganization can proceed in an orderly manner without the possibility of assets being separated before the reorganization has been finalized. Exceptions to this principle might be needed where the particular collateral is not essential to the reorganization or where the creditor can demonstrate other reasons for lifting the stay.

(d) Lifting of the stay

74. In both liquidation and reorganization proceedings, circumstances might arise where it is appropriate to provide relief from the application of the stay by allowing the stay to be lifted or cease to apply. To accommodate such

circumstances, the law may provide, for example, that the creditor can apply for the stay to be removed where the creditor is not receiving protection for the value of the collateral. Where the provision of protection may not be feasible or would be overly burdensome to the estate, the insolvency representative, of its own initiative, may release the collateral. There are examples of laws that provide that relief from the stay may be granted to an unsecured creditor to allow, for example, a claim to be determined in another forum where litigation may be well advanced and it would be efficient for it to be completed, or a claim against an insurer of the debtor to be pursued.

75. In liquidation, provision may also be needed to allow assets over which the secured creditor has security to be surrendered to the secured creditor, where its security is determined to be valid and the secured assets have no value to the insolvent estate, or cannot be realized in a reasonable period of time by the insolvency representative.

(e) Protection of economic value

76. A further set of measures designed to address any negative impact of the stay on secured creditors is one directed at maintaining the economic value of secured claims during the period of the stay (in some jurisdictions referred to as “adequate protection”). One approach is to protect the value of the collateral itself on the understanding that, upon liquidation, the proceeds of sale of the collateral will be distributed directly to the creditor to the extent of the value of the secured portion of the claim. In addition to lifting of the stay, this may involve a number of steps including providing compensation for depreciation; payment of interest; and protection and compensation for use of the collateral.

77. Another approach to protecting the interests of secured creditors would be to protect the value of the secured portion of the claim. Immediately upon commencement, the encumbered asset is valued and, based on that valuation, the value of the secured portion of the creditor’s claim is determined. This value remains fixed throughout the proceedings and, upon distribution following liquidation, the secured creditor receives a first-priority claim to the extent of that value. During the proceedings, the secured creditor could also receive the contractual rate of interest on the secured portion of the claim to compensate for delay imposed by the proceedings. Provision of interest is limited in some insolvency systems to situations where the value of the collateral exceeds the amount claimed. Otherwise, compensation for delay depletes the assets available to unsecured creditors.

78. Guidance may be needed to determine when and how creditors holding some type of security over the debtor’s assets would be entitled to the types of protection described above. Although some minor erosion of secured creditors’ security positions is to be expected in conjunction with a reorganization proceeding, it is undesirable that a single secured creditor or group of secured creditors solely or primarily bear the burden, nor is it desirable that the body of creditors as a whole be prejudiced in a material way by the continuation of the reorganization proceeding.

2. *Summary: stay of proceedings*

79. Application of the stay could be automatic or discretionary.

(a) Time of application of the stay

80. In both liquidation and reorganization, the stay could apply:

(a) On application (in the case of a debtor application);

(b) On commencement (in the case of a creditor application).

(b) Parties to whom the stay will apply

(i) Liquidation

81. Two different approaches may be taken:

(a) The stay would apply to both secured and unsecured creditors; or

(b) The stay would apply to unsecured creditors with provision for application to secured creditors on request of the debtor and/or the insolvency representative.

(ii) Reorganization

82. The stay would apply equally to both secured and unsecured creditors, subject to provision for relief.

(c) Duration of the stay

(i) Unsecured creditors

83. In both liquidation and reorganization, the stay would apply for the duration of the proceedings.

(ii) Secured creditors

84. In liquidation, the stay would apply to secured creditors for a limited period (30-60 days), with provision for exceptions such as where the collateral is not essential to the sale of the business as a whole.

85. In reorganization, the stay would apply to secured creditors for the duration of the proceedings, subject to a determination that the collateral is not required for the reorganization proceedings.

(d) Relief from the stay: liquidation and reorganization

86. A secured creditor may apply to have the stay lifted where it can demonstrate severe prejudice (for example it is not receiving appropriate protection of the economic value of the collateral). The stay may cease to apply where the insolvency representative determines that protection of the value of the collateral is not feasible or is too burdensome.

(e) Protection of economic value

87. [Specific measures to be included]

C. Treatment of contracts

1. General remarks

88. It is inevitable that, at the commencement of insolvency proceedings, the debtor will be a party to a contract that has not yet been fully performed. It is a common feature of many insolvency laws that the insolvency representative may interfere in those contracts, electing to either reject and terminate or continue (and possibly subsequently assign) those contracts. As an example, in a contract where the debtor had agreed to purchase a particular good at a price which is half the market price at the time of the insolvency, it would obviously be advantageous to the insolvency representative to continue to purchase at the lower price and sell at the market price. The counterparty would naturally like to get out of what is now an unprofitable agreement, but in many systems it will not be permitted to do so, although it may be entitled to an assurance that it will be paid the contract price in full.

89. As in the case of avoidance actions (see sect. III.D), the underlying rationale for the insolvency representative's ability to interfere in contracts is maximization of the value of the estate. Achieving that goal might involve taking advantage of those contracts which are beneficial and contribute value and rejecting those which are burdensome, or where the ongoing cost exceeds the benefit of the contract. Maximization of value must be balanced against competing interests, such as the social concerns raised by some types of contracts, for example labour contracts, and the effect of the insolvency representative's ability to interfere with the terms of unperformed contracts on the predictability of commercial and financial relations. Whatever rules are adopted with respect to continuation and termination, it is desirable that any right to continue or terminate a contract be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue certain parts of a contract while terminating others.

90. As an economy develops, more and more of its wealth is apt to be contained in or controlled by contracts, rather than in land. As a result, the treatment of contracts in insolvency is of overriding importance. There are two overall difficulties in developing legal policies in that regard. The first is that contracts are unlike all other assets of the insolvent estate in that they usually are tied to liabilities or claims. That is, it is often the case that the estate must perform or pay in order to enjoy the rights that are potentially valuable assets. The result is that difficult decisions must be made about the treatment of a contract that will produce the most value for the estate. Typically, the insolvency representative is charged with making this evaluation. In some jurisdictions, court approval is also required.

91. The second difficulty is that contracts are of so many different types. They include simple contracts for the sale of goods; short-term or long-term leases of land or of personal property; and immensely complicated contracts for franchises or for the construction and operation of major facilities, among many others. Further, the debtor may have been either buyer or seller or provider or receiver under a contract and the problems presented in insolvency may be very different when viewed from each side. A common

solution is to provide general rules for all kinds of contracts and then exceptions for certain special contracts, as discussed below.

92. Contracts in bankruptcy fall into two financial categories: contracts made before insolvency by the debtor and contracts entered into after the start of an insolvency proceeding. Breach of a pre-insolvency contract in many laws gives rise to a pre-insolvency unsecured claim that is usually paid on a pro-rata basis, while breach of a post-insolvency contract is usually a first claim on the available funds and therefore is paid in full as an expense of the insolvency administration. The line between them is crossed when the insolvency representative seeks to perform a pre-insolvency contract based on an evaluation that performance of the contract will yield greater net returns than its breach. If the estate thus continues the contract, it adopts the debtor's contract as its own and any later breach will also be a first-priority administration claim (see sect. V below) in most systems.

93. Some classes of contracts raise social concerns that may require special treatment under insolvency laws. These would include, for example, labour agreements, financial market transactions and contracts for personal services, where the identity of the party to perform the agreement, whether the debtor or an employee of the debtor, is of particular importance. The insolvency representative's ability to terminate labour contracts, for example, may be limited by concerns that liquidation can be used as a means of expressly eliminating the protections afforded to employees by such contracts. A related issue is the circumstances in which an insolvency representative may alter the terms and conditions of contracts of the type requiring special treatment.

(a) Termination

(i) Liquidation

94. As a general matter, it is desirable that an insolvency representative have the power to terminate a contract in which both parties have not fully performed their obligations. Different mechanisms may be adopted to facilitate termination. Under one approach, the insolvency representative is required to take action to terminate the contract. Under a second approach, the contract may be regarded as automatically terminated if the insolvency representative does not elect to continue it within a specified time period. Where such a contract is terminated, the counterparty is excused from performing the rest of the contract and the only serious issue to be determined is calculation of the unsecured damages that result from the termination. The counterparty becomes an unsecured creditor with a claim equal to that amount of damages. There may be circumstances in which it would be desirable for special remedies to apply upon cancellation of certain types of contracts, such as leases, whether the debtor is a lessee or lessor under the lease. If the debtor is a lessee, a ceiling may be set on damages so that the claim under a long-term lease does not overwhelm the claims of other creditors. Lessors ordinarily can mitigate losses by re-letting the property. If the debtor is a lessor, the occupancy rights of the lessee may need to be protected.

(ii) *Reorganization*

95. In reorganization, the prospects of success may be enhanced by allowing the insolvency representative to reject burdensome contracts where the cost of performance is higher than the benefits to be received or, in the case, for example, of an unexpired lease, the contract rate exceeds the market rate.

(iii) *Exceptions*

96. Irrespective of the extent of the continuation or termination powers given to an insolvency representative, exceptions may be needed for certain contracts. One important exception to the power to terminate is labour contracts. Although particularly relevant to reorganization, such contracts are also relevant in liquidation where the insolvency representative is attempting to sell the enterprise as a going concern. A higher price may be obtained if the insolvency representative is able to terminate onerous employment contracts. To avoid insolvency proceedings being used as a means of eliminating employee protection, some countries specifically limit the ability to terminate labour contracts. A similar limitation on the right to terminate may be appropriately applied to the case of lease agreements where the debtor is the lessor or franchiser or where the debtor is a licensor of intellectual property and termination of the licence would end the licensee's business, particularly where the advantage to the debtor might be relatively minor.

(b) *Continuation*

(i) *Reorganization*

97. In reorganization, where the objective is to enable the enterprise to survive and continue its affairs to the extent possible, the ability to continue contracts that are beneficial to the business and contribute value may be crucial. If an insolvency regime does not establish limits on the effectiveness of contract termination clauses upon initiation or commencement of reorganization, the chance of a successful reorganization may be affected.

98. An initial question is whether the contract under consideration contains a clause providing that commencement of insolvency proceedings constitutes an event of default that gives the counterparty an unconditional right of termination, acceleration or other right. Some laws uphold the validity of such clauses and the insolvency representative will be able to continue the contract only if the counterparty does not elect, or can be persuaded not to elect, to terminate or accelerate the contract. Where a counterparty can terminate a contract, the insolvency law may provide a mechanism that can be used to persuade the counterparty to continue the contract, such as that payment under the contract gives priority for payment of services provided after commencement of the proceedings. Other laws provide that the insolvency representative can continue the contract over the objection of the counterparty, that is, any event of default which is triggered by commencement of insolvency proceedings that would give rise to a right to terminate or accelerate the contract is overridden by operation of the law.

99. Arguments in favour of overriding termination and acceleration clauses in reorganization include the need to enhance the earnings potential of the business; to reduce the bargaining power of an essential supplier; to capture for creditors the value of the debtor's contracts; [...].

100. Arguments against overriding the counterparty's right to terminate the contract might include the need to prevent the debtor from selectively performing contracts that are profitable and cancelling others, an advantage which is not available to the innocent counterparty; the effect of such an override provision on netting; the belief that since an insolvent business will generally be unable to pay, delaying the termination of contracts may potentially increase existing levels of debt; the ability of creators of intellectual property to control the use of that property; and the effect on the counterparty's business of termination of a contract with respect to a general intangible.

101. Where insolvency laws provide that termination clauses may be overridden, creditors may take pre-emptive action to avoid that outcome by terminating the contract before the application for insolvency proceedings is made. Such a result may be mitigated by providing that the insolvency representative has the power to reinstate those contracts, provided that both pre- and post-commencement obligations are fulfilled.

102. Continued contracts are treated as ongoing obligations of the enterprise that must be performed and all contractual obligations of the estate become post-commencement obligations. Claims arising from the performance of the contract after the commencement of insolvency proceedings are treated in a number of insolvency laws as an administrative expense (see sect. V below) and given priority in distribution. Where the insolvency representative breaches an agreement after it has been continued, the party that has been damaged as a result of the breach may be entitled to pursue its rights and remedies under the agreement in accordance with applicable non-insolvency law and to the payment of damages, which might also rank as an administrative claim (as opposed to an unsecured claim).

103. Where the debtor is in default under a contract at the time of the application for insolvency, the policy issue is whether it is fair to require the counterparty to deal with an insolvent debtor when there was already a pre-insolvency default. Some laws require, as a condition of continuation, that the insolvency representative must cure any defaults under the contract and provide assurance as to future performance by providing, for example, a bond or guarantee.

(ii) *Liquidation*

104. In liquidation, the desirability of continuing contracts is likely to be less important than in reorganization, except where the contract may add value to the business or to a particular asset and therefore promote the sale of it as a going concern. A lease agreement, for example, where the rental is below market value and that still has a substantial term to run, may prove central to any proposed sale of the business.

105. The arguments in favour of overriding termination clauses in liquidation would include the need to keep the business together to maximize its sale value or to enhance its earnings potential; the need to reduce the bargaining power of an essential supplier; and the desirability of locking all parties into the final disposition of the business.

(iii) *Exceptions*

106. Exceptions to the power of the insolvency representative to continue contracts generally fall into two categories. In respect of the first, where the insolvency representative has power to override termination provisions, specific exceptions may be made for contracts such as short-term financial contracts (for example, swap and futures agreements). The second category relates to those contracts where, irrespective of how the insolvency law treats termination provisions, the contract cannot be continued because it provides for performance by the debtor of irreplaceable personal services (for example, an opera singer).

(c) *Assignment*

107. Contracts that have been continued may subsequently be assigned for value. In some insolvency laws, agreement of the counterparty or of all parties is required, while in other laws non-assignment clauses are made null and void by insolvency proceedings. The insolvency representative is then free to assign the contract for the benefit of the estate. While this latter option is considered of critical importance to the liquidation proceedings of some countries, in other countries it is entirely foreign and is precluded.

108. The ability of the insolvency representative to elect to continue and assign contracts in violation of the terms of the contract can have significant benefits to the estate and therefore to the beneficiaries of the proceeds of distribution following liquidation. However, this ability clearly undermines the contractual rights of the counterparty to the contract and may raise issues of prejudice, especially where the counterparty has little or no say in the selection of the assignee. Some laws provide that if the counterparty does not consent to assignment, the insolvency representative may assign with permission from the court if it can be shown that the counterparty is withholding consent unreasonably. Some laws that permit continuation and assignment require that the insolvency representative demonstrate to the counterparty that the assignee can adequately perform the contract.

(d) *Procedural issues*

109. Some laws permit the insolvency representative to make a determination regarding continuation, while in other laws approval of the court is required. To avoid unnecessary delay in the proceedings, it is desirable that that determination be made within a specified period of time. Given the nature of the proceedings, the time period might be longer in reorganization than in liquidation, with flexibility provided to extend the period where it would be beneficial to the reorganization to do so. In the event that the determination is not made within the time specified in the law or ordered by the court (if the counterparty to the contract requests the court to make such a determination

where the insolvency representative has failed to do so), some laws include default provisions, such as termination of the agreement automatically or at the election of the counterparty.

110. In many laws, an insolvency representative is not required to give notice of termination, except in cases of employment and lease agreements (for real estate). Some laws, however, require the insolvency representative to observe contractual requirements as to notice, although provisions may be made for this to be shortened in cases of long term lease contracts.

111. [Set-off]

112. [Financial contracts and netting]

2. *Summary: treatment of contracts*

(a) *Termination*

113. An insolvency representative may terminate contracts in liquidation and reorganization proceedings. Termination may be effective when:

(a) The insolvency representative gives notice of termination; or

(b) Automatically in the absence of a decision to continue within a specified period of time.

114. Termination gives rise to an unsecured claim for the damages arising from the termination.

115. The right to terminate certain specified classes of contracts, such as labour contracts, in reorganization proceedings should be limited.

(b) *Continuation*

116. The insolvency representative, with or without the approval of the court, may continue contracts, with the exception of certain specified classes. Where any provision of the contract has the effect of terminating it upon commencement of insolvency, there are several approaches:

(a) The provision may be treated by the insolvency representative or the court as null and void;

(b) The insolvency law will provide that it is null and void.

117. Contracts continued by the insolvency representative become obligations of the estate from the commencement of proceedings.

(c) *Assignment*

118. The insolvency representative may assign a continued contract either:

(a) By treating a non-assignment provision as void;

(b) Subject to the agreement of the counterparty [all parties];

(c) Where the counterparty [all parties] do not agree, the court may approve the assignment.

D. Avoidance actions

1. General remarks: avoiding pre-insolvency transactions

119. Many laws regard some transactions executed prior to the initiation of an insolvency proceeding as unfair or financially harmful to the interests of all of the debtor's stakeholders, especially if they are executed in contemplation of a likely insolvency. A transaction may fall into this category retrospectively—that is, it may be a transaction that would not ordinarily be regarded as legally wrongful, but is seen as harmful in light of a subsequent insolvency. As discussed below, this area is one in which a delicate balancing of competing social benefits, such as between the value of strong powers to maximize the value of the estate for the benefit of all creditors and the possible undermining of contractual predictability and certainty, must be struck. When the balance suggests that a particular transaction is harmful, it may become legally “avoidable,” that is, it may be subject to being treated as legally void, so that property the debtor has transferred, or its value, may be recovered by an insolvency representative for the benefit of stakeholders generally.

120. Insolvency proceedings may commence at lengthy periods after a debtor first becomes aware that such an outcome cannot be avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations to relatives and friends or pay certain creditors to the exclusion of others. The result of such activities, in terms of the eventual insolvency proceedings, is to disadvantage general unsecured creditors, who were not party to such actions and do not have the protection of security, and to undermine the objective of equitable treatment of all creditors. A principal goal of avoidance powers is to ensure that creditors receive a fair allocation of an insolvent debtor's assets consistent with established priorities for payment.

121. Different approaches are taken to avoidance provisions. One approach emphasizes the reliance on generalized, objective criteria for determining whether transactions are avoidable. The question would be, for example, whether the transaction took place within a specified period prior to commencement or whether the transfer or transaction contains any of the general characteristics set forth in the law (for example, requirements for provision of appropriate value). While generalized criteria may be simple to apply, if relied upon exclusively they can also have arbitrary results, so that legitimate and useful transactions that fall within the specified period may be voided, while fraudulent or preferential transactions that fall outside the period may be protected. Another approach emphasizes case-specific, subjective criteria such as whether there is evidence of intention to hide assets from creditors, whether the debtor was insolvent when the transaction was made and whether the counterparty knew of the insolvency. Adopting a balanced approach that combines elements of each may minimize the undesirable aspects of a strictly generalized approach.

122. Four common types of avoidable transactions are found in most legal systems. They are transfers intended to defraud creditors; transfers at an undervalue; preferential payments to certain creditors; and invalid security interests. Some transactions may have the characteristics of more than one of these different classes, depending upon the individual circumstances of each contract. For example, transactions which appear to be preferential may be more in the character of fraudulent transactions when they occur while the debtor is nearly insolvent or where they leave the debtor with insufficient assets to conduct its business. In respect of each category, legal systems vary as to whether the transferee—the person who received the property—can be required to return it if they were innocent, gave value and had no knowledge of the crucial facts. Some systems permit such a defence by the transferee, while others require a return of the property regardless, although with some protection for any value actually given by the transferee.

123. The first three types of avoidable transactions are made avoidable for several reasons, including:

- (a) To prevent fraud (for example, transfer of assets to hide them for the later benefit of the debtor);
- (b) To prevent favouritism, where the debtor wishes to advantage certain creditors at the expense of the rest;
- (c) To prevent a sudden loss of value in a company just before court supervision is imposed; and
- (d) To create a framework for out-of-court settlement—creditors will know that last-minute transfers or seizures of assets can be set aside and therefore will be more likely to work with debtors to arrive at workable settlements without court intervention.

124. The avoidability of the fourth type of transaction, an invalid security interest, is simply an instance of enforcement of the rules concerning such interests in the context of insolvency. Thus, for example, those systems that require public registration of certain sorts of security may provide that the security will be unenforceable or void in insolvency proceedings if the registration was not made. The policies served are those established in the laws permitting the grant of security to creditors. On the other hand, a security interest valid under those laws may be avoidable in insolvency under one of the first three headings listed above. For example, the grant of a security interest shortly before insolvency, although otherwise valid, may be found to have favoured unfairly a certain creditor at the expense of the rest.

(a) Fraudulent transactions

125. Fraudulent transfers are those made by the debtor's management with an intent to defraud creditors or defeat or delay efforts to collect claims, by transferring assets beyond the reach of creditors to any third party. Many insolvency laws do not limit the time period within which these transactions must have occurred in order to be avoided.

(b) Undervalued transactions

126. Transactions may be avoidable where the value received by the debtor as the result of a transfer to any third

party was either nominal or much lower than the true value of the asset transferred. Some laws also require a finding that the debtor was insolvent at the time the transfer was made, or was made insolvent as a result of the transfer.

(c) *Preferential transactions*

127. Preferential transfers are typically payments which violate the *pari passu* principle by preferring some creditors and third parties over other creditors that may go unpaid during the period leading up to the initiation of proceedings. Such transactions may be subject to avoidance where the transfer was made within a defined period (“the suspect period”) before the application for initiation of the insolvency proceeding to a creditor on account of a debt and, as a result of such transfer, the creditor will receive more than its lawful, *pro rata* share of the debtor’s assets. Many countries also require evidence of insolvency or near insolvency when the transaction took place. Another category of preferential transaction might include transfers made after the application for initiation of the insolvency proceedings but before commencement, unless the transaction was authorized by the terms of the insolvency law.

128. Gifts might be either fraudulent or entirely innocent, but in either case may be unfair to creditors and therefore avoidable. A set-off occurring within a short time before the initiation of the insolvency proceeding may be considered prejudicial and subject to avoidance.

129. [Unauthorized transfers occurring after initiation of proceedings; avoidance of pre-payments during suspect period; transactions seriously inconsistent with normal commercial practice.]

(d) *Establishing the suspect period*

130. Some insolvency laws explicitly specify the suspect period (for example, so many days or months before commencement of insolvency) during which each of these types of transactions would be subject to avoidance. In other laws, the suspect period is defined retrospectively by the court after proceedings have commenced. In those laws, the court’s decision is often based on a finding as to when the debtor ceased paying its debts in the normal way (“cessation of payments”). [Discuss advantages of each approach]. Some systems may have one suspect period for all types of avoidable transactions, while others have different periods depending upon factors such as whether the injury to creditors was intentional, whether the transferee was an insider (that is, a person who has a close corporate or family relationship to the debtor or its creditors). Because fraudulent transactions involve intentionally wrongful conduct, substantial suspect periods, which might be anything from one to six years, are often fixed. Where preferential transactions involve creditors who are not insiders, the suspect period may be relatively brief, perhaps no more than several months. Where insiders of the debtor are involved, many countries adopt the approach that stricter rules, including longer suspect periods and shifted burdens of proof, apply. For example, an undervalued transfer to an insider may be avoided although the debtor was neither insolvent at the time of such transfer, nor rendered insolvent as a result of such transfer.

(e) *Liability of transferees*

131. With regard to each of these types of transactions, the questions arise of whether the transferee may be exempted from liability and whether annulment of the transfer is desirable. Such a decision may be subject to different considerations for each type of transaction and will involve balancing requirements of fairness in respect to innocent parties against the difficulties of proving motive and knowledge and the harm occasioned to creditors independent of the transferee’s state of mind. In the case of fraudulent transactions, for example, the extent to which the transferee paid adequate value and had knowledge of the debtor’s actual intent to defraud creditors will be relevant. In the case of undervalued transfers, the question of whether or not the transferee was an insider and had knowledge of the debtor’s actual or imminent insolvency or that the debtor was likely to become insolvent as a result of the transfer will be relevant.

132. With regard to an action to avoid preferential transactions, different approaches may be taken. Under one approach, where the creditor transferee acted in good faith and had no knowledge that the debtor was insolvent at the time of the transfer or was rendered insolvent as a result of the transfer, the creditor is not subject to liability and the transfer is not annulled. Another approach provides the same result where the transfer by the debtor was substantially contemporaneous with the creation of the creditor’s claim, was subsequently followed by provision of value, or occurred in the ordinary course of business.

(f) *Void and voidable transactions*

133. Where a transaction falls into any of these categories, insolvency laws will either render it automatically void or make it voidable. In those laws where it is voidable, the insolvency representative is required to decide whether the avoidance of the transaction will be beneficial to the estate, taking into account delays in recovering either the assets involved or the value of the assets or the possible costs of litigation. That discretion would generally be subject to the insolvency representative’s obligation to maximize the value of the estate, and it may be responsible for its failure to do so. Where the insolvency representative does not take action to avoid certain transactions, some insolvency laws permit a creditor or the creditor committee to take action to require the insolvency representative to initiate an avoidance action where it appears to be beneficial to the estate to do so. Other laws also permit a creditor itself or the creditor committee to commence an action to avoid these transactions. Where this latter action is permitted, some laws provide that assets or value recovered by the creditor are to be treated as part of the estate; in other cases whatever is recovered can be applied to satisfy the claim of the creditor which takes the action.

(g) *Evidentiary issues*

134. Insolvency laws adopt different approaches to establishing the elements of an avoidance action. In some laws, the debtor is required to prove that the transaction did not fall into any category of avoidable transactions. In other laws, a creditor or other person challenging the transaction,

such as the insolvency representative, is required to prove the existence of each element of an avoidance action. Some laws allow for the burden of proof to be shifted where, for example, it is difficult for the insolvency representative to establish the debtor's actual intent to defraud creditors except through external indications, objective manifestations or other circumstantial evidence of such intent. The burden of establishing the debtor's innocent motive is shifted in those laws to the transferee.

2. *Summary: avoidance action*

[...]

IV. *Administration of proceedings*

A. *Debtor's rights and obligations*

1. *General remarks*

(a) *Control of debtor's management*

(i) *Liquidation*

135. Once liquidation proceedings have commenced, the conservation of the estate requires comprehensive measures to protect the estate not only from the actions of creditors, but also from the debtor's managers or owners. For this reason, many insolvency laws divest the debtor's management or owners of all rights to manage and operate the business and an insolvency representative is appointed to assume all responsibilities divested. These might include the right to initiate and defend legal actions on behalf of the estate and the right to receive all payments directed to the debtor. Upon commencement of the liquidation proceedings, any actions taken by the debtor that are detrimental to the estate would normally be void.

136. Where it is determined that the most effective means of liquidating the estate is to sell it as a viable business, some laws provide the insolvency representative with the power to permit the debtor's managers or owners to retain some control to facilitate the sale of the assets and the business under the supervision and control of the insolvency representative. Under that approach, the insolvency representative may be made liable for the wrongful acts of the debtor during the period of its control.

(ii) *Reorganization*

137. In the case of proceedings for reorganization, there is no agreed approach on the extent to which displacement of the debtor is the most appropriate course of action and whether there may be an ongoing role for the debtor's management. In many circumstances, the debtor's management, notwithstanding its role in the financial difficulties of the enterprise, will have immediate and intimate knowledge of the business of the debtor. This knowledge may provide a basis for management to have a continuing role in making short-term management decisions. For similar reasons, the debtor's management is often well positioned

to propose a reorganization plan for approval by creditors and the court. In such circumstances, total displacement of the management of the debtor, notwithstanding its role in creating the financial difficulties of the debtor, might eliminate the incentive for debtors to commence reorganization procedures at an early stage and may undermine the chances of success of the reorganization.

138. There are different approaches to balancing these considerations. One approach would be to establish a sharing arrangement between the debtor and the insolvency representative, where the latter supervises the activities of the debtor and approves significant transactions and the debtor continues to operate the enterprise on a day-to-day basis. This approach may need to be supported by relatively precise rules to ensure that there is clarity as to the division of responsibility between the insolvency representative and the debtor and certainty as to how the reorganization will proceed. However, if there is evidence of gross mismanagement or misappropriation of assets or the goal of reorganization is no longer realistic, it may be appropriate for the debtor's managers or owners to be displaced by the court, on its own motion or on that of the insolvency representative or perhaps the creditors or creditor committee. Where the power is given to creditors or the creditor committee, there may be a need for protections that would prevent possible abuse by creditors seeking to frustrate the reorganization proceedings or gain improper leverage. This could be achieved by requiring, for example, the vote of an appropriate majority of creditors before such relief can be sought.

139. Another approach, which is used in very few insolvency laws, is to enable the debtor to retain full control over the operation of the business, with the consequence that the court does not appoint an independent representative once the proceedings begin (known as "debtor in possession"). While such an approach might have advantages in terms of the chances of a successful reorganization, there may also be disadvantages. These disadvantages might include the process being used where the outcome is clearly not likely to be successful, that is where the process is used to delay the inevitable with the result that assets continue to be dissipated, and the possibility that management may act irresponsibly and even fraudulently during the period of control, undermining the reorganization as well as the confidence of creditors. These difficulties may be mitigated by adopting certain protections such as appointment of an insolvency representative to supervise the debtor or a mechanism that allows the court (either on its own motion or at the request of creditors) to convert the proceedings to liquidation, as well as giving the creditors a significant role in supervising or overseeing the debtor. Nevertheless, this approach is a very complex one which affects a number of different aspects of the design of an insolvency regime and requires detailed consideration.

140. To assist the debtor in carrying out its duties, some laws permit the debtor to employ professionals such as accountants, attorneys, appraisers and other professionals as may be necessary, subject to authorization. In some laws, that authorization is provided by the insolvency representative, in other laws by the court or the creditors.

(b) Provision of information

141. To enable the court, creditors and affected parties to reasonably evaluate the debtor's immediate liquidity needs and the advisability of new financing; the enterprise's business prospects and long term viability; and whether management is qualified to continue to lead the enterprise, they will need to have information concerning the business that can be provided by the debtor. To satisfy that need in both types of insolvency proceedings, but in particular in reorganization proceedings, it is desirable for the debtor to have a continuing obligation to disclose information regarding its business and financial affairs in some detail. To ensure that the information provided can be used for these purposes, it needs to be current and therefore be provided as soon as possible after the commencement of the proceedings. Where the debtor is not a natural person, the information could be supplied by officers and other relevant third parties of the debtor to the insolvency representative. An alternative approach is to require one or more of the directors to be represented at and required to attend a main meeting of creditors to answer questions, except where this is not physically possible when directors are not located in the place in which creditors meetings may be held. Often the information in question will be commercially sensitive and it is desirable that an insolvency law include provisions to protect confidential information. Where information is withheld, there may be a need for some mechanism to compel the provision of relevant information. This might take the form of a "public examination" of the debtor or, following the practice of a number of countries, the imposition of criminal sanctions.

142. To facilitate the provision of information by the debtor, some laws have developed standardized information schedules that set out the specific information required. These are to be completed by the debtor (with appropriate sanctions for false or misleading information) or by an independent person or administrator.

2. Summary: debtor's rights and obligations

[...]

B. Insolvency representative's rights and obligations

1. General remarks

143. The insolvency representative plays a central role in the effective implementation of the law. Where it is a court appointed official, many laws provide that the insolvency representative has an obligation to ensure that the law is applied effectively and impartially. Since it normally has the most information regarding the situation of the debtor, the insolvency representative is in the best position to make informed decisions. That does not mean that the insolvency representative is a substitute for the court: a court of competent jurisdiction would adjudicate a dispute between the insolvency representative and an interested party. Even in countries where the role of the court in insolvency proceedings is restricted, there is a limit to the amount of authority that would normally be conferred upon an insolvency representative.

(a) Selection and appointment of insolvency representative

144. In some jurisdictions, the court selects, appoints and supervises the insolvency representative. In other jurisdictions, a separate office or institute selects the insolvency representative after the court directs it to do so and it is charged with the general regulation of all insolvency representatives. A third approach allows creditors to play a role in recommending and selecting the insolvency representative to be appointed, provided that that person meets the qualifications for serving in that capacity in the specific case. Although these latter approaches may serve to avoid perceptions of bias, they may have the disadvantage of requiring additional resources and infrastructure.

(b) Qualifications

145. The insolvency representative can be selected from a number of different backgrounds such as from the ranks of the business community, from the employees of a specialized governmental agency or from a private panel of qualified persons. A related issue is whether the insolvency representative must be a natural person, or whether a legal person may also be eligible for appointment. However appointed, the complexity of many insolvency proceedings makes it desirable that the insolvency representative have knowledge of the law, be impartial and have adequate experience in commercial and financial matters. If specialized knowledge is required, it can always be provided by hired experts. Conflicts of interest arising from a pre-existing relationship with the debtor, a creditor or a member of the court may be sufficient in some countries to preclude the appointment of that person as an insolvency representative.

(c) Duty of care

146. The standard of care to be employed by the insolvency representative and its personal liability are important to the conduct of insolvency proceedings. The insolvency representative serves as a fiduciary in the performance of its duties, owing a general duty of loyalty to the estate and the various constituencies in the case. As such, the insolvency representative may be liable for a breach of those duties. Establishing a measure for the care, diligence and skill which is owed requires a standard that will take into account the difficult circumstances in which the insolvency representative finds itself when fulfilling its duties, such as a standard of negligence. Some insolvency laws require the insolvency representative to post a bond or provide insurance coverage against a breach of its duties. Where losses are sustained by the estate as a result of the negligence, incompetence or dishonesty of agents and employees of the insolvency representative, some laws provide that the insolvency representative is not personally liable except where it fails to exercise the proper degree of care in the performance of its duties. [Note to the Working Group: Are there other approaches to liability of the insolvency representative?]

147. Some insolvency laws require court authorization for the insolvency representative to retain accountants, attorneys, appraisers and other professionals that may be

necessary to assist the insolvency representative in carrying out its duties. Other laws do not require court authorization. In terms of remuneration of those professionals, some laws require an application to and approval by the court, while another approach might be to require approval of the creditor body. Professionals may be paid periodically during the proceedings or may be required to wait until the proceedings are completed.

(d) *Replacement or removal*

148. In the event of the death or resignation of the insolvency representative, disruption of the proceedings and the delay that may be occasioned by failure to provide for succession may be avoided by providing for the appointment of a successor insolvency representative. Some insolvency laws permit the insolvency representative to be removed in certain circumstances. These could include that the insolvency representative had violated or failed to comply with its legal duties under the insolvency regime or had demonstrated gross incompetence or gross negligence. Different approaches provide that removal may occur on the basis of a decision of the court, acting on its own motion or at the request of an interested party, or a decision taken by an appropriate majority of unsecured creditors.

2. *Summary: insolvency representative's rights and obligations*

[...]

C. *Creditor claims*

1. *General remarks*

149. Claims operate at two levels in insolvency proceedings: for purposes of determining which creditors may vote and how they may vote (according to the class of creditor into which they fall); and for purposes of distribution. Laws differ in the types of claims that may be made. In some laws, a distinction is made between secured and unsecured claims. A secured creditor does not generally make a claim unless it surrenders its security or is undersecured (that is, the value of the claim exceeds the value of the collateral) and wishes to claim for the unsecured portion (which may be a provisional claim). Some laws provide that certain claims are not admitted on public policy grounds, for example, foreign revenue claims, judgements obtained by fraud, fines and penalties and gambling debts.

(a) *Making of claims*

150. Different mechanisms may be used for the making of claims. The laws of many countries place the burden upon creditors to produce evidence of their claims to the insolvency representative for its review. Some laws provide that, as an initial step, a list of creditors and claims is prepared, either by the court or by the debtor. Once the list is prepared, creditors may be invited to make their claims to the insolvency representative. Preparation of such a list by the debtor takes advantage of the knowledge the debtor will have about its creditors and their claims and gives the insolvency representative an early indication of the state of

the enterprise. Presentation of claims by creditors and their subsequent verification by the insolvency representative tends to assure proper distributions.

(b) *Provisional claims*

151. Creditors' claims may be of two types: those that involve a determined amount and those where the amount owed by the debtor has not been or cannot presently be determined. Such claims may be either contractual or tortious in nature and may arise in respect of both secured and unsecured claims. Where the amount of the claim cannot be or has not been ascertained at the time the claim has to be made to the insolvency representative, many laws provide for a claim to be made provisionally or to be given a provisional value. Admission of provisional claims raises a number of issues. These concern valuation of the claim and the party to undertake that valuation; voting of provisional creditors on important issues such as determining whether the case is one of liquidation or reorganization or approval of the reorganization plan; and whether as minority creditors, they can be bound by a plan to which they have not agreed (see sect. IV.F, Reorganization plan).

(c) *Verification of claims*

152. Although most laws provide for the insolvency representative to verify the claims of the creditors, some laws do not require verification unless a claim is challenged. Verification involves not only an assessment of the underlying legitimacy and amount of the claim, but also a determination of the category within which a claim fits for purposes of voting and distribution (for example, secured as opposed to unsecured claims; and pre-commencement as opposed to post-commencement claims).

(d) *Procedural issues*

(i) *Notice to creditors*

153. Most laws provide that all identified and identifiable creditors are entitled to receive notice of claims that have been made. That notification may be given personally or by publishing notices in appropriate commercial publications. An insolvency representative may additionally be required to prepare a list of claims, both [admitted][approved] and disputed, and file it with the court or other administrative body to facilitate the provision of notice to unknown creditors and provide updated information on progress with regard to [admission][approval] or rejection of disputed claims.

(ii) *Requirements for filing claims*

154. To ensure that claims are made in a timely fashion and that the insolvency proceedings are not unnecessarily prolonged, deadlines for the making of claims with the insolvency representative can be of assistance. Where creditors fail to meet those deadlines, they may be treated in different ways. These may include exclusion from the receipt of dividends or from distributions or limitation of their participation in the distribution of assets to those assets remaining after the verification of claims.

155. Under some laws, the insolvency representative has the power to verify claims and where disputes arise they are to be resolved by the court. Other laws provide that the court would verify all claims and resolve disputes. Some laws allow claims to be disputed only by the insolvency representative, while other laws permit other interested parties, including creditors, to challenge a claim. Where this occurs, one means of addressing it may be to provide for final review of the list of creditors' claims at an assembly of creditors, following preparation of the list by the insolvency representative or the court. Where disputes as to claims arise, whether between a creditor and the insolvency representative or the debtor and the insolvency representative, and including disputes as to collateral or security rights, a mechanism for quick resolution is essential to ensure efficient and orderly progress of the proceedings. If resolution of disputed claims cannot be quickly and efficiently addressed, the ability to dispute a claim may be used to frustrate the proceedings and create unnecessary delay.

2. Summary: creditor claims

[. . .]

D. Creditor committee

1. General remarks

156. Creditors have a significant interest in the enterprise once an insolvency proceeding is commenced. As a general proposition, these creditor interests are safeguarded by the appointment of an insolvency representative. However, creditors may also be given the power of decision-making in a number of key areas in both liquidation and reorganization. In some laws, for example, they have the authority to dismiss an insolvency representative, approve a private sale of the business in liquidation, propose and approve a plan for reorganization and to request or recommend action from the court, such as conversion of reorganization to liquidation. Creditors are given a role in the insolvency process for a number of reasons. As the party with the primary economic stake in the outcome of the proceedings they may lose confidence in a process where key decisions are made by individuals that are perceived as having limited experience, expertise or independence. In addition, creditors are often in the best position to monitor the actions of the insolvency representative, thus discouraging fraud, abuse and excessive administrative costs.

157. In cases where there are a large number of creditors, the formation of a creditor committee can provide a mechanism to facilitate creditor participation in the administration of the case, whether it is liquidation or reorganization proceedings. The creditor committee can be appointed to undertake a number of tasks, including monitoring the progress of the case, consulting with other principals in the proceeding, especially an insolvency representative and the existing management of the debtor, and advising the insolvency representative on the wishes of the creditor body. The committee's duty would be to the general body of creditors. As a representative body, it would not have any liability or fiduciary duty to the owners of the insolvent enterprise.

(a) Involvement of creditors in the decision-making process

158. There are varying possible degrees of involvement by creditors in the decision-making process of the proceedings. In some systems, the insolvency representative makes all key decisions on uncontested general matters of administration and liquidation, with the creditors playing a marginal role and having little influence. Such an approach may be very efficient where it is handled by an experienced insolvency representative because it avoids the delays involved in managing the participation of creditors. That approach may be supported where the system already provides a high level of regulation of the process and its participants. Some approaches that limit the participation of creditors distinguish between liquidation and reorganization, allowing creditors to participate only in the decision whether to proceed as a liquidation or reorganization and to vote on a reorganization plan.

159. Other approaches afford creditors greater participation in the proceedings. Under some laws, in liquidation proceedings creditors may be able to select and replace the insolvency representative, approve the temporary continuation of the business by the insolvency representative and approve private sales of assets. In reorganization proceedings, they may perform a vital role in the proceedings, serving as a primary check on the activities of the enterprise (especially where the system allows the debtor to remain in possession after commencement) and the insolvency representative and proposing and approving reorganization plans. They may also have a role in requesting or recommending action from the court, including, for example, a recommendation that the reorganization be converted to liquidation.

(b) Creditors to be represented

160. Different approaches may be taken as to the composition of creditor committees. In some systems, although a creditor committee would generally represent only unsecured creditors, it is recognized that there may be cases where a separate committee of secured creditors might be justified. Those systems base this approach on the fact that the interests of the different types of creditors do not always converge and the ability of secured creditors to participate in and potentially affect the outcome of decisions by the committee may not always be appropriate or in the best interests of other creditors. Other systems provide for both types of creditors to be represented on the same committee. Under those systems, the exclusion of secured creditors from the committee is viewed as effectively excluding them from participation in the making of important decisions. The participation of shareholders of the enterprise may be controversial, especially where the creditor committee has the power to affect the rights of secured creditors or where they are involved with the management of the debtor.

(c) Formation of the creditor committee

161. Where the law provides for the formation of creditor committees, details of the manner in which the committee is formed, the scope and extent of its duties, its governance

and operation, including voting eligibility and powers, quorum and conduct of meetings, as well as replacement and substitution of members are often also addressed. A further issue is that of situations where the input, not only from the creditor committee but also from all creditors is appropriate, and how that input is to be obtained.

162. To facilitate administration and oversight of the committee, some insolvency laws specify the size of the committee, which would preferably be an odd number in order to ensure the achievement of a majority vote. Membership of the committee may be limited to the largest unsecured creditors, who are representative of the overall creditor body. These creditors can be identified by a number of means, including requesting the debtor's managers to prepare a listing of the debtor's largest creditors. To ensure equality of treatment of creditors, classes of creditors such as those whose claims have not yet been approved and foreign creditors can be eligible for appointment to the committee.

163. Representatives to the committee can be appointed or selected in a number of ways. One approach is for the insolvency representative to appoint representatives to the committee. Alternatively, and with the consent of the insolvency representative or pursuant to provisions of the law, creditors may select the members of the committee at an initial meeting of creditors. Another approach is for the court or some other authorized body to appoint the creditor committee. Oversight of the committee, to ensure that it fulfils its duty to fairly represent unsecured creditors, may be required and could be undertaken by the insolvency representative.

(d) Duties of the creditor committee

164. The committee can undertake a number of functions, including meeting periodically with the insolvency representative to be advised on the progress of the case, including proposals to sell significant assets, to operate some or all of the debtor's business and to pursue, forgo or settle significant litigation; reviewing claims; and negotiating reorganization proposals on behalf of the unsecured creditors. To perform its functions, the committee may require administrative and expert assistance. Provision may be made in the law for the committee to request the insolvency representative for permission to hire a secretary and, if circumstances warrant, consultants and professionals at the expense of the insolvency estate.

(e) Voting of creditors

165. Where actions to be taken in the course of the proceedings will have a significant impact on the creditor body, it is desirable that all creditors are entitled to receive notice of, and to vote on, those actions. A number of different approaches may be taken with respect to achieving that vote, depending upon the nature of the matter to be voted upon. Some laws provide for voting to occur at a meeting of creditors, while other laws provide that where a large number of creditors are involved or where creditors are not local residents, voting may take place by mail or by proxy.

166. Different approaches are taken to the type of vote that is required to bind creditors. Some laws provide that the vote of a supermajority of the value of the claims that actually vote is sufficient to bind all creditors, where the proportion required for a supermajority may be three fourths or two thirds. In other examples, the law provides that a simple majority is sufficient on some issues such as election or removal of the insolvency representative. In some laws, secured creditors will only participate in the vote on specified matters such as selection of the insolvency representative and matters affecting their collateral.

2. Summary: creditor committee

[...]

E. Post-commencement finance

1. General remarks

167. The continued operation of the enterprise is critical for reorganization. To facilitate that continuing operation it is important that the insolvency representative [or the debtor] should be able to obtain credit to pay for crucial supplies of goods and services and to maintain business activities. An insolvency law can recognize the need for such post-commencement lending, provide authorization for it and create priority for repayment of the lender. The central issue is the scope of the power, in particular, the inducements that the insolvency representative can offer a potential creditor as a means of obtaining credit. To the extent that the solution adopted has an impact on the rights of existing secured creditors or those holding an interest in assets that is prior in time, it is desirable that provisions addressing post-commencement financing are balanced against the general need to uphold commercial bargains and the need to protect the rights and priorities of creditors.

168. Many laws provide that the insolvency representative can obtain unsecured credit without approval by the court or by creditors, while other laws require approval by the court or creditors in certain circumstances. Credit can also be obtained by giving a security interest on unencumbered property or a second-priority security interest on encumbered property. Where these inducements are not sufficient or not available, a number of different approaches may be taken to obtain the necessary credit. Pre-commencement lenders will have a key interest in security granted to secure the post-commencement lending in terms of the priority of their own security over any security that is later in time. In some insolvency systems, parties that lend to the business after the commencement of proceedings are entitled to priority in repayment ahead of all creditors. Such a priority is effectively a surcharge against the entire estate and assets. Another form of priority is an administrative priority (see sect. V, Distribution priorities), which gives a priority in repayment over the general unsecured creditors, but not over a secured creditor with respect to its collateral. An intermediate approach allows for lenders and those advancing goods to take a security interest in the debtor's secured and unsecured assets. Some countries also allow the insolvency representative to give a "super" administrative priority, that is,

priority over other administrative creditors. An extreme approach is one that allows the granting of a “super” priority security interest that is senior to all existing securities. In some legal systems, all of these options are available. Some laws provide that the insolvency representative can approve such priorities, while in other laws approval by the court or creditors is required in respect of some forms of priorities.

2. *Summary: post-commencement finance*

[. . .]

F. *Reorganization plan*

1. *General remarks*

169. Insolvency laws address a number of issues in the context of formulation of a reorganization plan, such as when the plan is to be prepared; who is able to prepare the plan; what is to be included in the plan; how the plan is to be approved and the effect of the plan.

(a) *Preparation of a plan*

170. Some laws adopt the approach that the plan for reorganization forms a part of the application for reorganization proceedings (where the application may be called a “proposal” for reorganization), while other laws provide for it to be prepared after commencement of reorganization proceedings.

171. Different participants in the reorganization proceedings might prepare the reorganization plan. Some insolvency laws require the debtor to prepare the reorganization plan. This approach may have the advantage of encouraging debtors to utilize reorganization proceedings and to make the best use of the debtor’s familiarity with its business and knowledge of the steps necessary to make the enterprise viable again. That opportunity could be made exclusive or exclusive for a specified period, with the court having the power to extend the period if it will be of advantage to the reorganization proceedings.

172. Since the plan will only be successful if it is approved by a requisite majority of creditors, there is always a risk that reorganization will fail if the plan presented by the debtor is not acceptable. For example, creditors may only wish to approve a plan that deprives the debtor’s shareholders of a controlling equity interest in the enterprise and may also deprive the incumbent management of any management responsibilities. If the debtor is given the exclusive opportunity to prepare the plan and refuses to consider such an arrangement, there is a danger that the reorganization will fail, to the detriment of the creditors, the employees, and the enterprise. To address that concern, some insolvency laws provide that, if the debtor fails to provide an acceptable plan, the creditors are given the opportunity to propose a plan at the end of the exclusive period. This may be achieved through a creditor committee (see sect. IV.D, Creditor committee). This

option may provide the leverage necessary for one participant (the creditors) to persuade the other participant (the debtor) to compromise

173. A further approach would be to give the insolvency representative an opportunity to prepare the plan, whether as an alternative to preparation by the debtor or creditors or as a supplement. The importance of providing for participation by the insolvency representative or the creditors depends upon the design of the law. In circumstances where approval by the requisite majority of creditors is a necessary condition for effectiveness of the plan, a plan that takes account of proposals that will be acceptable to creditors has a greater likelihood of being approved than one which does not. This consideration will not apply where the law provides that creditor approval is not necessary or can be overruled by the court. Where a number of parties are given the opportunity to participate in preparation of a plan, the preparation of a number of plans simultaneously may complicate the process, although it may also promote the preparation of a mutually acceptable plan.

174. Some laws provide for the court to consider the opinions of third parties on the plan, such as governmental agencies and labour unions. Since such a procedure may have the potential to lengthen the duration of the process, it may be desirable only if carefully monitored and with time limits imposed.

(b) *Content*

175. Most countries have laws requiring that the reorganization plan should adequately and clearly disclose to all parties information regarding both the financial condition of the enterprise and the transformation of legal rights that is being proposed by the proponent of the plan. The question of what is to be included in the plan is closely related to the question of approval and effect of the plan. To the extent that a plan can be approved and enforced upon dissenting creditors, there may be a need to ensure that the content of the plan provides appropriate protection for those dissenting creditors.

176. The content of the plan also raises issues related to other laws. For example, to the extent that national company law precludes debt-for-equity conversions, a plan that provides for such a conversion could not be approved. Since debt-for-equity conversion can be an important feature of reorganization, it would be necessary to eliminate the prohibition if such provisions are to be included in the plan and approved. Similarly, if the plan is limited to debt forgiveness or the extending of maturity dates, it might not receive adequate support from creditors for it to be successful. Some insolvency cases raise similarly straightforward and uncontroversial issues of the relationship between the insolvency law and other laws. Other cases may raise more complicated questions. These may include limits on foreign investment, especially in cases where many of the creditors are non-residents, or the treatment of employees under relevant labour laws where, for example, the reorganization may raise questions of modification of collective bargaining agreements.

(c) *Approval and effect of the plan*

177. Designing the law with regard to the approval and effect of the plan requires balancing of a number of competing considerations. On the one hand, it may be desirable to provide a way of imposing an agreed plan upon a minority of dissenting creditors, in order to increase the chances of success of the reorganization. On the other, to the extent that the approval procedure results in a significant impairment of creditors' claims without their consent, there is a risk that the willingness of creditors to provide credit in the future might be undermined.

(i) *Secured and priority claims*

178. Different approaches may be taken to the approval of the plan by secured and priority creditors. In many cases, secured claims will represent a significant portion of the value of the debt owed by the debtor. Under one approach, where the law ensures that an approved plan will not preclude secured creditors from exercising their rights, there is generally no need to give these creditors the right to vote since their interests will not be impaired by the plan. Priority creditors are in a similar position under this approach—the plan cannot impair the value of their claims and they are entitled to receive full payment. The disadvantage of this approach is that it may reduce the chances for a successful reorganization, particularly where the assets securing the claim are vital to the success of the plan—if a secured creditor elects to exercise its rights it may make the plan impossible to implement. Similarly, the plan may provide that, in order for it to succeed, priority creditors receive less than the full value of their claims.

179. To resolve some of these difficulties, secured and priority creditors may be permitted to vote as separate classes on a plan that would otherwise impair the value of their claims. The creation of these classes recognizes that the respective rights and interests of those creditors differ from those of unsecured creditors. To the extent that majority support is obtained from both secured and priority classes of creditors, they will be bound by the terms of the plan. In those circumstances, laws generally require that dissenting creditors are entitled to receive at least as much as they would have received under liquidation.

(ii) *General unsecured creditors*

180. Even if voting by secured or priority creditors is not permitted, it is desirable that the general unsecured creditors have an effective means for voting on a plan. Different mechanisms may be used.

181. *Majorities.* Some laws identify the minimum threshold of support required of general unsecured creditors in order to make the plan binding on those creditors, as well as the voting procedures that are to be used to determine that support. One issue of importance is the manner in which votes are calculated, whether on the basis only of the percentage of value of the debt that supports the plan or also of the number of creditors that are supportive. Some laws require, for example, that the plan should be supported by two thirds of the value of the debt and one half of the number of creditors. Other combinations are also

used. Although increasing the difficulty of achieving approval, such a procedure may be justified on the basis that it protects the collective nature of the proceedings. For example, if a single creditor holds a majority of the value, such a rule prevents that creditor from imposing the plan on all other creditors against their will.

182. With regard to voting procedures, many countries adopt the approach of calculating the percentage of support on the basis of those actually participating in the voting. Absentees are considered to have little interest in the proceedings. Such an approach requires adequate notice provisions and their effective implementation, especially where creditors are non-residents.

183. *Classes.* Some countries that have established classes for secured and priority creditors also provide for the division of unsecured creditors into different classes. The creation of these classes is designed to enhance the prospects of reorganization in at least three respects, by providing a useful means of identifying the varying economic interests of unsecured creditors; a framework for structuring the terms of the plan; and a means for the court to utilize the requisite majority support of one class to make the plan binding on other classes that do not support the plan.

184. *"Cram-down" authority.* A few countries that provide for voting by secured and priority creditors and for the creation of different classes of unsecured creditors also include a mechanism that will enable the support of one class to make the plan binding on other classes (including classes of secured and priority creditors) without their consent. This is often referred to as a "cram-down" provision. The creation of classes and the application of such rules complicate both the insolvency law and its application by the insolvency representative and the court and may require, for example, the exercise of considerable discretion on economic matters, such as categorization of unsecured creditors by the court on the basis of their economic interests. This discretion, where it is not exercised in an informed, independent and predictable manner, has the potential to undermine creditor confidence.

185. *Shareholders.* Some laws provide for the approval of plans by shareholders of the debtor enterprise, at least where the corporate form, the capital structure or the membership will be affected by the plan. In addition, where the debtor's management proposes a plan, the terms of the plan may already have been approved by the shareholders. (Depending upon the enterprise in question, this may be required under the constitutive instrument of the enterprise.) This is often the case where the plan directly affects shareholders such as by providing for debt-for-equity conversions, either through the transfer of existing shares or the issuance of new shares.

186. In circumstances where the law permits creditors or an insolvency representative to propose a plan and the plan contemplates debt-for-equity conversion, some countries allow the plan to be approved over the objection of shareholders, irrespective of the terms of the constitutive instrument of the enterprise. Such plans may result in existing shareholders being entirely displaced without their consent.

187. *Court approval.* The court would normally be expected to approve a plan that has been approved by the requisite majority of creditors. Many countries enable the courts to play an active role in “binding in” creditors by making the plan enforceable upon a class of creditors where they have not approved the plan. Conversely, in cases where the plan has been approved by the requisite majority of creditors, the court will normally have the authority to reject the plan on the grounds that the interests of dissenting creditors have not been adequately protected (because, for example, they have not received as much as they would have received in liquidation) or there is evidence of fraud in the approval process.

188. Some laws also give the court the authority to reject a plan on the grounds that it is not feasible. This may be justified, for example, where secured creditors are not bound by the plan but the plan does not provide for full satisfaction of the secured claims of these creditors. The court may reject the plan in such a case if it considers that secured creditors will exercise their rights against the collateral, thus rendering the plan impossible to perform. The risk of this occurring can be addressed in provisions relating to preparation and approval of the plan.

189. Several countries also provide that the court has an ongoing role in supervision of the debtor after approval and confirmation of the plan, pending completion of implementation of the plan. This may be important where issues of interpretation of the performance or obligations of the debtor or others arise.

[*Note to the Working Group:*

The Working Group may wish to consider whether the following issues should be addressed under the topic of reorganization:

(a) *The role of the reorganization plan: is the plan the tailpiece of reorganization proceedings dealing with the pay-out of a dividend in full and final settlement of all claims (also referred to as a composition or a scheme of arrangement) or does the plan set out the way the debtor and the business enterprise should be dealt with during the reorganization period, which plan is set out at the beginning of the proceedings;*

(b) *Can a reorganization plan be prepared in liquidation as well as in reorganization proceedings;*

(c) *Minimum requirements of the reorganization plan, including provision for distribution of funds and the continuation or termination of contracts that are not fully executed and non-expired leases, the settlement of claims, the sale of collateral, minimum dividend pay-out to creditors, the disclosure and acceptance procedure, the rights of disputed claims to take part in the voting process and provisions for disputed claims to be dealt with; voting rights and powers of “insiders”; restriction on content of the plan;*

(d) *Amendment of the reorganization plan;*

(e) *Conversion to liquidation where a plan is not approved or implementation fails;*

(f) *Challenges to the reorganization plan;*

(g) *Oversight of implementation of the reorganization plan;*

(h) *Discharge of debts and claims;*

(i) *Termination of proceedings.]*

2. *Summary: reorganization plan*

[. . .]

V. *Liquidation and distribution*

Distribution priorities

1. *General remarks*

190. For the purposes of determining the priority of distribution of the proceeds of the estate in liquidation, many laws adopt the general principle that creditors should be ranked by categories that reflect a balance of the legal and commercial relationships entered into with the debtor. That balance is aimed at preserving legitimate commercial expectations and fostering predictability in commercial relationships. While distribution policies reflect choices that recognize important public interests, these broader public interests often compete with private interests and may lead to a distortion of normal commercial incentives.

(a) *Secured creditors*

191. The method of distribution to secured creditors depends on the method used to protect the secured creditor during the proceedings. If those interests were protected by preserving the value of the collateral, the secured creditor will have a first-priority claim on the proceeds of its collateral to the extent of the value of the secured claim. Alternatively, if the interests of the secured creditor were protected by fixing the value of the secured portion of the claim at the time of the commencement of the proceedings, the creditor will have a first priority claim to the general proceeds with respect to that value. It is desirable that exceptions to the first priority rule be limited. One exception may relate to the administrative expenses associated with the maintenance of the collateral.

(b) *Administrative claims*

192. Insolvency proceedings often require the assistance of professionals, such as the official insolvency representative and advisers to the debtor or insolvency representative. Creditor committees may also incur costs. These expenses of the insolvency proceeding often have a top priority, as administrative claims, over other claims and are often treated differently from other claims to ensure proper payment for the parties dealing with the insolvency process. Expenses of insolvency proceedings may include many or all post-commencement debts not just professional fees incurred by the debtor, insolvency representative and creditor committee, but also post-commencement claims of employees, lease costs and similar claims.

(c) *Privileged creditors*

193. Once secured claims and administrative expenses have been satisfied, the means by which remaining

resources are distributed vary considerably among countries. Insolvency laws often identify priority rights, which are rights attributed by domestic law to certain (mainly unsecured) debts to be paid in priority to other, unsecured and non-preferential (or less preferential) debts. In some countries, some priority rights, such as those relating to employees, rank ahead of secured creditors. Priority rights militate against the principle of *pari passu* distribution and operate to the detriment of ordinary, unsecured debts. The types of privileges provided by countries vary, but two categories are particularly prevalent. The first type provides priority for employee salaries and benefits (social security and pension claims) while the second type relates to government tax claims. Although some recent insolvency laws have significantly reduced the number of priority rights, reflecting a change in the public acceptability of such preferential treatment, in other countries there is a tendency to increase the categories of debt that enjoy priority. Maintaining a number of different preferential positions for many types of claims has the potential to complicate the basic goals of the insolvency process and to make the achievement of an efficient and effective process difficult. It may create inequities and, in reorganization, complicates preparation of the plan.

(d) Unsecured creditors

194. Once all privileged creditors have had their claims satisfied the balance would be distributed *pro rata* to unsecured creditors. There may be subdivisions within the class, with some claims being treated as subordinate. Some countries subordinate claims such as gratuities, fines and penalties, shareholder loans and post-petition interest to general unsecured claims, while in others they are treated as excluded claims.

(e) Owners

195. Many insolvency laws adopt the general rule that the owners of the business are not entitled to a distribution of the proceeds of assets until the creditors, who are senior in priority, have been fully repaid. This may or may not require the payment of interest. Where a distribution is made, it would be in accordance with the ranking of shares specified in the company law and corporate charter.

(f) Method of distribution

196. In systems where the preferential debts of the same priority rank equally amongst themselves after the expenses of the insolvency procedure, they will be paid in full unless the assets subject to their payment are insufficient to meet them. In that case they would abate in equal proportions according to their priority. Thus, each level of priority would be paid in full before the next is paid. Once a priority is reached where there are insufficient funds to pay all the creditors in full, the creditors of that priority share *pro rata*. In some laws that do not have different levels of priority, all the creditors share *pro rata* if there are insufficient funds to pay them in full. It may be desirable to provide in reorganization proceedings that priority claims must be paid in full as a predicate to confirmation of a plan unless the affected priority creditors agree otherwise.

197. [A plan of reorganization may propose distribution priorities that are different to those provided by the insolvency law, provided that such a modification has been approved by creditors voting on the plan.]

2. Summary: distribution

198. The amount available for distribution to creditors would be paid in the following order:

(a) [Secured claims];

(b) Expenses and remuneration in connection with the appointment, duties and functions of the insolvency representative;

(c) Administrative expenses;

(d) [other approved claims].

199. Priority rights can be [maintained for employee claims and other privileged creditors][kept to a minimum].

200. The claims in each of these categories are ranked equally between themselves. All the claims in a particular class would be paid in full before the next class was paid. If there is not sufficient to pay them in full, they would be paid in proportion.

A/CN.9/WG.V/WP.54/Add.2

**Report of the Secretary-General on the draft legislative guide on
insolvency law, working paper submitted to the Working Group on
Insolvency Law at its twenty-fourth session**

ADDENDUM

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[The introduction and part one of the draft guide appear in A/CN.9/WG.V/WP.54 and part two appears in A/CN.9/WG.V/WP.54/Add.1]

GENERAL REMARKS

1. The model legislative provisions set forth in part three of the draft legislative guide on insolvency law are provided to assist the Working Group in its consideration of possible alternative solutions to some of the substantive issues discussed in part two of the guide and to reflect and implement some of the approaches identified in section B in relation to each topic. As preliminary draft provisions, they are not intended to reflect particular recommended approaches, but rather to indicate how such provisions might be drafted in legislative language. In many instances, the provisions deal with only some of the issues that may need to be covered in the legislative guide. The provisions have been collected together in part three for ease of reference at this stage of the Working Group's deliberations, but it is envisaged that they would ultimately appear in the body of the legislative guide at the end of the analytical discussion of the subject matter to which they relate.

2. When the Working Group has completed its consideration of part two of the draft guide at its current session, it may wish to request the Secretariat to redraft the provisions in part three to reflect the decisions taken by the Working Group.

Part Three. Draft legislative provisions**Provisions relating to liquidation****I. Relationship between liquidation and reorganization proceedings**

(see provisions relating to reorganization under chapter V below)

II. Initiation and commencement requirements**A. Scope**

(1) Insolvency proceedings of all debtors engaged in a business enterprise are governed by this law.

(2) Insolvency proceedings concerning *[designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in the enacting State or that the enacting State wishes to exclude from this Law]* are not governed by this Law.

(3) Insolvency proceedings may be commenced against a debtor if it has its centre of main interests in this State.¹

(4) In the absence of proof to the contrary, a legal person is presumed to have its centre of main interests in this State if its registered office is in this State.²

(5) In the absence of proof to the contrary, a natural person is presumed to have its centre of main interests in this State if its habitual residence is in this State.

Explanatory notes

¹The provision may be extended to include reference to an establishment or assets of the debtor in this State.

²The language of paragraphs (4) and (5) is drawn directly from article 16, paragraph 3, of the UNCITRAL Model Law on Cross-Border Insolvency.

B. Initiation and commencement criteria

(1) An application for liquidation may be made by:

- (a) The debtor itself;
- (b) [A creditor] *[specify number of creditors]* of the debtor;
- (c) A [prescribed] [government] agency;
- (d) [Other].

(2) A debtor may make an application for liquidation proceedings when it is insolvent. A debtor is insolvent if it is [unable to pay] [not generally paying] its debts as they fall due [or is experiencing financial difficulties that will make it unable to pay its debts as they fall due].

(3) Creditors may make a liquidation application against an insolvent debtor, provided that:

(a) *[specify minimum number of]*¹ Creditors are owed a debt of not less than *[specify minimum amount]*² or, if the debtor has less than the specified minimum number of creditors, one or more creditors that hold liquidated, matured claims totalling at least *[specify minimum amount]*;

(b) [Evidence that the debtor is insolvent is provided].

(4) *[Conditions for involuntary initiation by governmental authority]*

(5) Notice of an application by a debtor for liquidation proceedings shall be given to creditors [promptly] [within [...] days] and published in *[specify publication such as official government gazette or a widely circulated national newspaper]* within [...] days.

(6) Notice of an application by creditors for liquidation proceedings shall be given to the debtor [promptly] [within [...] days]. The debtor has a right to dispute the creditors' application within [...] days. The court shall decide any such dispute [promptly][within [...] days].

(7) [In the absence of proof to the contrary, the creditors' assertions of their claims and of the failure of the debtor to pay such claims are presumed to be correct.]

Explanatory notes

¹Some countries specify that more than one creditor must make the application. This varies: 3 (Philippines); 2 (Netherlands); 1-3 depending upon additional criteria (United States of America); [others].

²Some countries require a minimum amount of debt to be specified. For example, under United States law an involuntary bankruptcy petition may be filed by three creditors owed a total of \$10,775; if the debtor has fewer than 12 creditors, an involuntary petition may also be filed by one or two creditors.

III. Consequences of commencement of liquidation proceedings

A. The insolvency estate

(1) The commencement of liquidation proceedings creates the insolvency estate.

(2) The insolvency estate includes all tangible and intangible assets in which the debtor has an ownership interest or to which the debtor is otherwise entitled, including:

(a) All claims and contractual rights in which the debtor has an interest or to which the debtor is otherwise entitled;

(b) All statutory and public rights to which the debtor is entitled which have or are capable of having a monetary value.

(3) The assets referred to in paragraph (2) are included in the estate if they exist at the commencement of the liquidation or come into existence after the commencement of the liquidation as a result of circumstances prevailing before the commencement of the liquidation [subject, in all such cases, to valid security interests and third party rights].

(4) The insolvency estate also includes all assets that are recovered by the insolvency representative through avoidance actions.

(5) If the debtor is a natural person, the insolvency estate does not include: [*specify assets to be excluded such as certain personal household property and property necessary for the debtor to earn a living*].

B. Stay of proceedings

(1) Upon commencement of liquidation proceedings:

(a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;

(b) Execution against the debtor's assets is stayed; and

(c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

(2) Paragraph (1) of this article does not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.¹

(3) The stay of proceedings applies to all creditors of the debtor, including secured creditors, preferential creditors, creditors holding statutory security interests and government claimants.

Variant A

[(4) The stay of proceedings applies to secured creditors for a period of [. . .] days. At the expiration of that period, the application of the stay may be extended by the court provided that [*set forth requirements, for example that the security is not essential to the sale of the business, extension of the stay is required to enable the insolvency representative to maximize the value of the estate [and] [or] the secured creditor will suffer no material prejudice to the value of its security or [. . .]*].²

Variant B

[(4) The stay of proceedings may be lifted as against a secured creditor in respect of the assets over which it has security, provided that [*set forth requirements, for example that the value of the assets over which the secured creditor has security is less than the amount of its secured claim or if the value of the security held by the secured creditor will be materially harmed by the continuation of the stay and protection for the secured creditor cannot be provided or [. . .]*].

Explanatory notes

¹Paragraphs (1) and (2) repeat the wording of paragraphs 1 (a)-(c) and 3 of article 20 of the Model Law on Cross-Border Insolvency.

²The alternatives for paragraph (4) indicate two different approaches, the first limiting the application of the stay to secured creditors to a fixed period, with the possibility of extension, the second providing for the stay to apply for the duration of the proceedings with provision for lifting in certain circumstances.

C. Treatment of contracts

(1) The insolvency representative may continue or terminate all contractual obligations of the debtor other than [*specify exclusions*].

(2) The insolvency representative shall take into account a minimum notice period of [. . .] days in order to terminate the following contracts: [*specify contracts for example, labour contracts with the debtor's employees*].

(3) The [insolvency representative] [court] may [override] [treat as null and void] any contract clause that terminates a contract upon commencement of liquidation proceedings. This provision does not apply to [. . .].

(4) Where the insolvency representative does not declare within a reasonable period that the debtor's contractual obligations will be duly performed, the creditor may determine to continue or terminate the contract.

(5) [In the event of a termination of a contractual obligation of the debtor, a pre-commencement claim must be approved for any monetary damages resulting from the termination.] [Termination of a contract gives rise to an unsecured claim for the damages caused by the termination.]

(6) The insolvency representative may reinstate a contract that, due to any monetary default on the part of the debtor, has been terminated by a creditor within [...] days prior to commencement of liquidation proceedings, provided the default is remedied by full payment of all amounts due. This provision does not apply to: [...].

(7) The insolvency representative may assign a contract [that has been continued] to a third party for value, subject to approval of the [counterparty][creditors][the court]. [Where a contract is assigned, the assignee should be able to perform the contract and may be required to provide security of performance.]

(8) All contractual obligations that the insolvency representative continues become obligations of the insolvency estate from the commencement of liquidation proceedings. [The creditor may require the insolvency representative to provide security].

D. Avoidance actions

(1) The insolvency representative has a right to avoid or otherwise render ineffective acts prejudicial to creditors, such as transfers of property or rights, encumbrances of property and obligations incurred. This provision does not apply to: [...].

(2) Prejudicial acts are subject to avoidance where the insolvency representative proves that:

(a) The debtor intended to defraud creditors, or defeated or delayed efforts to collect claims (“fraudulent acts”);

(b) The debtor received unfair value as a result of the act and the debtor was insolvent at the time the act took place, or was rendered insolvent as a result of the act (“undervalued acts”); or

(c) The act took place within [...] days [months] before [initiation] [commencement] of the liquidation proceeding to a creditor on account of a debt [and, as a result of that act, the creditor will receive more than its lawful pro rata share of the debtor’s assets] (“preferential acts”).

(3) Prejudicial acts that take place after the initiation of proceedings but before the commencement of proceeding are considered prejudicial, and subject to avoidance, unless authorized by an interim insolvency representative.¹

(4) A set-off occurring within [...] [days] [months] before [initiation] [commencement] of the liquidation proceeding is [is not] considered prejudicial and subject to avoidance.

(5) The following time periods apply to prejudicial acts occurring before the [initiation] [commencement] of the liquidation proceeding:

(a) In case of fraudulent acts, [...] [months] [years] before [initiation] [commencement];

(b) In case of undervalued or preferential acts which involve creditors that have a close corporate or family

relationship to the debtor of the debtor [...] [days] [months] before [initiation] [commencement];

(c) In the case of preferential acts which involve creditors that do not have a close corporate or family relationship to the debtor. [...] [days] [months] before [initiation] [commencement].

(6) The following rules apply to transfers to creditors that have a close corporate or family relationship to the debtor: [*specify suspect periods and burdens of proof*].

(7) A creditor or other person participating in a fraudulent act with the debtor is not subject to liability, nor is the act annulled, to the extent that the creditor or other person paid adequate value and [did not know] [neither knew nor should have known] of the debtor’s intent to defraud creditors.

(8) A creditor or other person participating in an undervalued act with the debtor is not subject to liability, nor is the act annulled, where the creditor or other person was not a creditor or person that has a close corporate or family relationship to the debtor and [did not know] [neither knew nor should have known] that the debtor was insolvent at the time of the act or was rendered insolvent as a result of the act.

Variant A

(9) A creditor participating in a preferential act with the debtor is not subject to liability, nor should the act be annulled, where the act by the debtor:

(a) Was made substantially contemporaneously with the creation of the creditor’s claim;

(b) Was followed by provision of fresh value from the creditor to the debtor, or

(c) Occurred in the ordinary course of business.

Variant B

(9) A creditor participating in a preferential act with the debtor is not subject to liability, nor is the act annulled, where the creditor [did not know] [neither knew nor should have known] that the debtor was insolvent at the time of the act or was rendered insolvent as a result of the act.

(10) Where a transaction falls within paragraphs (2) to (4) above, the insolvency representative may claim the return of the transferred assets, or recover the value of the assets [from the transferee] [from the person participating in the act].

Explanatory note

¹Some insolvency systems make provision for an interim insolvency representative to be appointed after initiation but before commencement of proceedings. The interim insolvency representative may have powers which include authorizing various transactions which would then not be subject to avoidance after commencement.

IV. Administration of proceeding

A. Debtor's rights and obligations

- (1) In both liquidation and reorganization proceedings, the debtor has a right be heard on any issue concerning the proceedings.
- (2) The debtor shall provide to the court, the insolvency representative [and, when required, the creditor committee] all information relevant to the proceedings [*such as the debtor's books and records that are in the debtor's possession or to which it has access, or about which it has knowledge, concerning all of the debtor's creditors to which it is or may be indebted, assets, liabilities, business operations, current income and current expenditures and transfers of its assets made by or on behalf of the debtor, as at, and within [. . .] days prior to, the commencement of the proceedings*].
- (3) [The debtor shall submit to examination in respect of its assets and affairs when and as required by the [insolvency representative] [court] [or as otherwise specified by this Law].
- (4) The debtor shall cooperate with the insolvency representative in all additional respects which might be necessary to enable the insolvency representative to perform its duties including the prosecution of or defence against actions relating to the debtor and the insolvency estate.¹
- (5) Management of the debtor shall be conducted by, or under the control of, the insolvency representative.

Explanatory note

¹The Working Group may wish to consider the related issue of a debtor's duty of disclosure. Since this might relate to facts that could result in the prosecution of a crime or administrative offence, it potentially raises issues that may be beyond the scope of this legislative guide and more in the area of criminal law. Information provided by the debtor in accordance with its obligation to disclose such facts may or may not be used in criminal proceedings against the debtor.

B. Insolvency representative's rights and obligations

- (1) An insolvency representative shall be appointed by the court [upon commencement of the proceeding] [if such an appointment is in the best interests of the various constituencies in the case]. The insolvency representative may be a natural [or a legal] person.
- (2) The insolvency representative shall [meet the following requirements] [possess the following qualifications]: [*specify qualifications including for example, independence, requisite knowledge of the law, experience in commercial matters [...]*].
- (3) Upon application by [*specify by whom*], the court may remove the insolvency representative for breach of its duties.

(4) Upon death, resignation or removal of the insolvency representative, a successor insolvency representative shall be appointed by the court. A vacancy in the office of the insolvency representative does not abate any proceeding in which the insolvency representative has appeared as the representative of the insolvency estate and the successor insolvency representative shall be substituted as the proper party in any such proceeding.

(5) The court may remove the insolvency representative if it is determined that the insolvency representative has acted with gross [incompetence] [negligence]. Evidence of such [incompetence] [negligence] may include failing to perform the duties assigned to the insolvency representative, engaging in fraudulent or illegal activities, or causing excessive monetary loss. [The creditors, by a majority vote of [*specify quantum such as three fourths*] may apply for removal of the insolvency representative to the court. Upon removal, the court shall appoint a successor insolvency representative.

(6) In liquidation proceedings, the insolvency representative is accountable for the insolvency estate and its [functions] [rights and duties] include:

- (a) Acting as the representative of the insolvency estate;
- (b) Having the exclusive capacity to sue and be sued on behalf of the insolvency estate;
- (c) Taking all steps necessary for preserving and keeping in reasonable condition any asset comprised in the insolvency estate;
- (d) Registering rights of the estate (where registration is necessary to perfect the rights of the estate against bona fide purchasers);
- (e) Requesting court authorization for the retention of accountants, attorneys, appraisers and other professionals as may be necessary to assist the insolvency representative in carrying out its duties;
- (f) Examining the debtor and any person having had dealings with the debtor in order to investigate the financial affairs of the debtor and to establish the existence, whereabouts, extent and condition of any assets that the insolvency representative believes should be included in the insolvency estate;
- (g) Applying to the court for an order requiring the delivery from any person of any asset included in the insolvency estate or restraining any person from disposing of any asset included in the insolvency estate;
- (h) Examining and admitting claims and preparing a statement as to admitted and contested claims;
- (i) Responding to reasonable requests for information concerning the insolvency estate or its administration, except as restricted by the court;
- (j) Submitting to the court periodic reports of the insolvency estate's operation. The report shall contain: [*specify details to be included such as details of the assets sold during the period in question, the prices realized, the expenses of sale and such information as the court may require or the creditor committee may reasonably require*];

(k) Attending meetings of creditors and the creditor committee and reporting on the insolvency estate's operation. The report shall contain: *[specify details]*;

(l) Selling the assets comprised in the insolvency estate at the best price reasonably obtainable in the [open] market;

(m) Closing the estate promptly, efficiently and in accordance with the best interests of [the creditors] [various constituencies in the case];

(n) Submitting a final report and accounting of the insolvency estate's administration to the court.

(7) The insolvency representative shall apply to the court for authorization to recover the reasonable expenses incurred in the performance of its duties *[specify means of calculating remuneration]*.

C. Creditors and claims

(1) Each [pre-commencement] creditor is entitled to make claims against the estate within [...] days after [commencement of liquidation proceedings] [notice of commencement has been given by the [court] [insolvency representative]].

(2) To make a claim, a creditor shall provide to the [court] [insolvency representative] the following information:

(a) The amount of the claim;

(b) The grounds upon which the claim is based;

(c) [Whether the claim is secured and the type or object of the security].

(3) The amount of the claim is estimated at the commencement of liquidation proceedings [in the currency of this State]. No interest is awarded on unsecured claims after commencement of liquidation proceedings.

(4) The insolvency representative shall admit or reject any claim. Claims of an undetermined value, secured claims and contested claims may be provisionally admitted pending valuation of the claim or of the security or resolution of the dispute concerning the claim.

(5) A creditor may request the court to make a determination that a claim is provisionally admitted or rejected for voting purposes only.

(6) The insolvency representative shall file lists (schedules) of all admitted, provisionally admitted and rejected claims with the court. The list of claims shall be available for inspection and the insolvency representative shall notify all creditors of the availability of the list of claims.

(7) Each creditor may contest each claim as to amount, the way the claim is recorded or to the fact that the claim is omitted from the list of claims within [...] days [of notice] of publication of the list.

(8) The court shall deal with each contested claim [promptly] [within *specify time period*].

(9) Upon final determination of a provisionally admitted, rejected or contested claim, [a creditor may request the insolvency representative to] [the insolvency representative shall] amend the list of claims accordingly.

D. Creditor committee

(1) A creditor committee may be appointed in liquidation proceedings [unless creditors elect not to participate].

(2) The creditor committee has a duty to monitor the liquidation proceeding and to consult with the insolvency representative regarding the disposition of significant assets, the conduct of significant litigation, the operation of the debtor's business and [...]. The committee may object to actions by the insolvency representative and bring such objections to the court.

(3) The committee shall be [appointed by the [court] [insolvency representative]] [selected by the majority vote of those creditors in attendance at the initial meeting of creditors on the basis of *[specify criteria]*], subject to confirmation by the court].

(4) The committee shall consist of no more than *[specify an odd number]* of [secured and] unsecured creditors determined by *[specify means including, for example, consulting a listing of creditors prepared by the debtor]*.

(5) An initial meeting of creditors shall be held to review the debtors' affairs, to consider the insolvency representative's plan of action and to conduct such other business as falls within the duties of the committee.

(6) In order to provide accountability, the creditor committee may examine the financial affairs of the debtor and the insolvency estate, including its books, records and financial transactions.

(7) Members of the committee are not liable for any actions taken by them in their capacity as members of the committee, unless the court finds that [the committee has breached its fiduciary obligation to the creditors] [the committee or any member of the committee has acted in an improper manner]. An individual member of the committee may be removed by the court if it is shown that the member has acted fraudulently or illegally or has otherwise abused its position on the committee.

(8) To assist it in its work and with the approval of the [court] [insolvency representative], the creditor committee may retain a secretary, consultants and professionals to be paid out of the assets of the insolvency estate.

(9) Each member of the committee has one vote and decisions are to be taken on a majority basis. [Members shall abstain from voting in the event of a conflict of interest].

(10) All creditors are entitled to [participate in] [be consulted on] the following actions:

(a) Decisions to terminate the proceedings, with terms to be agreed upon with creditors as to the basis for consent to the dismissal;

(b) Decisions to convert the proceedings from a liquidation proceeding to a reorganization proceeding;

(c) Decisions to sell substantially all the assets of the enterprise as a going concern.

V. Liquidation and distribution

Distribution priorities

(1) In a distribution to creditors of assets of a debtor in liquidation, the insolvency representative shall apply the amount available for distribution in the following order of payment:

(a) First, all expenses and remuneration in connection with the appointment, duties and functions of the insolvency representative;

(b) Second, [administrative expenses];

(c) Third, [all other admitted claims].

(2) The debts in each of the above classes rank equally and are to be paid in full before creditors in the next class. If there are insufficient funds to pay all creditors in a particular class in full they shall be paid in proportion.

(3) If all of the above claims are paid in full, the insolvency representative shall distribute the surplus first, in payment of any interest calculated after the relevant date on approved debt claims and then to the shareholders or the debtor according to their proper entitlements.

Provisions relating to reorganization

II. Initiation and commencement requirements

A. Scope

Same as paragraphs (1)-(5) for liquidation.

B. Initiation and commencement criteria

Same as paragraphs (1)-(7) for liquidation.

Possible alternative provisions for reorganization proposals

Same as paragraphs (1) and (4)-(7) for liquidation, with paragraphs (2) and (3) modified as follows:

(2) A debtor may make a proposal for reorganization when it is [insolvent] [in financial difficulty].

(3) Creditors may make a proposal for reorganization against a debtor, provided that:

(a) [*Specify minimum number of*]¹ Creditors are owed a debt of not less than [*specify minimum amount*]² or, if the debtor has less than the specified minimum number of creditors, one or more creditors that hold liquidated, matured claims totalling at least [*specify minimum amount*];

(b) [The debtor is [insolvent] [in financial difficulty]] [the rights of creditors have been impaired].

III. Consequences of commencement

A. The insolvency estate

Same as paragraphs (1)-(5) for liquidation.

B. Stay of proceedings

Same as paragraphs (1)-(3) for liquidation, with the following additional provisions:

(4) The stay of proceedings may be lifted as against a secured creditor in respect of the assets over which it has security if:

(a) The value of the security held by the secured creditor will be materially harmed by the continuation of the stay and protection for the secured creditor cannot be provided;

(b) The debtor is unable to propose a plan to its creditors within [. . .] days of commencement; or

(c) The [court] [insolvency representative] determines that the continuation of reorganization proceedings is not in the best interests of creditors.

(5) No application for liquidation proceedings relating to the debtor may be presented or commenced until the reorganization proceedings are completed, or terminated or converted to liquidation proceedings by the court.

C. Treatment of contracts

Same as paragraphs (1)-(8) for liquidation.

D. Avoidance actions

Same as paragraphs (1)-(10) for liquidation.

IV. Administration of proceeding

A. Debtor's rights and obligations

Same as paragraphs (1)-(5) for liquidation.

B. Insolvency representative's rights and obligations

Same as paragraphs (1)-(7) for liquidation, except the deletion of subparagraphs (6)(l) and (m) and addition of the following:

(..) Implementing the plan, as approved by creditors and confirmed by the court.

C. Creditors and claims

Same as paragraphs (1)-(9) for liquidation.

D. Creditor committee

Same as paragraphs (1)-(10) for liquidation.

V. Additional issues specific to reorganization

A. Post-commencement financing

(1) If the insolvency representative determines that further finance is necessary for the continued operation of the debtor or its business, it may approve the debtor entering into financing agreements and giving security over its property.

(2) Post-commencement financing approved under paragraph (1) is an expense incurred during the reorganization period and has priority for payment.

(3) A security created over the property of the debtor for post-commencement financing approved under paragraph (1) does not have priority ahead of any existing security over the same property unless the insolvency representative obtains a written agreement to that effect from the holder of the existing security.

B. Reorganization plan

Contents of the reorganization proposal

(1) A proposal for reorganization shall include:

(a) The terms of the proposed reorganization (the “plan”);

(b) A statement of the debtor’s affairs containing details of its creditors [and claims], assets, debts and other liabilities;

(c) [Such other information as prescribed in a regulation issued pursuant to this Law].

Appointment of a preliminary insolvency representative

(1) Upon the making of a proposal for reorganization the court shall appoint a preliminary insolvency representative.

(2) The preliminary insolvency representative shall estimate the prospects of the plan being approved, confirmed and implemented.

(3) The preliminary insolvency representative shall submit its report to the court within [. . .] days of the making of the proposal for reorganization.

(4) If the court deems it appropriate it may convene a meeting of the debtor and its creditors for approval of the proposal for reorganization.

(5) Every creditor of the debtor has a right to attend the meeting and to vote on the proposal and to propose amendments to the proposal.

Contents of the plan

(1) A reorganization plan shall:

(a) List and classify all claims outstanding against the debtor;

(b) Specify any class of claims that is impaired under the plan;

(c) Specify the treatment of any class of claims that is impaired under the plan;

(d) Specify means for implementation of the plan [such as:

(i) Retention by the debtor of any part of the property of the insolvency estate;

(ii) Restructuring of the debtor including merger or consolidation;

(iii) Sale of any part of the property of the estate, either subject to or free of any encumbrances or security interests, or the distribution of any part of the property of the estate among those having an interest in the property of the estate;

(iv) Satisfaction of any security interest;

(v) Modification of the rights of secured creditors [, other than . . .] or of unsecured creditors;

(vi) Taking of avoidance actions;

(vii) Provision for the continuance, assignment or termination of any pending contract [, including any unexpired lease];

(viii) Provision for the settlement, adjustment, retention or enforcement of any claim of the debtor;

(ix) Inclusion of any other provision as might be appropriate to facilitate successful reorganization of the debtor.]

(3) For the purposes of this law, a class of claims is not impaired under a plan where the plan does not alter the rights to which the creditors of that class are entitled under their claims.

Restrictions on the content of a plan

(1) A plan may place a claim in a particular class only if that claim is substantially similar to the other claims of that class.

(2) A plan shall provide the same treatment for each claim of a particular class, unless a creditor agrees to a less favourable treatment of its particular claim.

(3) No plan can affect the rights of a secured creditor without the agreement of that creditor.

(4) Where the debtor is a natural person, a plan proposed by an entity other than the debtor may not provide for the use, sale or lease of property [not included in the insolvency estate] [specifically excluded from the insolvency estate], unless the debtor consents to such use, sale or lease.

- (5) A proposal shall not be confirmed by the court if:
- (a) Non-preferential debts are given priority over preferential debts; or
 - (b) Preferential creditors are to be paid otherwise than proportionately. This provision does not apply where the preferential creditors receiving a lesser proportion have agreed in writing.

Acceptance of the plan

- (1) Each creditor may accept or reject the plan.
- (2) A plan is accepted by a class of claims if it has been accepted by creditors that hold at least [*two thirds in amount*] and [*more than one half in number*] of the claims included in that class.
- (3) A plan is accepted if it has been accepted by the majority in number of the classes of claims included in the plan.
- (4) Where a class is not impaired under a plan, each creditor of that class is conclusively presumed to have accepted the plan. Solicitation of acceptances from creditors of that class is not required.

Confirmation of the plan

- (1) Following acceptance of the plan, the court shall invite all creditors to attend a hearing to confirm the plan.
- (2) The court shall deny confirmation of a plan if:
 - (a) The assets of the debtor [considerably] exceed the liabilities of the debtor under the plan;
 - (b) The performance of the plan is insufficiently secured;
 - (c) The plan was concluded as a result of fraudulent transactions or the undue preference of one or more creditors or other unfair means.

Effects of confirmation of the plan

- (1) A plan approved in accordance with the rules set forth in article [...] and confirmed by the court is binding upon the debtor and all creditors, [whether secured or unsecured].

Avoidance of the plan

- (1) The court may avoid a plan after confirmation if it finds that:
 - (a) The plan as approved at the meeting of creditors unfairly prejudices the interests of one or more creditors;
 - (b) There has been some material irregularity at or in relation to the meeting of creditors.

- (2) An application for avoidance of a plan after confirmation may be made by:

- (a) A person excluded from participating in the meeting or from voting on the plan;
- (b) The insolvency representative;
- (c) [...].

Limitations to amendment of the plan

- (1) The proponent of a plan may modify the plan at any time before confirmation [, provided that the plan as modified meets the requirements set forth by this Law].
- (2) The proponent of a plan [or the debtor] may modify the plan at any time after confirmation of the plan and before substantial consummation of such plan, provided that the plan as modified meets the requirements set forth by this law.
- (3) Any creditor that has accepted or rejected a plan is deemed to have accepted or rejected, as the case may be, the plan as modified. This provision does not apply where the creditor, within [...] days] [the time fixed by the court], notifies the court of its objection to the modification.

- (4) No proposed amendment affecting the right of a secured creditor to enforce its security shall be effective unless the creditor has agreed to that amendment.

Conversion of proceedings

- (1) The court shall convert liquidation proceedings to reorganization proceedings if it is likely that reorganization can be successfully achieved within [...] days] [a reasonable time].
- (2) Liquidation proceedings which have already been converted from reorganization proceedings may not be reconverted to reorganization proceedings.
- (3) The court may take the decision to convert liquidation proceedings to reorganization proceedings upon request of the [debtor] [insolvency representative] [creditors] or on its own motion at any time prior to distribution.
- (4) The court shall convert reorganization proceedings to liquidation proceedings if:

- (a) The debtor fails to submit the reorganization plan or amendments to the reorganization plan within the time specified by the court;
- (b) The plan is not accepted by creditors;
- (c) The plan is not confirmed and a request for additional time to amend the plan or to file a further plan is not granted;

(d) The provisions of a confirmed plan are not or cannot be satisfied;

(e) The estate continues to suffer loss or a diminution of value and there is no reasonable likelihood of reorganization;

(f) A condition of the plan which would lead to termination of the plan occurs;

(g) The debtor acts fraudulently or dishonestly; or

(h) Fees or charges [required by this law to be paid] [prescribed in a regulation issued pursuant to this law] have not been paid.

(4) The court may take the decision to convert reorganization proceedings to liquidation proceedings upon the request of the [debtor] [insolvency representative] [creditors] at any time prior to the completion of implementation of the plan.

C. Report of the Secretary-General on alternative approaches to out-of-court insolvency processes, working paper submitted to the Working Group on Insolvency Law at its twenty-fourth session
(A/CN.9/WG.V/WP.55) [Original: English]

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I. INTRODUCTION

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. In considering that proposal, the Commission noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund, the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. Among the topics considered in those projects was the development, in a number of countries, of informal insolvency procedures that provided alternatives to formal insolvency procedures and that offered a greater degree of flexibility and an earlier proactive response from creditors than was normally possible under formal regimes.

2. At its twenty-second session, in December 1999, the Working Group on Insolvency Law discussed issues

related to informal insolvency procedures on the basis of a note by the Secretariat (A/CN.9/WG.V/WP.50, paras. 157-160), which took into account work undertaken by other international organizations on the topic.

3. The purpose of the present report is to facilitate the Working Group's further consideration of informal insolvency procedures by recalling the discussions that took place at both the twenty-second session of the Working Group, in December 1999, and the Global Insolvency Colloquium, in December 2000, and outlining a number of proposals that have been developed to promote the use of informal processes and address some of the issues raised by their increasing use.

4. The Working Group may wish to take these developments and proposals into account in considering whether legislative action on this topic is desirable or feasible. It will be recalled that the decision of the Commission at its thirty-third session, in 2000, was to give the Working Group a mandate that included consideration of out-of-court

reorganization as one of the core features of a strong insolvency, debtor-creditor regime. If the Working Group is of the view that legislative work should be undertaken, it may wish to consider whether that work should be prepared as an integral part of the draft legislative guide, which is essentially aimed at formal insolvency proceedings, or whether it could be developed in parallel with the guide, but as a separate, related project, on the basis that the topic raises different issues and concerns and is not as widely understood or practised as formal procedures.

5. Informal out-of-court proceedings are often referred to by a number of different terms, including “restructuring”, “rescue”, “reorganization”, “reconstruction” and “workout”, sometimes in combination with the word “voluntary”. To distinguish these informal, voluntary proceedings from the formal proceedings discussed in document A/CN.9/WG.V/WP.54 and Add.1 and 2, the processes discussed in the present report are referred to, where possible, as “out-of-court procedures”. Where the reports of other organizations are referred to, the terminology used in those reports is maintained, with the result that a number of different terms may appear in this document.

II. ASIAN DEVELOPMENT BANK

6. The issues associated with informal insolvency procedures were considered in a report by the Asian Development Bank (ADB)¹ which described the conditions necessary for informal procedures, as well as the main processes and practical problems. It noted that since the commercial culture of many of the countries studied for the report were conditioned towards non-confrontational dispute resolution, there might be a relatively firm basis upon which to promote and build the elements necessary to structure an informal negotiated approach to the problems of insolvent or financially troubled debtors. The following material, which is extracted from document A/CN.9/WG.V/WP.50, paras. 158-160, was considered by the Working Group on Insolvency Law at its twenty-second session, in December 1999:

“158. The ADB report (p. 24) points to a number of well-defined initial premises that are required for informal processes to be effective. These include significant debts owed to a number of different creditors, usually banks or other financial institutions; a preference for negotiating an arrangement for the financial difficulties of the debtor; availability of relatively sophisticated refinancing, security and other commercial techniques that can be used to rearrange or restructure the debts; the sanction of resort to insolvency law if the informal process breaks down; and the prospect of greater benefit for all through negotiation rather than formal processes.

“159. The process of what the ADB terms ‘informal workout’ includes a number of steps: creation of a forum in which debtor and creditors can explore and

negotiate an arrangement to deal with the debtor’s financial difficulties; appointment of a “lead” bank creditor to organize and manage the process; establishment of a “steering” committee of creditors; an agreement to suspend adverse actions by both creditors and the debtor, which may be compared to the stay of actions and proceedings in formal proceedings; and the provision of information on the debtor’s situation, including its activities, current trading position and so on.

“160. The ADB report raises a number of issues (pp. 25-27) that may need to be resolved in developing an informal process. These include identifying which party may initiate the process and the tools that may be used to ensure the progress of that process; the extent to which independent experts and advisers should be involved in the process; the means of resolving differences between creditors, particularly with respect to competing priority rights; dealing with dissenting creditors and creditors that it may not be possible actively to engage in the process because of [their] sheer number; the provision of ongoing funding to the debtor entity; and the establishment of priorities to secure that funding.”

III. UNCITRAL WORKING GROUP ON INSOLVENCY LAW

7. The following paragraphs are extracted from the report of the twenty-second session (December 1999) of the Working Group (document A/CN.9/469, paras. 105-112 and 116-121):

“105. At various stages of the discussion references were made to the fact that frequently an insolvent debtor and its creditors engaged in out-of-court collective negotiations with a view to finding an agreed solution to the debtor’s financial difficulties. It was noted that such negotiations (which might include, for example, fresh financing and restructuring of the debtor’s operations), in order to be successful, had to include all creditors or at least creditors representing the critical part of the debtor’s total obligations.

“106. It was noted that such voluntary out-of-court arrangements were often the lowest-cost way of resolving an insolvent company’s financial difficulties. They provided an important opportunity to preserve the ongoing business enterprise, preserve employment and, by preserving the going-concern value of the business, frequently maximized the value available to all interested parties. Out-of-court restructuring also avoided many of the costs, delays and difficult distributional issues faced in the context of plenary, court supervised, insolvency proceedings.

“107. It was further observed that fast growing companies in developing economies often had numerous lenders based in different countries. When those companies encountered financial troubles, it was often difficult for them to organize a productive out-of-court resolution with their multinational creditors from diverse commercial cultures. Voluntary arrangements were also

¹Asian Development Bank, *regional technical assistance project, TA No: 5795-REG, Insolvency law reform: preliminary comparative report*, 1999 (“the ADB report”); also, *Special report: insolvency law reform in the Asian and Pacific region, law and development at the Asian Development Bank*, 1999 ed.

impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of existing classes of debt. In the context of complex international transactions it was especially difficult to obtain agreement from all the relevant parties. For those reasons, it was stated, existing non-binding measures designed to facilitate voluntary arrangements had been implemented with only limited success.

“108. It was suggested that, in light of those considerations, an internationally developed mechanism for binding creditors could assist greatly in facilitating voluntary out-of-court arrangements. The view was expressed that the Commission could be instrumental in developing a legal mechanism that could be used in connection with voluntary arrangements. It was proposed that discussion might be confined to major cross-border insolvency situations and to financial indebtedness (i.e., banking and other financial loans), thus leaving aside creditors such as suppliers of goods or services and employees. The purpose of such a mechanism to be elaborated might be to set out conditions under which a solution agreed upon by a majority might be imposed on the minority, to provide for a stay of actions and executions by the creditor group covered, and to ensure that the minority group was treated fairly.

“109. However, it was observed that financial loans were sometimes extended through banks in the debtor’s country and that, therefore, the proposed mechanism should cover major financial indebtedness insolvency situations even if the creditors were from the same country as the debtor.

“110. Comments were made that the strongest incentive to engage in such out-of-court negotiations was the imminence, effectiveness and credibility of proceedings to enforce private claims and securities and of involuntary, formal, court supervised insolvency proceedings and the desire of both debtor and creditors to avoid the disruptive and stringent consequences of those proceedings. When such court proceedings were not credible or effective (e.g., because of court delays or because they did not ensure equitable treatment of creditors), the debtor might not be willing to engage in out-of-court negotiations. Even the prospect of fresh financing linked to an informally negotiated solution might not be sufficient incentive for the debtor inasmuch as ineffective court proceedings allowed the debtor to delay having to meet its obligations. Furthermore, experience had shown that leverage was needed over some creditors who might hold out for full satisfaction of their claims.

“111. Reservations were expressed regarding the proposition of elaborating a mandatory legislative mechanism designed to promote out-of-court negotiations. It was said that the informal process of out-of-court negotiations might be disturbed by the formality of the proposed mechanism. It was also said that the proposal was likely to encounter opposition, in particular in the banking community, and that therefore any further work should be preceded by consultations with the banking community. Furthermore, any such legislative

concept might have to be tailored to conditions in various regions and, therefore, universal solutions were difficult to obtain. It was suggested that, to the extent formality was desirable, an institution instigating and promoting out-of-court negotiations could be useful, but such institutional arrangements did not lend themselves to internationally harmonized solutions. Concerns were also expressed about whether the court was an appropriate body to give rulings on what were essentially matters of business judgment.

“112. However, opinions were also expressed that, while realizing potential difficulties and pitfalls involved in a mandatory legislative framework for out-of-court procedures, the proposal should not be abandoned because a well thought out mechanism might offer significant benefits. It was added that if the role of the court in informal negotiations was limited to the approval of the fairness of the outcome, that might be widely acceptable and would not be overly intrusive.

“115. Views were expressed that the envisaged out-of-court negotiation mechanism might include a non-judicial forum that would be empowered, by agreement of the parties, to evaluate whether the arrangement negotiated between the debtor and the majority of creditors was fair and, if it was found to be fair, to bind the minority of non-consenting creditors.

“116. In response to questions, it was suggested that the debtor and creditors would join out-of-court negotiations out of their own interest or pursuant to their contractual obligations, and that any legislative mechanism to be prepared should not establish a statutory duty for the debtor or creditors to participate in the negotiations.

“117. In response to a further question as to why the process was limited to financial creditors and did not include creditors who had supplied goods or services to the debtor, statements were made to the effect that experience showed that financial creditors often shared the same or similar interests and therefore more easily organized themselves for negotiations with the debtor, which was not the case with trade creditors. Furthermore, the focus and goal of the out-of-court negotiations was typically the reorganization of the capital structure of the debtor and the provision of fresh financing, which was more easily addressed by providers of finance than by trade creditors. Moreover, the terms of agreement reached with the debtor often allowed trade creditors to ‘ride out’ the debtor’s crisis and be paid in full or make a smaller sacrifice than the providers of finance.

“118. Several cautionary opinions and reservations were expressed about the proposed work. They included the following: there was a danger that large and influential creditors might use the mechanism to impose their views without taking due account of the interests of small or dissenting creditors; the proposed process lacked transparency, which was potentially troublesome in view of the fact that the result was to be binding on the dissenting creditors; the envisaged mechanism should only be allowed to operate to the extent the negotiations were not covered by the laws and regulations in

the debtor's country or by international treaties; it was essential that the envisaged mechanism should ultimately be subject to court control; the mechanism, in particular if it involved a non-judicial forum such as arbitration, was likely to be costlier than the mechanism involving court supervision and that the negotiations might take place at a place distant from the debtor's place of business, which might, for that reason, impose a substantial burden on the debtor and some creditors. In response, it was stated that experience with out-of-court restructuring showed that such procedures were less costly and more efficient than court supervised insolvency proceedings.

"119. It was considered that it was necessary to elaborate substantive criteria and rules under which minority creditors could be bound by an arrangement negotiated by the majority of creditors and that proper balance had to be found between the need to maintain confidentiality of certain types of information divulged during negotiations and the need for transparency of the process.

"120. Statements were made, and the Working Group agreed, that much of the expertise and experience regarding out-of-court procedures rested in organizations such as the International Monetary Fund, the World Bank, The Group of Thirty, INSOL International and the International Bar Association and that any work in the Commission should be carried out in close cooperation with those organizations and with the financial sector.

"121. After discussion, it was found that there was sufficient support in the Working Group for proposing to the Commission that it include in its agenda out-of-court arrangements between financial creditors and the debtor that included also the possibility of binding dissenting creditors."

8. The proposal of the Working Group was agreed to by the Commission at its thirty-third session, in 2000.

IV. JOINT UNCITRAL/INSOL/IBA GLOBAL INSOLVENCY COLLOQUIUM

9. At the jointly sponsored UNCITRAL/INSOL/IBA Global Insolvency Colloquium, held in Vienna in December 2000, the issue of out-of-court procedures was further discussed as an element, along with 13 other key topics relating to liquidation and reorganization, identified as a topic for possible consideration by UNCITRAL in its draft legislative guide. An account of the discussion is contained in document A/CN.9/495, paragraph 27 of which reads as follows:

"27. It appeared to participants that it would be advantageous to have a system which encouraged the parties to avoid the delay of a formal court proceeding over an extended period of time, which provided alternative processes to assist in and facilitate the rescue of capital at an early stage, and which might be more cost effective than formal proceedings. It was suggested that

while such a system worked best where there was a functional law and infrastructure that could ensure certainty of outcome, it was also useful where the institutional framework was not effective."

Work by the INSOL Lenders Group on the "Statement of Principles for a global approach to multi-creditor workouts" was introduced. The Principles are discussed in more detail in paragraphs 13-21 below. The Principles were formulated with a broad base of participation from over 150 institutions, including banking institutions, insurance companies, institutional investors, investment bankers, insolvency and finance professionals, Government representatives and regulatory authorities in many countries. The development of the Principles was in recognition of the increasingly widespread use of informal insolvency processes and the growing difficulties associated with bringing them to a successful conclusion.

10. The Principles are designed to expedite those processes, and therefore increase the prospects for success, by providing guidance to diverse creditor groups about how to proceed on the basis of some common agreed rules. They have the potential to make the process quicker; to reduce uncertainty, time, cost and inter-creditor tension and distrust, thereby helping preserve the value of the business by turning attention more quickly to the issues of preserving economic value.

11. The Principles point out that although there has been a growing international trend in the development of local insolvency laws to facilitate the rescue and rehabilitation of companies and businesses in financial difficulty, it is a truism that, no matter how debtor-friendly and "rescue"-oriented local insolvency regimes may be, there are often material advantages for both creditors and debtors in the expeditious implementation of informal or contract-based rescues or workouts compared with the unpredictable costs and uncertainties of a formal insolvency.

12. The Principles are not intended to be binding and it is emphasized that they are most likely to facilitate workouts where there is an appropriate legal, regulatory and governmental policy framework for insolvency that is effective, predictable and reliable; the Principles would operate in what is described as the "shadow of the law". The existence and prospective implementation on a consistent basis of a well-designed insolvency law, by providing financial creditors with effective means of recourse against uncooperative debtors, encourages debtors to cooperate with those creditors with a view to negotiating an agreement outside a formal insolvency in an acceptable timeframe. The formulation of the Principles was welcomed by participants at the Colloquium, paragraph 28 of the report of which reads as follows:

"28. ... There were suggestions, however, that the Principles might not go far enough and that something more might be required to ensure that agreements reached out-of-court were implemented. A further proposal was made to have introduced into the insolvency system an accelerated procedure to implement a restructuring plan that was not fully consensual, but that was endorsed by the vast majority of creditors. The plan

would be processed through a court (being a court administering insolvency cases) with a view to binding the dissenting minority, provided that it met certain objective criteria specified in the insolvency law. It was widely felt by participants that in-depth analysis would be required in order to decide whether such a proposal should be pursued within the scope of the work on insolvency that the Commission might undertake.”

The proposal is set forth in more detail in paragraphs 22-24 below.

V. INSOL LENDER’S GROUP STATEMENT OF PRINCIPLES FOR A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS

13. The Principles were completed by the INSOL Lender’s Group in 2000. They are accompanied by a commentary, which explains the scope and application of each principle and indicates best practice and offers suggestions on a number of issues not specifically addressed in the Principles themselves. As noted above in paragraph 12, the Principles are intended to operate against the backdrop of an effective, predictable and reliable insolvency system. The eight Principles are set forth below and are accompanied by a summary of the commentary, prepared by the Secretariat.

First Principle

Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to cooperate with each other to give sufficient (though limited) time (a “standstill period”) to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor’s financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.

14. The commentary indicates that this Principle is intended to ensure that all creditors whose cooperation is needed in order to make any attempted rescue or workout succeed are included within the informal process requiring, firstly, the identification of those classes of creditors that need to be included and, secondly, which creditors in the affected classes are to be included. The establishment of a standstill period recognizes the benefits to be derived for creditors as a whole from a coordinated and measured response to the debtor in difficulty. Although not specified in the Principle, the commentary addresses the commencement of the standstill period, noting that whilst this is a problematic area, it is quite common for the relevant creditors to choose the date on which the financial creditors as a group (or at least some significant group or class of their number) were first notified by the debtor or by another financial creditor of a meeting called to allow the debtor to explain its position to the relevant creditors. The commentary notes that while the duration of the standstill period will vary from case to case, depending upon the complexity of the information to be gathered and the nature of any restructuring proposal, it is customarily applied for an initial period of weeks or months, usually with a capacity

for extension if all relevant creditors agree, or for termination if a predetermined number elect to do so following agreed events of default or at their discretion.

Second Principle

During the standstill period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the standstill period their position relative to other creditors and each other will not be prejudiced.

15. The commentary underlines the importance of the stay to ensure stability, an essential backdrop to any attempted rescue or workout. Whilst noting that some jurisdictions do provide for statutory pre-insolvency stay of creditor claims, there is often advantage to both creditors and the debtor in adopting an informal or contract-based approach to avoid the costs associated with the formal approach. It outlines the issues that such a standstill agreement should address, including provisions that are designed to ensure that the position of relevant creditors does not deteriorate vis-à-vis each other during the standstill period. More sophisticated standstill agreements include provisions addressing the more difficult issue of maintaining the position of creditors relevant to each other.

Third Principle

During the standstill period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the standstill commencement date.

16. The commentary notes the importance of the debtor refraining from such actions and cites a number of examples of prejudicial actions which might include offering security in the form of charges, mortgages, liens, guarantees or indemnities to non-participating creditors; transferring assets or value away from the companies to which participating creditors have recourse; selling assets to third parties at an undervalue or to creditors who, because they are already owed money, will not pay for them.

Fourth Principle

The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative coordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

17. The commentary outlines the advantages to be gained from the use of coordination committees and a number of the issues to be addressed where they are used, including the ways in which such committees might be formed and operate, the powers of coordinators and recompense for

discharging their role, as well as their liability to creditors and how coordinators should be selected.

Fifth Principle

During the standstill period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

18. The commentary underlines the importance of this Principle to the success of rescue, workout or reconstruction. It points out that the information must be obtained, or at least capable of due diligence, by independent advisers acting for relevant creditors and the need for the debtor to accept that the advisers to the relevant creditors will be expected to review the accuracy of accounts, projections, forecasts and business plans related to any proposals for rescue or reconstruction. They will also need to estimate the consequences of the relevant creditors refusing to agree to the proposals being put to them.

Sixth Principle

Proposals for resolving the financial difficulties of the debtor and, so far as is practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the standstill commencement date.

19. Having evaluated the debtor's position and satisfied themselves that they are receiving equitable treatment relative to other creditors, relevant creditors will wish to compare what may be offered to them with what they might expect from a formal insolvency or from other options open to them. In making such assessments, it is not uncommon for accountants and other financial advisers acting for relevant creditors to base their advice on insolvency models produced in respect of the debtor, which operate by reference to certain stated accounting and legal assumptions and are based on the information produced through the due diligence process (Fifth Principle). The models should take account of all relevant claims and entitlements that would be counted in any insolvency of the debtor and of all relevant insolvency laws. The output from the insolvency models can be used to identify the claims that relevant creditors may have against the debtor, to estimate the likely return to such creditors from their claims and to estimate the proportion of the indebtedness due to relevant creditors that appears to be covered by assets.

Seventh Principle

Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, be treated as confidential.

20. The commentary to this Principle notes that it is essential that all relevant creditors are provided with the same information regarding the assets, liabilities and business of the debtor during the informal process and that they all see the proposals put forward by the debtor. It notes that this should be the case even where differing proposals are being put to differing constituencies within the relevant creditor group as a whole and even if differences in the position between the relevant creditors mean that separate professional advice is required for separate constituencies. It is noted that the holding of confidential information by some groups of creditors, such as banks, is generally not problematic. The commentary points to other groups, however, such as holders of debt that either are not subject to express or implied duties of confidence or cannot accept confidential information without prejudice to their ability to trade debt, where special arrangements may need to be made. It addresses debt trading as a mechanism that is increasingly favoured by financial institutions for managing credit exposures and realizing values associated with their lending and notes some of the sensitivities that may arise with respect to protection of confidential information.

Eighth Principle

If additional funding is provided during the standstill period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as possible, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

21. The commentary addresses the means of securing the availability of additional funding and notes that it might involve not only additional loan facilities, but also other forms of increase in exposure levels. Treatment of these other forms will be a matter of negotiation among relevant creditors. It is suggested that all relevant creditors participating in the process should be given the opportunity to participate in the provision of additional funding and should accept the risks associated with the provision of additional funding on a proportionate basis.

VI. PROPOSAL FOR IMPLEMENTING RESTRUCTURING THROUGH THE USE OF COURT SUPERVISED INSOLVENCY PROCEEDINGS

22. Several members of the United States of America's delegation to the UNCITRAL Working Group on Insolvency Law have developed a proposal for a statutory framework that would provide for expedited insolvency proceedings to implement a voluntary restructuring of borrowed money indebtedness (institutional lender debt and bonds) of insolvent international business enterprises based upon approval of the restructuring by a requisite supermajority of each affected class and judicial review of the adequacy of the restructuring assessed against appropriate international restructuring standards.

23. The principle features of the proposal include the ability to declare a brief moratorium to permit voluntary restructuring discussions to be completed; solicitation of creditor approvals for a restructuring before the

commencement of legal proceedings; an approval requirement of 75 per cent in number and value of affected classes of creditors; expedited insolvency procedures for approval of the restructuring by an insolvency court to make it binding on dissenting creditors; and minimum legal criteria for court approval of the restructuring.

24. The proposal is set forth below.

“(a) Eligible debtors

“1. The procedures under the model statute would be available to any insolvent or defaulting business enterprise with substantial borrowings from foreign persons. Criteria addressing size, for proving insolvency/default status and for establishing that sufficient amounts of debt are held by foreigners would be established. Certain types of regulated debtors, such as financial institutions and insurance companies, might be excluded from the application of the law.

“(b) Parties affected

“2. Under the model statute, restructuring would have to be approved by a supermajority vote of each affected class of claimants. However, only borrowed money indebtedness (institutional and public, whether secured or unsecured) and other similar financial obligations could be adjusted by such a vote. Indebtedness held by other creditors would not be affected unless they individually agreed to adjustment of their claims. Indebtedness such as that of trade creditors, employees and taxing authorities would not be affected by the proposal. Common stockholders and other equity holders could, however, be covered.

“(c) Stay

“3. In many instances, restructuring can be accomplished, even after default, because of the voluntary agreement of creditors to delay collection actions. In order to facilitate restructuring efforts, however, the proposed statute might include an appropriately limited statutory stay on such actions to ensure that restructuring efforts would not be thwarted by creditor action. In connection with a bona fide restructuring proposal, an eligible company could declare a brief temporary stay that would suspend collection activities by affected classes, that is lenders, bond holders and shareholders, but not vendors or employees. Public notice of that declaration would be given by, for example, filing the declaration in the appropriate court, publication or other appropriate means, specifying whether all, or only certain, creditors and shareholders are subject to the stay.

“4. The initial period of application of the stay would be relatively short (e.g., 15 days), but might be subject to extension with the consent of holders of a material portion of creditors in affected classes (e.g., a further 30-60 days with the written approval of a majority in principal amount of each affected class of unsecured creditors). In addition, the stay could be designed to terminate if the debtor sought to effect transactions (e.g., terminate its business or engage in substantial asset transfers) outside the ordinary course of business

or sought, outside of an approved restructuring, to afford preferential treatment to a subset of creditors.

“(d) Acceptance of the negotiated restructuring proposal

“5. After proposal of a restructuring and informal negotiations with representatives of affected creditors and shareholders, the enterprise would solicit acceptances of the negotiated restructuring proposal from affected creditors and equity security holders in accordance with otherwise applicable law.

“(e) Requisite vote

“6. Claims and interests would have to be appropriately classified for voting purposes and the affirmative vote of the requisite statutory majorities in amount and number of claims of each class for approval of the restructuring would need to be obtained. Under the proposed statute, a substantial supermajority vote of each affected class (e.g., 75 per cent in number and value of those voting in each class) would be required for approval of a restructuring.

“(f) Judicial determination of adequacy of restructuring under international criteria

“7. Because the dissenting minority of creditors in each class would be bound by a restructuring under the model statute, judicial determination, applying appropriate international restructuring criteria, should be made as to the adequacy of the restructuring to the dissenting minority of creditors. The effectiveness of a restructuring would be conditioned upon that judicial determination of adequacy. An independent expert could be retained by the debtor company to facilitate judicial review. Eligibility criteria for selection of the independent expert might be specified in the statute. The expert, who would be compensated by the debtor company, would review the restructuring proposal, make findings as to satisfaction, or otherwise, of the international restructuring criteria and issue a report containing such findings. The proposal, together with the expert's report, would then be submitted for approval by an appropriate local court.

“(g) Notice and criteria for approval

“8. Affected parties should be notified of completion of the solicitation procedures and submission of the restructuring for review by the independent expert and final court approval. Expedited procedures for submissions to the independent expert in support of, and in opposition to, the restructuring would also be envisaged. Copies of these submissions would be filed with the Court and a deadline for submissions (e.g., 20 days after publication of notice) and perhaps also for a qualifying report (e.g., 30 days after completion of submissions to the independent expert) might need to be specified.

“9. Upon completion of the independent expert's report, proceedings would be commenced in an appropriate local court (the court) to obtain approval of the restructuring. In order to approve a restructuring over the vote of dissenting creditors in each affected class,

the court would be required to make certain findings of fact and law to establish the adequacy of the restructuring under appropriate international restructuring criteria. In making its determination, the court would be expected to give substantial weight to the independent report. The international restructuring criteria might require the court to conclude, for example, that:

- “(i) The company is eligible to implement a restructuring under the model statute;
- “(ii) The restructuring was proposed, negotiated and solicited in good faith;
- “(iii) Disclosure to each affected class of creditors was adequate;
- “(iv) Creditors and shareholders in affected classes were properly classified, and the requisite supermajorities of each affected class of creditors have agreed to the restructuring;
- “(v) Claims in affected classes having the same status and priority are receiving comparable treatment in connection with the restructuring (except to the extent they have expressly agreed otherwise);
- “(vi) Each non-assenting creditor in an affected class will receive, in the restructuring, property having a value at least equal to what it would receive if the company were liquidated in formal insolvency proceedings under local law;
- “(vii) After effectuating the restructuring, the company is likely to meet its obligations when due; and
- “(viii) In the event that any class of affected equity holders fails to accept the plan, the aggregate indebtedness of the company exceeds the (debt free) value of its business as a going concern (i.e., the enterprise is insolvent).

“(h) *Declaration of effectiveness*

“10. Where restructuring is approved by the court and all conditions for effectiveness of the restructuring are satisfied, notice to affected creditors would be published in accordance with specified procedures and the court would issue a “declaration of effectiveness” (to be given the effect of a binding judicial decree) to the effect that the restructuring was effective under the statute.

“(i) *Discharge and enforceability*

“11. The declaration of effectiveness would discharge any indebtedness extinguished under the terms of the restructuring and local courts would be bound to enforce the restructuring in accordance with its terms.

“(j) *Alternatives to judicial approval*

“12. While the judicial systems of some States may afford the type of cost-effective, expedited review of restructuring proposals required under the model statute, there may be States in which it would be desirable to avoid more cumbersome judicial processes to enhance the potential for successful rescue, to preserve value, to

prevent the loss of employment and production and to lessen the systemic impact of failing enterprises. Options could be considered, drawing upon established practices and structures, to validate restructurings utilizing non-judicial methods—approval procedures that foster expeditious and equitable voluntary out-of-court restructurings are critical to upgrading country risk factors and lessening systemic financial risk, as well as to facilitating both investment and the restructuring of invested capital when that is required.

“(k) *Effect on national law*

“13. National laws that require unanimous agreement to adjust indebtedness outside of insolvency would have to be modified to permit adjustments of indebtedness in restructurings approved in accordance with the proposed model statute. Similarly, where national laws provide that directors or officers of a business enterprise may be liable for trading while insolvent, modification may be needed to provide for some form of relief, after appropriate disclosure, to allow ongoing trading while bona fide efforts to restructure under the model statute are under way.

“(l) *International recognition*

“14. In order to enhance the likelihood that the restructuring under a home country’s model statute will be honoured by courts both at home and abroad, commercial parties could be encouraged to adopt a practice of expressly incorporating application of the model statute into the terms of their debt obligations. The model statute could also provide that the right to restructure indebtedness after insolvency under the model statute is an implied term of each obligation incurred by a local debtor unless expressly disclaimed.

“15. To the extent that issues relating to the binding effect or enforceability of a restructuring under the model statute arise in courts of another jurisdiction, those issues should be addressed consistent with the notions of coordination and cooperation in UNCITRAL’s Model Law on Cross-Border Insolvency. To facilitate this, it may be desirable to provide for a procedure whereby a debtor restructured under the model statute can obtain the appointment of a representative who would be recognized as a foreign representative in other States for purposes of seeking enforcement of the terms of the restructuring.

“16. Finally, the model statute could also contain provisions granting recognition in national courts to restructuring of foreign debtors accomplished under the model statute as enacted in other States.”

VII. WORLD BANK

25. The recently completed report by the World Bank “Principles and guidelines for effective insolvency and creditor rights systems” includes a discussion of informal out-of-court processes in principles 25 and 26 which provide as follows:

“Principle 25: Enabling legislative framework. *Corporate workouts and restructurings should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of or ensure access to timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt write-offs, reschedulings, restructuring and debt-equity conversions; and provide favourable or neutral tax treatment for restructuring.*

“Principle 26: Informal workout procedures. *A country’s financial sector (possibly with the informal endorsement and assistance of the central bank or finance ministry) should promote the development of a code of conduct on an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure—especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more*

likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process. The formal process may work better if it enables creditors and debtors to use informal techniques.”

26. Many of the issues considered above are raised in the discussion of these two principles in the report. The report notes, in respect of principle 26, the development of the INSOL Principles and the background to the increasing use of informal out-of-court processes. In addition to the well-defined initial premises identified in the ADB report as necessary pre-conditions for an effective informal process (see para. 6 above), the World Bank principles add a further one: that the debtor does not require relief from trade debt, or the benefits of formal insolvency, such as the automatic stay or the ability to reject burdensome contracts and the existence of favourable or neutral tax treatment for restructuring both in the debtor’s jurisdiction and the jurisdictions of foreign creditors. The principles emphasize the primary importance of the presence of the sanction, that is the ability to resort to formal processes should the informal processes break down.

D. Report of the Working Group on Insolvency Law on the work of its twenty-fifth session (Vienna, 3-14 December 2001)

(A/CN.9/507) [Original: English]

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I. INTRODUCTION

1. The United Nations Commission on International Trade Law (UNCITRAL), at its thirty-second session, in 1999, had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission of the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country adopted had become a “front line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work at an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session.

4. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had

made in the report on its exploratory session, held in Vienna from 6 to 17 December 1999 (A/CN.9/469, para. 140), and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches that were possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the UNCITRAL secretariat, in cooperation with INSOL International and IBA, organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna from 4 to 6 December 2000.

6. At its thirty-fourth session, in 2001, the Commission took note with satisfaction of the report of the Colloquium (A/CN.9/495) and commended the work accomplished thus far, in particular the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

7. The twenty-fourth session of the Working Group on Insolvency Law, held in New York from 23 July to 3 August 2001, commenced consideration of the work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504.

8. The Working Group on Insolvency Law, composed of all States members of the Commission, held its twenty-fifth session in Vienna from 3 to 14 December 2001. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Morocco, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand and United States of America.

9. The session was attended by observers from the following States: Antigua and Barbuda, Argentina, Australia, Belarus, Bulgaria, Croatia, Cuba, Denmark, Indonesia, Iraq, Lebanon, Libyan Arab Jamahiriya, Nigeria, Peru, Philippines, Poland, Portugal, Republic of Korea, Slovakia, Sri Lanka, Switzerland, Turkey and Yemen.

10. The session was also attended by observers from the following international organizations: American Bar Association, American Bar Foundation, Asian Development Bank, Center of Legal Competence, European Bank for Reconstruction and Development, European Central Bank, Groupe de Reflexion sur L'Insolvabilité et sa Prévention, International Bar Association, International Federation of Insolvency Professionals (INSOL International), International Insolvency Institute and Organisation for Economic Cooperation and Development. The International Monetary Fund also attended as an observer.

11. The Working Group elected the following officers:

Chairman: Wisit WISITSORA-AT (Thailand)

Rapporteur: Jorge PINZON SANCHEZ (Colombia)

12. The Working Group had before it the following documents:

(a) Report of the Secretary-General on the draft legislative guide on insolvency law (A/CN.9/WG.V/WP.57 and 58);

(b) Report of the Secretary-General on the draft legislative guide on insolvency law (A/CN.9/WG.V/WP.58);

(c) Comments by the Commercial Finance Association on alternative informal insolvency processes (A/CN.9/WG.V/WP.59).

13. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on insolvency law.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

14. The Working Group on Insolvency Law continued its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third (New York, 12 June-7 July 2000)¹ and thirty-fourth (Vienna, 25 June-13 July 2001)² sessions and of the Working Group on Insolvency Law at its twenty-fourth session (see A/CN.9/504). The decisions and deliberations of the Working Group with respect to the legislative guide are reflected in chapter III below.

15. The Secretariat was requested to prepare a revised version of the draft guide, based on the deliberations and decisions, to be presented to the twenty-sixth session of the Working Group on Insolvency Law (New York, 13-17 May 2002) for review and further discussion.

III. CONSIDERATION OF DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

A. General remarks

16. The Working Group commenced its discussion of the draft legislative guide with a general consideration of part one and the introduction to part two (A/CN.9/WG.V/WP.57). With respect to part one, it was generally the view that the reference in paragraph 14 to the definition of the term "court" needed to be expanded. It was suggested that a separate section addressing the institutional framework required to support the effective and efficient implementation of an insolvency law was essential; no matter how adequate an insolvency law was, if it was rarely applied or applied badly it could never be efficient or effective. It was noted, however, that addressing the institutional framework would require sensitive issues relating to the judiciary and possible judicial reform to be considered.

B. Part One. Key objectives of an effective and efficient insolvency regime

17. With respect to the key objectives, it was suggested that they could be used as a measuring stick to assess the recommendations to be included in part two and to explain to readers of the draft guide how policy decisions on the various recommendations had been reached. Some concern was expressed, however, that there was an obvious tension between the different objectives, which might render them inappropriate as currently drafted for use as benchmarks. For example, it was suggested that objective 1, which focused on maximization of value, might conflict with objective 2, which required a balance to be achieved between liquidation and reorganization, and that objective 2 was really more a means for achieving objective 1 than a separate objective of an insolvency regime. To address that issue, it was suggested that the objectives could be

¹See *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 400-409.

²*Ibid.*, *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, paras. 296-308.

arranged in a hierarchy and that the ways of achieving a balance between them should be discussed.

C. Part Two. Core provisions of an effective and efficient insolvency system

1. Introduction to insolvency procedures

18. In terms of the processes described in the introduction to part two of the draft guide (see A/CN.9/WG.V/WP.57), general support was expressed in favour of addressing both informal (or out-of-court) processes and the so-called “hybrid” processes (with reservation being expressed as to whether that was the appropriate term by which to refer to processes that started as informal out-of-court negotiations and at some point became formal court-based proceedings). However described, it was noted that the latter processes commenced as entirely informal processes, and whilst the level of agreement necessary to take the arrangement forward might not be achieved, nevertheless a significant level of support from creditors for the proposed plan might be obtained. At that point, it was often desirable to be able to take what had been achieved through informal negotiation into the formal court-based insolvency system in order to create a binding plan. It was suggested that what was required in the insolvency law was the development of a mechanism that would include the necessary protections that could be used to enable the conversion of the informal out-of-court process into formal proceedings. It was also noted that those processes had developed, in practice, to address capital structure problems rather than trade debts (which it was assumed could be managed in the course of trading) and were therefore applicable in a limited number of situations, although not only those involving international debt. It was suggested that where the particular insolvency involved significant amounts of unsecured debt, it might be inappropriate to consider using that type of process, as the unsecured debt might be too large to be addressed by the group of secured creditors.

19. It was suggested that the point of time at which the process might need to be converted into formal court proceedings might differ depending upon the factual circumstances of the specific case. For example, if a moratorium was required, if there was a need for fresh capital or if management needed to be protected against possible liability for improper trading, the process might need to be converted into formal court proceedings at an early stage. If, in comparison, a formal court-based proceeding was needed to address creditors who were holding out against the proposed plan, that conversion might come at a later stage. It was pointed out in response that, if conversion of the process could occur at an early stage, the problems of hold-outs might not arise at all.

20. It was noted that informal out-of-court processes were increasingly supported in practice although the growing diversity of lender groups made them more complex and harder to achieve. It was observed that they operated in the “shadow of the law” with no binding effect and were not therefore part of the legislative framework of an insolvency law. It was observed in response that they were nevertheless important because they were developed to address

certain types of debtor situations and in response to certain disadvantages, in terms of flexibility, speed and cost, of the formal court-based insolvency proceedings. In addition, since those informal out-of-court processes were part of the “hybrid” process, detailed information on them would serve as an introduction to the so-called “hybrid” processes, which included both informal and formal elements, and might also be helpful in addressing how the informal processes could be integrated with formal proceedings. As a further issue, it was observed that the draft guide did not address any international aspects of the informal process.

21. The view was expressed that the two types of process warranted detailed treatment, perhaps in a separate chapter of the draft guide. It was suggested that it might be useful to consider in the chapter the types of debtor and debt to which those processes might apply, how they could be commenced, how they would be supervised, what relief might be required and how they could be completed in terms of voting procedures and the treatment of minority creditors who did not agree with the proposed plan (including for example, their right to be heard, the validity of preferential treatment of certain creditors and issues of fraud). It was suggested that the draft guide should clarify the choice the debtor would have between different options, whether informal negotiation processes or formal court procedures.

22. Another view was that the “hybrid” or expedited court proceedings could be included in the parts of the draft guide dealing with formal reorganization as a further option based on the same standards and requirements for approval of a formally developed reorganization plan. It was suggested that that approach could encourage expedition and foster the use of informal negotiations. It was noted that a number of different organizations were researching the development of those types of processes and that the Working Group’s deliberations might benefit from the outcomes of that work.

23. With respect to administrative processes, it was emphasized that because those processes had developed in response to systemic financial breakdown and were not part of the usual insolvency regime, they should not be addressed in any greater detail or accorded any greater importance than was already included in paragraph 45. It was suggested that a note of caution should be introduced lest the draft guide be interpreted as advocating the development of those processes for general use. In that regard, it was noted that administrative processes often raised issues of transparency, particularly with regard to the acquisition of non-performing loans, and required the development of comprehensive rules to ensure their proper operation.

24. With regard to the relationship between liquidation and reorganization, it was suggested that the draft guide should address the limits required to ensure that the process was not abused by, for example, a debtor or creditor commencing successive proceedings or, where the threshold for liquidation was too low, a creditor commencing proceedings against a debtor in an attempt to gain control of the debtor or its assets. It was also suggested that paragraph 54 should address the situation where a business could be sold

as a going concern in liquidation or where reorganization involved the sale of the debtor's assets or transfer of the business to another entity.

2. *Application for and commencement of insolvency proceedings*

A. *Scope of the insolvency law*^a

25. The Working Group exchanged views as to which debtors should be subject to the insolvency regime.

26. A suggestion was that the insolvency of charities and similar entities should be addressed in the draft guide. In response, it was noted that such inclusion would be inconsistent with the terms of the mandate of the Working Group, which was limited to entities involved in commercial business activities. Accordingly, it was agreed to focus on commercial insolvency only, without prejudice however to the desirability of the draft guide mentioning that national laws could provide for the insolvency regime to be extended to debtors other than business entities.

27. Different views were expressed as to whether individuals should be included within the scope of the insolvency law. A view was that in principle no distinction was to be made on the basis of the individual or corporate structure of the debtor, provided that countries would always be able to include provisions specifically applying to individual debtors only. Focus should rather be put upon the conduct of trade and business, irrespective of the structure of the entity by which the business activity might be conducted. It was suggested that a debt limit might be provided in respect of small business entities with a view to avoiding proliferation of small filings.

28. A different view was that only debtors of a corporate nature should be included, given the limited relevance to the economy generally of insolvency concerning individual or personal business entities. A similar view relied on the assumption that treatment of the insolvency of individuals raised a number of policy and social considerations (including the issue of discharge), which were likely to be addressed in different manners within the various legal systems. Furthermore, the treatment of individual insolvency might prove especially difficult when reorganization was at stake.

29. After discussion, the prevailing view was to avoid distinctions based on the individual or corporate structure of the debtor. The Working Group was reminded that any decision in that respect would have to be accurately reflected in the glossary appearing in the introductory part of the draft guide.

30. It was pointed out that paragraphs 5-7 of the summary and recommendations section addressed issues of international jurisdiction and competence, as such falling outside the scope of the discussion on the identification of the debtors to which the insolvency regime would apply. It was

further observed that it would be inappropriate for a legislative guide to suggest restrictions or limits to national States as to the criteria for international competence in insolvency matters.

31. Some support was expressed in favour of including in the draft guide a discussion of the issues arising in connection with consolidation of multiple debtors and related debt, as well as of the principles that should be followed in addressing those issues, with a view to ensuring that the insolvency of debtors being or acting as connected was treated in an equitable manner.

B. *Application and commencement criteria*^b

32. A suggestion was made that the reference in paragraph 17 of the commentary to the "balance sheet" test as an alternative standard to the general cessation of payments standard for liquidation proceedings was potentially misleading. In that regard, it was noted that a clear distinction needed to be drawn between a test based on the "book value" of the assets and their "market value". It was noted that the market value represented a more reliable measurement of the worth of the business concern, while the book value presented a potentially inaccurate picture of the business as a consequence of variations in accounting practices.

33. The issue of application for the commencement of liquidation procedures was discussed. In the case of creditor initiated applications, it was noted that a single incident of non-payment by the debtor should not suffice to enable a creditor to initiate liquidation procedures (see paras. 20-22 of the commentary). Regarding whether creditors holding non-mature debt should be able to initiate insolvency proceedings, concern was expressed that such a capability carried the potential for abuse by creditors, who might threaten to commence insolvency proceedings in order to pressure debtors to negotiate preferential payments (see para. 20). In that regard, it was noted that paragraph 23 provided that creditors with non-mature claims should perhaps be able to commence insolvency procedures in exceptional circumstances, which might include to prevent incidents of abusive behaviour such as fraud by the debtor. The view was stated, furthermore, that government authorities should not utilize insolvency proceedings to the extent alternative legal means were available to counter illegal acts or acts that might be contrary to public policy.

34. Similarly, the need for flexibility to be expressed in the summary and recommendations section was noted. The view was stated that while it was possible for the same criteria to be applied to applications for liquidation and reorganization, the criteria for reorganization should be broader, in keeping with the principle underlying the draft guide of encouraging bona fide early commencement and reorganization before the debtor became overburdened with debt (see summary and recommendations, paras. 2 and 3). Consistent with that approach, it was further noted that a flexible time in which a court must make a decision on an involuntary application was preferable and that

^aReference document A/CN.9/WG.V/WP.58, paras. 1-9 and related summary and recommendations.

^b*Ibid.*, paras. 10-39 and related summary and recommendations.

specifying a particular number of days for a judicial response might raise constitutional issues in certain jurisdictions (see summary and recommendations, para. 7).

35. A suggestion was made to include an additional subparagraph in paragraph 1 of the summary and recommendations stating that a purpose of provisions in insolvency law on application and commencement criteria was to ensure the adoption of criteria that were transparent and certain.

Costs

36. General support was expressed in favour of the issue of costs being addressed in the draft guide, with a view to preserving the crucial objective of the overall cost-effectiveness of the procedure. More specifically, it was observed that it was important to avoid a situation where the procedure was subject to cost burdens that might work as a deterrent to creditors and therefore frustrate the objectives of the procedure.

37. It was pointed out that clarification was desirable as to the identification of the items that were to be understood under the term “costs”. In that connection, it was suggested that application fees should be addressed separately from fees pertaining to professionals involved in the administration of the estate or other expenses arising with respect to the procedure and that criteria as to their respective ranking within the procedure should be established.

3. Consequences of commencement of insolvency proceedings

A. The insolvency estate^c

38. General support was expressed in favour of the position that the insolvency estate should include all that the debtor owned or in which the debtor had an interest, including those in which secured creditors had rights, at the time of the commencement of the proceeding, as reflected in paragraph 43 of the commentary. However, it was suggested that the draft guide should clarify that the existence of such ownership or interest should be assessed in accordance with the applicable property law, rather than being established in an insolvency law. An alternative view was that such a determination in accordance with applicable property law could frustrate the establishment of an effective insolvency system and, accordingly, that approach should not be followed.

39. In respect of assets acquired after the date of commencement, a concern was that the wording of paragraph 42 might be too restrictive, in that it limited such assets to those acquired “in the exercise of avoidance powers or in the normal course of operating the debtor’s business”. Accordingly, it was suggested that the paragraph could be redrafted to clarify that any assets acquired by the debtor would fall within the scope of the insolvency estate irrespective of the way in which such acquisition occurred.

40. Support was expressed in favour of addressing the treatment of specific contractual arrangements, such as transfers created for the purpose of security, trusts and fiduciary arrangements or consigned goods. As a general remark, it was suggested that the close link existing between the issue of the extension of the insolvency estate, on the one hand, and the treatment of specific claims, on the other, particularly in connection with the scope of the stay to be applied to actions brought by individual creditors, should be addressed.

41. Reference to assets to be “readily found on the debtor’s balance sheets” appearing in paragraph 43 was found to be misleading as those assets were often not found on the balance sheets and its deletion was suggested.

42. In respect of reorganization, the Working Group agreed that the draft guide should clearly spell out the need to include in the estate all the assets that were crucial for reorganization to be successful. In that connection, it was also suggested that an explicit link might be established between the scope of the estate and the purpose of the proceeding (that is, reorganization as opposed to liquidation). A further suggestion was that the draft guide should make a distinction between property or other rights (including security interests) in the assets, which would not be affected by commencement, and the exercise of those rights, which might be limited for the purposes of carrying out the reorganization procedure.

43. As to paragraph 52, it was observed that the ability to sell the assets had to be addressed separately from the issue of the methods or procedures by which such sale had to occur.

B. Protecting the insolvency estate^d

44. The Working Group discussed the issue of the stay and its application in insolvency proceedings. The importance of the stay was noted to preserve the status quo and allow time for a decision to be made regarding reorganization or liquidation as early as possible. The view was stated that the draft guide should emphasize the importance of an adequate judicial infrastructure in order to facilitate the stay.

45. As a general remark it was observed that paragraphs 62 and 63 of the commentary addressed the types of actions to which the stay applied, while the summary and recommendations section focused on the parties to which it would apply. It was suggested that the summary and recommendations should address both issues.

Paragraph 1: purpose clause

46. A number of suggestions were made with regard to the drafting of the purpose clause of the summary and recommendations. It was suggested that the meaning of the phrase “various parties in interest” in subparagraph (a) should be clarified. It was also suggested that the meaning

^cIbid., paras. 40-52 and related summary and recommendations.

^dIbid., paras. 53-83 and related summary and recommendations.

of the phrase “activities to be affected by” in subparagraph (b) was uncertain and should be deleted in order to broaden the application of the text. It was further suggested that subparagraphs (b) and (c) could be merged and that the grounds for relief from a stay could be set forth in subparagraph (d).

Variants 1 and 2: discretionary and automatic application of the stay

47. The draft summary and recommendations set forth two variants: variant 1 providing for a discretionary application of the stay and variant 2 providing for an automatic application of the stay. It was suggested that variant 1 should be deleted and that automatic application of the stay should be recommended. In that regard, it was observed that the discretionary application of the stay by a court discussed in variant 1 was potentially complex and lengthy, with the potential for dismemberment of the assets of the debtor during the time the stay was being considered by the court, whereas the automatic stay enhanced certainty and was more predictable. The importance of an automatic stay in the case of insolvencies involving global tort claims was emphasized.

48. It was noted that while the stay should apply automatically on the commencement of the insolvency proceedings, it would not interfere with the court’s discretion to decide whether proceedings should in fact commence. In addition, it was suggested that provisional measures (which might include a stay) which might apply between the time of the application for commencement and actual commencement would only be available at the discretion of the court. In that regard, it was suggested that the structure of articles 19-21 of the UNCITRAL Model Law on Cross-Border Insolvency could be adopted. Under that approach the stay could be applied on a provisional basis between application and commencement; it would apply automatically on commencement to specified actions, with the possibility of additional measures being ordered at the discretion of the court. That proposal was supported.

49. Although the stay would be generally applicable by reference to the commencement of the proceedings, it was proposed that the language of the draft guide needed to be more specific. It was noted that in some jurisdictions, the stay became effective as of the time of the court’s decision to commence proceedings, in others when the decision as to commencement became publicly available, while in yet other jurisdictions the stay became effective retroactively from the first hour of the day of the order. It was noted that the rules on the time at which the stay applied would be important to protection of the estate and in terms of the application of the stay to payments and the need to minimize systemic risk.

Paragraph 3: provisional measures

50. The Working Group agreed that provisional measures should be available to address the period between the application for commencement of proceedings and commencement and it was suggested that the draft guide might

further discuss the reasons why such discretionary provisional measures might be necessary. As to the scope of provisional measures available, it was suggested that they should be limited to execution actions.

Scope of the stay

51. As to the scope of the stay, various suggestions were expressed as to what might be covered and to whom it should apply. It was noted that, as drafted, the recommendations provided that the stay would apply to both secured creditors and unsecured creditors, but not to third parties. It was observed that actions against the estate by parties who were not creditors, such as personal injury claimants, might need to be considered, as well as directors (particularly where they had provided guarantees in respect of the indebtedness of the debtor) and, in the case of reorganization, managers (at least until the reorganization plan was approved). It was noted that that approach would require a distinction to be drawn between the application of the stay in liquidation and reorganization. As to the types of actions that should be covered, it was suggested that the language of article 20 of the UNCITRAL Model Law on Cross-Border Insolvency might indicate an appropriate approach.

Paragraphs 5 and 6: duration of the application of the stay to secured creditors and relief from the stay in liquidation

52. The view was stated that paragraph 5 should provide as a default rule the application of the stay to secured creditors for a short period, after which they could attempt to enforce against their security unless the insolvency representative requested the court to extend the stay. Some support was expressed in favour of that approach. Another view was that a distinction could perhaps be drawn between liquidation and reorganization, with the stay applying for a short period only in liquidation. It was noted that it was often the case that secured creditors were over-secured, and while they would generally seek to take every opportunity to enforce their security and remove themselves from the insolvency situation, there was no reason why the stay would not continue to apply to them for the duration of the proceedings. In light of the administrative burden placed upon the insolvency representative, it was suggested that a default rule that required the insolvency representative to take action to extend the stay might constitute an unnecessary additional burden and encourage litigation. It was observed that paragraph 5 as currently drafted had the advantage of flexibility in that it left to the court the decision to provide a remedy if there was prejudice to the secured creditor or creditors.

53. The provision of relief from the application of the stay for secured creditors as set forth in paragraph 6 was discussed. As an initial matter it was noted that providing an exception for secured creditors risked facilitating the dismemberment of the insolvency estate thus frustrating the goal of the insolvency proceedings and the stay, which was designed to ensure the protection of the estate. As such, it was suggested that allowing a secured creditor to realize its security might constitute a preference that could not be

justified. It was also noted that since certain jurisdictions granted the same level of priority to employment-related claims as to secured creditors, those employee claims might also be granted relief from the stay. In that regard, it was noted that some jurisdictions provided certain classes of claims with a “super-priority” for a specified period, including claims for wages due, and that in others employee contracts received special treatment under labour-related laws. The view was expressed that the exception in paragraph 6 should not be allowed to result in some additional priority being given to secured creditors at the expense of other creditors. If relief from the stay was to be granted, the draft guide should clearly set out the applicable grounds, whether lack of adequate protection, reduction of the value of the security or others.

54. The view was stated that the protection potentially available to secured creditors through paragraph 6 was generally acceptable. It was noted that, as currently drafted, each of the criterion listed in paragraph 6 had to be met in order for the secured creditor to gain relief. In comparison, paragraph 10 was seemingly satisfied if a single element was met. It was suggested that if, in the light of the discussion in the Working Group, those two paragraphs were still required, further consideration of the language might be needed.

Paragraph 9: application of the stay in reorganization

55. It was observed that paragraph 9 addressed the principle of the equality of secured and unsecured creditors. The view was expressed that since secured creditors could apply for relief from the application of the stay after a period of time, while unsecured creditors did not have such an option, paragraph 9 might need to be revised to reflect the actual position of the parties.

Paragraph 10: lifting of the stay applicable to secured creditors

56. It was suggested that if a reorganization was to be a decisive means of reconciling all claims, including those of secured creditors, the stay against secured creditors should apply until approval of the plan as a means of achieving a balance between secured creditors and collective interests. Allowing secured creditors to lift the stay prior to that time could jeopardize reorganization and result in prejudice to other creditors. There was general agreement that relief from the stay for secured creditors was warranted where there was no realistic possibility of reorganization and the proceedings might be converted to liquidation. A question was raised as to what would occur where the proceedings were converted to liquidation in terms of the stay. It was pointed out that if the rules on application were the same for both proceedings no issue arose, but where they were different the insolvency law would need to address the question of which rules would apply.

57. It was observed that while paragraph 5 proposed application of the stay for a limited period, that consideration was not reflected in the drafting of paragraph 10, which did not establish a limit for the duration of the stay.

The related issue of potential abuse by debtors who filed repeated applications for reorganization (in circumstances where there was no prospect of a reorganization plan being approved) to keep secured creditors at bay was noted and the inclusion of safeguard provisions suggested. The view was also expressed that the issue of abusive tactics perhaps could be better addressed in the portion of the draft guide dealing with reorganization plans. It was also noted that paragraph 10 did not address the issue of “adequate protection” for the secured creditor, although that was raised in paragraph 11. It was suggested that the concept of “adequate protection” might need to be expanded and should refer, among other things, to the possibility that in addition to fixing the value of the secured assets as of a specific date, the secured creditor should be able to obtain replacement liens or other types of protection.

C. Treatment of contracts^e

58. The Working Group exchanged views as to the treatment of contracts that had not been fully performed by either party upon commencement of the insolvency proceedings.

59. As to the overall structure of the chapter and the relevant recommendations, it was suggested that the issues of continuation and termination, on the one hand, and that of assignment, on the other hand, should be addressed separately. Some concern was expressed as to what was to be covered by the reference to “contracts” and it was suggested that some explanation should be set forth in the draft guide. It was also suggested that a reference to “contracts” was perhaps inappropriate and should instead be to the obligations continued or terminated.

60. Support was expressed in favour of mentioning in the recommendations the criteria upon which the insolvency representative should decide whether to continue or terminate a contract, it being understood that the exercise of those powers was exceptional and that any criteria for their exercise must relate to the goals of maximizing the assets for the benefit of creditors. In response, it was observed that including those criteria in the text of the legislative recommendations might give rise to uncertainty and that, accordingly, they should rather be set forth in the commentary section of the draft guide.

Paragraph 1: purpose clause

61. The use of the term “interfere” in paragraph 1 (a) of the summary and recommendations to designate the power of the insolvency representative to either terminate or continue contracts was felt to be inappropriate, since it might suggest a power to vary the contents of the contracts. Accordingly, it was suggested that the paragraph simply refer to “the power to terminate or continue” or be drafted without referring to the party that might have the ability to exercise those powers.

^eIbid., paras. 84-123 and related summary and recommendations.

62. A further concern was expressed in respect of limiting the exercise of the power to either terminate or continue contracts to the insolvency representative. It was pointed out that such a limitation might be too restrictive for those legal systems where an insolvency representative was not appointed and the insolvency estate remained in possession of the debtor. Some support was expressed in favour of addressing that situation in the commentary section of the draft guide. An alternative suggestion, that the definition of “insolvency representative” contained in the glossary could be amended so as to encompass the debtor in possession, was objected to on the basis that the general definitions should avoid mentioning devices or mechanisms that were peculiar to only some legal systems and that the concept of the insolvency representative as used throughout the draft guide seemed to suggest the need for both qualifications and relevant competency.

63. After discussion, the Working Group reaffirmed as a general view that the draft guide should focus on the insolvency proceeding being conducted by an entity appointed by or operating under the control of the court.

Paragraphs 2 and 3: termination of contracts

64. With respect to paragraph 2 of the summary and recommendations, which provided for termination of contracts, it was noted that in practice often no decision was taken in respect of outstanding contracts because they simply could not be performed and that requiring an explicit choice to be made for any single contract would result in an excessively costly and cumbersome procedure. It was suggested that that point should be reflected in the draft guide as an underlying premise of the chapter.

65. Another view was that a specific time limit should be provided within which the insolvency representative was required to make its decision to either continue or terminate a contract, with a view to providing certainty. That time limit should be reasonably short (a 45-60 day deadline was proposed) and be combined with a default provision to the effect that all contracts for which no decision had been taken within the deadline would be deemed to be terminated.

66. While that proposal was widely supported, it was pointed out that automatic termination by operation of a default provision should only apply to contracts that were not only outstanding at the time of commencement, but also known to the insolvency representative. No automatic effect would be acceptable when the insolvency representative was not aware of a contract and therefore not in a position to make a choice. Furthermore, the consequences of failure to take a decision within the prescribed time limit (that is, whether termination or continuation), were likely to involve both cost and issues of professional liability if the termination or continuation were found to be contrary to the interests of the insolvency estate.

67. Another view was that the issue of automatic termination should be treated differently depending on whether liquidation or reorganization was at stake. While, in principle, automatic termination would be acceptable in a

liquidation procedure, more flexibility was needed in respect of reorganization, with a view to avoiding the situation where the failure to take a timely decision deprived the estate of a contract that might be crucial for the procedure. The suggestion that the insolvency representative should be allowed to seek an extension of the deadline for those contracts which were deemed to be possibly useful for the estate, however, was objected to on the basis that it could exacerbate the administrative burden already borne by the insolvency representative and would conflict with the need for flexibility.

Paragraph 4: effect of termination

68. It was further suggested that the issue of control of the decisions of the insolvency representative should be addressed in a broad provision dealing with the consequences of those decisions, including damages, as currently mentioned in paragraph 4. In that connection, the prevailing view was that damages possibly arising in connection with termination of contracts should be subject to the general rules on damages, and also the determination of quantum. Those rules should apply without prejudice to the effectiveness of indemnification clauses being subject to the control of court. The proposal that such damages could be treated as debts of the insolvency estate and given priority was not supported on the grounds that many claims in insolvency arose from breached contracts and an approach that accorded them priority would give to those claims an excessive advantage not supported by general policy considerations. It was also noted that in some cases there might be justification for limiting the claims arising from termination, such as in a long-term lease where the outstanding period of the lease could lead to large claims and the lessee in any event had an opportunity to mitigate its potential losses. A similar situation might arise in respect of employment contracts where the employee often had an opportunity to seek alternative employment.

Paragraphs 5 and 6: continuation of contracts

69. General support was expressed in favour of set-off being allowed in respect of contracts other than financial contracts. As a general remark, it was suggested that the systemic implications of financial contracts required their exclusion from the scope of the power of the insolvency representative to continue or terminate contracts and that the reasons supporting that exclusion should be mentioned in the draft guide. It was further suggested that loan accommodations should also be expressly mentioned as deserving special treatment.

70. Concern was expressed that employment contracts should be treated in the insolvency law differently to other contracts, although it was noted that they might be subject to other laws which might, for example, accord them a high priority in terms of claims. It was also suggested that the question of whether the treatment of employment and similar contracts in an insolvency context should be dealt with by the insolvency court or some other specialized administrative or judicial bodies should be left to national laws and not addressed in the draft guide. The Working Group reaffirmed that the issue of termination of certain classes of

contracts involving weak parties, such as employment contracts, should be left to the discretion of national legislators and accordingly that the drafting of paragraph 5 should be amended from “should” to “may”. It was suggested that the draft guide might suggest to national legislators that a device for protection of those parties, possibly including social security systems and the like, should be considered.

Paragraph 7: termination clauses

71. Several views were expressed in respect of the treatment of clauses providing that the commencement of insolvency proceedings constituted an event that could lead to termination of the contract. While recognizing the desirability of the draft guide mentioning possible different levels of invalidity, as currently provided in paragraph 7, it was pointed out that it was for the law and not for the insolvency representative to establish that such a clause was either null and void or ineffective. Accordingly, the insolvency law might provide for those clauses to be either ineffective vis-à-vis the insolvency representative or void tout court. As a matter of drafting, it was further suggested that the opening words of paragraph 7 might be amended to clarify that termination under such a clause was the effect of the commencement of the proceedings rather than of the clause as such.

Paragraph 8: effect of continuation

72. Some support was expressed for the view that paragraph 8, referring to the regime of claims arising from contracts continued by the insolvency representative, should be interpreted to mean that claims arising in that connection should be treated as a debt of the estate and given priority as expenses of administration of the estate. A contrary view was that according such claims a priority could not be justified. It was also pointed out that the issue was linked to the one of post-commencement financing and might therefore also be addressed in that context.

Paragraphs 9 and 10: assignment

73. In respect of assignment, support was expressed in the Working Group for retaining the provision providing for the assignment of the contract by the insolvency representative upon approval of the court, irrespective of the existence of an assignment clause and of the agreement of the parties. Some concern was expressed however that the matter should be governed by the general law of contract, rather than be subject to special rules in an insolvency law. Under that approach if the parties to the contract agreed to the assignment it could occur and if not, no assignment could be made. It was suggested that if the provision were to be retained as an exception to general contract law, some qualifications as to the circumstances in which such an assignment could take place might need to be added. Support was also expressed for enabling the insolvency representative to override non-assignment clauses whenever those clauses were allowed under the general law of contracts. In that connection, it was pointed out that the term “non-assignment clauses” should include clauses with the effect of restricting assignment as well as prohibiting it.

Paragraph 11: exercise of the insolvency representative's powers

74. It was recommended that the rules stated in paragraphs 9-11, providing for the power of the insolvency representative to decide upon termination, continuation and assignment of contracts without approval by the court, should be subject to the right of interested parties to seek judicial review of decisions taken by the insolvency representative and should be realigned in the light of the discussions on other paragraphs of the summary and recommendations section.

D. Avoidance actions^f

75. Following some suggestions as to the appropriate terms to be used in the context of avoidance actions in different languages, the Working Group agreed to focus on the substantive regime and to defer terminology issues to a later stage.

76. As a preliminary remark, it was pointed out that the draft guide should clarify that avoidance actions were specifically aimed at preserving the integrity of the estate and the fair treatment of creditors within the context of insolvency, without purporting to replace or otherwise affect other devices for the protection of the interests of creditors that would be available under general civil or commercial law.

Paragraph 1: purpose clause

77. In that connection, a concern was that reference to the fraudulent nature of the act, appearing in paragraph 1 (a) of the summary and recommendations section as a ground for avoidance as an alternative to the act being in violation of the equal treatment of creditors, might be misleading and that both references should therefore be deleted. In response, it was observed that mention of fraudulent acts could be usefully retained as a specific example of an act prejudicial to the creditors as a whole, provided that either the commentary or the summary and recommendations section, or both, clarified that avoidance actions brought against fraudulent acts were aimed at allowing the reintegration of the estate.

78. As a matter of drafting, it was suggested that the provision might be usefully simplified by replacing the phrase “the circumstances in which certain transactions which occurred prior to insolvency proceedings” by the phrase “the circumstances in which transactions prior to insolvency proceedings”.

79. The suggestion that paragraph 1 (c), mentioning recovery of money or assets from third parties as one of the purposes of avoidance actions, should be deleted was objected to on the grounds that the provision might usefully serve a pedagogic function.

^fIbid., paras. 124-151 and related summary and recommendations.

80. As to the relationship between variant 1 and variant 2, it was noted that each one addressed different issues arising in the context of avoidance actions and therefore both were proposed for discussion by the Working Group.

Paragraph 2: transactions capable of avoidance—variants 1 and 2

81. Satisfaction was expressed with the degree of detail provided in variant 1 in respect of the types of acts to be addressed, the circumstances triggering the possibility of avoidance and the duration of the suspect period respectively applying to them. A suggestion was that the paragraph might reflect also the core elements of the main categories of avoidable transactions (that is, fraudulent, undervalued and preferential transactions), as respectively set forth in paragraphs 134, 135 and 136 of the commentary.

82. Various views were expressed as to the determination of the period prior to commencement during which transactions would be subject to avoidance (the “suspect period”). One view was that it would not be feasible to identify a single, specific period that would adequately address the cases that might occur in practice and that a flexible approach would be preferable. In response, it was observed that a fixed period was needed for the purposes of legal certainty. Whilst avoiding the suggestion of a specific period, there was support for the view that the period had to be conveniently short and that clarification should be provided as to the moment at which it started to run.

83. The Working Group agreed that a distinction had to be drawn between the issue of determination of the suspect period, on the one hand, and the limitation applying to the right of the insolvency representative to bring an avoidance action, on the other hand.

84. Strong support was expressed for avoidance of transactions involving “related persons” and “insider creditors” being specifically addressed. Whilst clarification as to the persons respectively included in those categories was recommended, possibly by supplementing the glossary and bearing in mind that entities other than individuals might also qualify as “related persons”, it was suggested that those transactions could be addressed in a separate paragraph rather than listed as a distinct category of avoidable acts. Reasons therefor included the need to establish special, derogatory rules for those transactions both as to evidentiary issues and the duration of the suspect period.

Paragraph 3: extension of the suspect period

85. Opposition was voiced against the court being able to extend the duration of the suspect period, as provided in paragraph 3. It was suggested that the discretion of the court in that respect could result in an excessive degree of uncertainty being cast over business transactions as a whole and in the impairment of the overall crucial goals of legal certainty and predictability.

86. A concern was that fixed time limits might not be adequate to address the issue of prejudicial transactions concealed by the parties that were discovered after

expiration of the period in which an avoidance action could be brought. In response, it was noted that (a) the limitation period of the right to bring the action would not run prior to those actions becoming known to the insolvency representative, pursuant to the general rules governing limitation, and (b) those situations might be addressed by resorting to the remedies provided and still available under laws other than insolvency law, including remedies of a criminal nature.

Paragraphs 4 and 5: evidentiary issues

87. The Working Group agreed that the draft guide should provide advice in respect of the treatment of evidentiary issues arising in connection with avoidance actions. It was recalled that in many legal systems presumptions covering one or more of the requirements of avoidance actions and, accordingly, reversal of the burden of proof upon the counterparty of the debtor were provided. Accordingly, it was advocated that the draft guide should clearly identify the elements to be proven and the elements to be presumed, in the latter case also specifying whether such presumption was rebuttable. Nevertheless, a note of caution was struck to the effect that the draft guide should avoid providing excessively detailed qualifications, especially on issues of a procedural nature, as those could be left to national laws. In that connection, it was reaffirmed that the purpose of a legislative guide, as opposed to a model law, was not to be prescriptive but rather to provide guidance to legislators by highlighting issues and setting out policy options with a view to possibly recommending one or more among them.

88. As to paragraph 5 (b), it was pointed out that requiring the counterparty to an allegedly fraudulent transaction to establish the debtor’s innocent motive would be tantamount to preventing that party from being successful in resisting avoidance, since it might be impossible for it to provide such evidence. Furthermore, it was noted that the solution was inconsistent with the approach taken by a number of legal systems, where good faith was presumed and only evidence of bad faith might be required.

Paragraph 6: failure to pursue avoidance actions

89. Support was expressed for including in the draft guide a discussion dealing with the failure of the insolvency representative to file avoidance actions. While agreeing that, in principle, creditors should be allowed to exercise such actions, the Working Group recommended that the draft guide should clarify, whether in the commentary or in the summary and recommendations section, that such power was to be exercised to the exclusive benefit of the insolvency estate and of creditors as a whole. Furthermore, the draft guide should establish whether creditors would be entitled to recover from the estate any costs borne in connection with the avoidance action brought in the interest of the latter and whether, if in the affirmative, that claim would be given priority. With a view to avoiding frivolous actions by creditors resulting in the disruption of the estate, a prior approval by the court could also be provided.

90. A different view was that failure by the insolvency representative to bring avoidance actions should rather entail criminal or administrative sanctions against the

insolvency representative, including the appointment of a substitute representative. In response, it was clarified that a distinction was to be drawn depending upon the circumstances of the case. Failure to act due to negligence or bad faith (or, more generally, not supported by adequate justification) needed to be addressed otherwise than failure due to the insolvency representative estimating that the avoidance action was not likely to succeed and would rather result in costs being imposed on the estate. Accordingly, the draft guide should clarify that it was for the court to assess the reasons for failure to act by the insolvency representative. Furthermore, it was suggested that the draft guide might address the issue of the exercise of avoidance actions in those systems where no insolvency representative or other administrative authority was provided.

Paragraph 7: transactions after commencement

91. Support was expressed for the view that transactions occurring after the commencement of proceedings, currently covered by paragraph 7, did not fall within the scope of avoidance actions. While post-commencement transactions might be considered ineffective or void, depending on the legal system in question, avoidance actions were generally conceived as a device allowing acts performed prior to commencement that were prejudicial to creditors but that would be valid outside the insolvency context to be rendered ineffective. Accordingly, transactions carried out after commencement should be addressed in a different section of the draft guide and possibly be subject to a different treatment depending on whether liquidation or reorganization was at stake. Suggestions in that respect included dealing with that issue within the context of the administration of the estate, the application of the stay or the powers of the insolvency representative.

92. As to substance, a view was that the provision should be more specific as to the various regimes that might apply to post-commencement transactions. Establishing voidability as a general rule was felt to be inappropriate, given that a wide range of solutions were adopted in different legal systems, including those transactions being subject to control and possible approval by the court, or their being valid but entailing the substitution of the insolvency representative. Accordingly, support was expressed for the provision to be redrafted to the effect that distinctions as to the type of act and the context (that is, liquidation or reorganization) in which it was carried out would be included. In that connection, a system of authorizations by the court and a more favourable treatment for transactions carried out in the ordinary course of business were suggested.

4. Administration of proceedings

A. Debtor's rights and obligations³

General remarks

93. It was observed that a section on the debtor's duties was important to the draft guide, since the proper carrying

out of those duties (particularly the duty to cooperate with the insolvency representative and the other authorities supervising the process) was often crucial for the success of both liquidation and reorganization proceedings.

94. It was suggested that the ancillary obligations implied by the debtor's duty of cooperation should be specifically identified and addressed for the purposes of transparency and predictability. Those might include the obligation (either of the individual debtor or of managers and directors of an insolvent company) not to leave their habitual place of residence, to disclose correspondence to either the insolvency representative or the court and other limitations touching upon personal freedom. It was observed that those limitations and their extension to company directors and officers were crucial to avoid disruption of the procedure by the common practice of individual debtors leaving the place of business and of directors and managers resigning from office upon commencement. A note of caution, however, was sounded as to the need to ensure that those ancillary duties were proportionate to their underlying purpose and to the overall purpose of the general duty to cooperate.

95. General support was expressed for the suggestion that the section should be supplemented by setting forth the remedies that would apply upon failure by the debtor to comply with its duties.

Paragraph 1: purpose clause

96. A suggestion was that paragraph 1 should be drafted along the lines of "(a) To ensure that full and proper information regarding the debtor, its assets and financial affairs is provided to the insolvency representative in a timely manner; (b) To identify the person or persons having the responsibility to provide such information."

Paragraph 2: right to be heard

97. The Working Group agreed to the need to preserve the right of the debtor to be heard during the procedure and that that right should be distinguished from any right to participate in the proceedings. Some suggestions providing that the scope of the right to be heard should be restricted to "matters affecting the interests of the debtor", pursuant to the approach taken in some legal systems, or be otherwise determined on the basis of whether liquidation or reorganization was at stake, did not receive support. It was observed that the right to be heard was established in the interest, and for the protection, of the debtor and touched upon fundamental issues of constitutional rights, which were not affected by the nature or purpose of the specific procedure involved.

98. A view was expressed that reference to the need to prevent the right to be heard from being abused by the debtor was not necessary, since abuse was prohibited as a general principle of law. However, a different view was that a specific mention in that context might be useful as a possible deterrent to attempts by the debtor to abuse that right with a view to obstructing the expeditious and effective conduct of the proceedings.

³Reference document A/CN.9/WG.V/WP.58, paras. 152-170 and related summary and recommendations.

99. It was suggested that the right of the debtor to participate in the decision-making process would have a wider scope in reorganization than in liquidation and that the reference appearing in square brackets should be appropriately supplemented.

100. Concern was expressed in response to the suggestion that the debtor should be given the right to be informed on matters pertaining to the proceedings, whether by the insolvency representative or by the court. On the one hand, it was felt that that right would impose an excessive burden upon the administration of the insolvency. On the other hand, it was observed that nothing in the law should prevent the debtor from requesting information from the insolvency representative or the court.

Paragraph 3: debtor's obligations

101. Support was expressed for including in the draft guide a recommendation to the effect that the obligations of the debtor should be expressly identified in the law, possibly by clarifying both their contents and the persons to whom the benefit of those obligations was to accrue. A related suggestion was that a qualification might be included in respect of those systems where no insolvency representative was appointed. It was suggested that the duty of the debtor to respond to requests for information by the insolvency representative or the court might be clearly set forth as a specific aspect of the general duty to inform, with a view to enhancing its effectiveness.

102. As a matter of drafting, it was suggested that the provision might be more effective if reformulated and expressed directly (that is, "the debtor shall cooperate . . ."). It was also suggested that the reference to the obligation of the debtor to provide "current" information on its affairs might be read as limiting that duty to the time of commencement, whereas relevant information covering periods prior to commencement had also to be provided. Accordingly, "past" information should also be required and a qualification to the effect that information had to be not only accurate and reliable, but also "complete", should be added to the paragraph.

103. Several views were expressed to the effect that the obligation to provide information to the court and the other insolvency bodies should be extended to any person or entity that might be in a position to provide information, including banks, financial institutions and the directors or officers of related companies. The issue of the boundaries of the power of the insolvency representative to request information from third parties was however felt to be a sensitive one, since it might conflict with confidentiality or similar duties to which those parties were equally subject. As a general remark, it was observed that the draft guide needed to clarify whether the power of requesting information from third parties, when provided, was as wide as the one vested in the insolvency representative vis-à-vis the debtor. It was further pointed out that such extension might be considered as a specific aspect of the general issue of the regime affecting third parties in the context of insolvency and that a section addressing those issues should be included in the chapter on the administration of the

procedure. Finally, it was recalled that the issue of the rights of third parties was addressed in the draft guide to enactment of the UNCITRAL Model Law on Cross-Border Insolvency. After discussion, the Working Group agreed that the topic should be further discussed at a later stage.

104. The need for insolvency law to provide remedies for failure either of the debtor or a third party to comply with their obligations, with a view to ensuring the effectiveness of those obligations, was reaffirmed. Differing views were expressed as to whether the draft guide should address that need by recommending that those remedies should be provided, or by suggesting specific types of remedies (including criminal sanctions, disqualification from professional or trade associations or, in respect of individual debtors, exclusion from the benefit of discharge).

Paragraph 4: information to be provided

105. It was suggested that paragraph 4 should appear as subparagraph (c) of paragraph 3, since it clarified the ways in which the objective underlying the debtor's duties to cooperate and inform might be achieved.

106. As to substance, several views were expressed as to the type of information to be submitted by the debtor. A view was that the obligation to surrender financial statements, accounts and books should be explicitly mentioned as a crucial aspect of the duty to provide information. Furthermore, disclosure of all transactions had to be provided, irrespective of whether they were capable of avoidance or not, since it was not for the debtor to decide upon issues of avoidance. After discussion, support was expressed for the proposal that mention of some of the documents to be provided should be supplemented by a general provision stating the debtor's obligation to submit any and all information that the insolvency representative might reasonably require.

107. While agreeing that timely submission of any relevant information had to be ensured, it was pointed out that the duty to provide information should be effective throughout the procedure and, accordingly, reference to commencement in the last line of the paragraph should be deleted.

108. Some support was also expressed for the proposal that an obligation to disclose any outstanding relationship to insiders and related entities should be provided, without prejudice, however, to the need to take account of issues of confidentiality that might arise.

Paragraph 5: sanctions

109. Support was expressed for adequate measures for obtaining the relevant information being provided in the draft guide, not only in respect of possible failure by the debtor to comply with its duty, but rather as a broad principle with a general scope. In that connection, the word "alternative" might lend itself to misunderstanding and, therefore, should be deleted.

110. According to one view, the power of the insolvency representative to require and obtain information from parties other than the debtor might be appropriately addressed in the context of the section on the debtor. A different view was that the issue related to the section on the rights and duties of the insolvency representative. The Working Group reaffirmed the need for the draft guide to deal specifically with the position of third parties.

Paragraph 6: confidentiality

111. While agreeing on the need to ensure confidentiality, given the commercially sensitive nature of most of the information relevant to insolvency proceedings, it was pointed out that the draft guide might recommend to legislators the need to coordinate the insolvency and the procedural laws in that respect.

Paragraph 7: management of the debtor—liquidation

112. Generally, it was felt that the provision should focus on the position of the debtor rather than of the insolvency representative, consistent with the subject matter of the section, and address the role of the debtor in both types of proceeding. In liquidation, for example, the debtor should transfer assets to the insolvency representative (depending upon whether that occurred automatically on commencement or required some physical surrender by the debtor) and assist the insolvency representative in the disposal of assets.

Paragraphs 8 and 9: management of the debtor—reorganization

113. Support was expressed for paragraph 8 to be amended to align it with the discussion contained in paragraphs 154-160 of the commentary, with a view to reflecting the different options as to management in the context of reorganization. The same suggestion, it was noted, could be extended to paragraph 9.

114. Several concerns were expressed in respect of the “sharing arrangement” mentioned in both paragraphs on the basis that it might suggest a private agreement. It was pointed out that in most legal systems rights and duties respectively pertaining to the debtor and the insolvency representative were not a matter for the parties to agree on but were rather provided and governed by the law. It was noted that the prohibition on the sale of assets by the debtor, as provided in paragraph 8, did not accurately reflect the power of the debtor to take any action as might be required in the ordinary course of business. A further suggestion was that the two paragraphs could be merged into one.

115. It was suggested that the draft guide should address the issue of liability of the debtor, directors and managers, including material along the lines of paragraph 170, and clarify whether the estate would be liable for any damages caused by the actions of those persons and bodies. More specifically, the draft guide should reflect the fact that different liability regimes would apply depending on whether

fraudulent or negligent conduct was implicated. It was suggested that a specific recommendation on the issue of liability might be included, irrespective of the fact that in many legal systems liability matters might be and often were governed by laws other than insolvency law. Another view was that the issue of liability should rather be addressed within the context of the duties of the insolvency representative.

116. As to the duty adequately to remunerate professionals or companies having carried out work in the interest of the insolvency estate, it was agreed that the principle should rather be addressed in the context of the duties of the insolvency representative.

B. Insolvency representative’s rights and obligations⁴

117. At the outset of the discussion it was noted that the definition of “insolvency representative” in the glossary in part one of the draft guide referred to the possibility that the insolvency representative might be an “entity”. The question was raised of how the obligations contained in the summary and recommendations section would apply in that case. In response it was observed that current practice in some countries included the appointment of both individuals and entities; where it was an entity that was appointed it was generally on the basis that the individuals who would undertake the work for the entity were qualified and the entity itself was subject to regulation. It was also noted that in cases where the insolvency representative was an officer of a government authority, the draft guide might need to reflect the manner in which that appointment might affect issues such as liability, remuneration and appointment qualifications. A further consideration was that in all respects the key objective of transparency should be reflected in the procedures for appointment of the insolvency representative and its conduct of the proceedings, although it was suggested that it was of relevance to the insolvency process more broadly, including all participants in the process.

Paragraph 1: purpose clause

118. A drafting suggestion was that subparagraph 1 (a) of the summary and recommendations should refer to the “insolvency representative” rather than to a “person” and that a reference to “qualifications” should be included in addition to “functions”.

Paragraph 2: appointment of the insolvency representative

119. With regard to the method for appointment of the insolvency representative, it was suggested that there were additional examples, which could be included in the draft guide, such as appointment by the debtor (or directors of the debtor), in some cases without authorization by the court, but with safeguards similar to those discussed in paragraph 7, or appointment by a governmental authority.

⁴Ibid., paras. 171-186 and related summary and recommendations.

It was also observed that in some legal systems the insolvency representative could be a government or public official or a group of experts, which might involve appointment processes additional to those included in subparagraph 1 (b). Some concern was expressed about the need to include in the recommendation a reference to a provisional appointment; that should perhaps be addressed in the section dealing with the stay and provisional measures. It was observed, however, that it was not simply a question of the timing of the appointment but rather the possibility of a difference in qualifications, experience and functions. Where such a provisional appointment was made, it was noted that it would only be by order of the court and not by any other means. It was questioned whether there might be cases where no insolvency representative was appointed.

Paragraph 3: qualifications

120. It was suggested that since the term “fiduciary” was known in only some legal systems it should not be used in the draft guide and was in any event implicit in the reference to obligations. Similarly the term “fit and proper” was common in only some systems and might be confused with the notion of competence; it was noted that the term was usually concerned with good character and an absence of criminality, rather than with competence. It was observed that in some legal systems, the method of appointment would determine the necessary qualifications of the insolvency representative (for example, where appointed by creditors, the insolvency representative might have to be a creditor). It was noted that some legal systems included a condition relating to the nationality of the insolvency representative and the issue was raised of how that could be defined by an insolvency law.

Paragraph 5: conflicts of interest

121. It was suggested that paragraph 180 of the commentary should refer to “prior or existing relationships” and give examples of what that might include, such as existing or prior ownership of the debtor, prior business relationships with the debtor or representation of the debtor (in the case of a professional). It was also suggested that the degree of relationship should be addressed, for example, membership of a firm that had represented the debtor, or family members who had had some connection with the debtor. A further example of a possible conflict of interest was given of one law that prevented an insolvency representative appointed in a reorganization from being appointed or continuing to act in the event that the reorganization proceedings were converted to liquidation. It was noted that the paragraph as drafted simply required disclosure, but it was suggested that it should go further and state that an insolvency representative could not act as such where there was a conflict of interest or lack of independence. In response, a concern was expressed that except in obvious cases, it would often be difficult to determine whether there was in fact a conflict of interest or lack of independence and that provided disclosure had been made, the appointment could generally proceed. A further view was that impartiality was essential, not merely desirable, and that if required, the court could be asked to make the

appropriate determination. It was suggested that any insolvency representative proposed for appointment should have a duty to disclose potential conflicts.

122. Another approach to a lack of impartiality or independence might be provided by specific sanctions or in terms of the remuneration of the insolvency representative. It was noted that some laws provided that disclosure was a condition of appointment, so that if a conflict arose after appointment, sanctions could be applied.

Paragraph 5: functions

123. It was suggested that the functions set out in paragraph 173 of the draft guide could be included in the summary and recommendations section, in order to provide the clarity and specificity recommended. A different view was that the list in paragraph 173 was too long and should either be cross-referenced to the summary and recommendations or shortened by creating general categories to describe the functions enumerated and distinguishing between liquidation and reorganization. To supplement the list and ensure that it should not be interpreted as exhaustive, the words “as specified by the court” could be added at the end of the list. A further suggestion was that the list should make reference to the function of managing the debtor’s operations and to the obligation to report to the authorities any behaviour of a criminal nature of which the insolvency representative might become aware. It was also recalled that in discussing the debtor’s rights and obligations the Working Group had considered issues related to the operation of the debtor’s business, including supervision and sale of assets, which could be addressed in paragraph 5.

Paragraph 6: liability

124. The view was expressed that the issue of liability was particularly important in the context of insolvency proceedings and might need to be addressed more broadly to cover not only injurious behaviour during the conduct of the insolvency (which might refer to the insolvency representative, the creditors and third parties) but also responsibility for the insolvency and the responsibility of the appointing authority and third parties. In terms of the insolvency representative, it was noted that the question of liability was closely connected to attracting qualified professionals to act as insolvency representatives and to encouraging conduct of the proceedings in a timely and professional manner. Some jurisdictions adopted the approach of presuming that the insolvency representative would exercise effective business judgement and placing the burden on the creditor or other party to prove that that was not the case. It was also noted that different standards of proof might apply to different levels of behaviour such as ordinary negligence or gross negligence. It was observed that some laws distinguished between the liability of the office of insolvency representative and the personal liability of the person performing that function, with the law often providing an indemnity from the estate for actions taken in the performance of those functions. Although a sensitive issue, it was suggested that the more the draft

guide could do to achieve clarity, the more it would promote proper practices and professional conduct. A contrary view was that it should be left to the general law that established standards and sanctions for professional misconduct; the draft guide should simply include a general statement along the lines of paragraph 6.

125. To address issues of liability, it was noted that the draft guide made reference to the use of bonds and indemnity insurance. It was observed that while the bond was intended to cover loss of assets of the estate, it would generally be insufficient to cover damages, for which insurance would be required. It was acknowledged that as a solution, insurance might not be widely available in a number of countries and other solutions might need to be explored.

Remuneration of the insolvency representative

126. The view was expressed that the draft guide should address the question of the remuneration of the insolvency representative. It was observed that remuneration should be commensurate with the qualifications of the insolvency representative and the tasks it was required to perform and should achieve a balance between risk and reward in order to attract qualified professionals. As to how it should be calculated, several methods were indicated: it could be fixed by reference to an approved scale of fees produced by a government agency or professional association, determined by the general body of creditors or the court or some other administrative body or tribunal in a particular case, and it could be based upon the quantum of debts or assets (which could only be assessed at the end of the procedure when they had been sold and the value determined) of the estate. The different approaches could be indicated in the draft guide, together with a clear statement that the priority of the remuneration of the insolvency representative should be recognized and that an insolvency law should address that issue and provide a mechanism for fixing the remuneration.

127. It was noted that there were different possible sources for payment of the remuneration. Where the estate included unsecured assets, the remuneration could be paid from those; a surcharge could be levied against assets to pay for the administration or sale of those assets where that administration was beneficial to the creditors; or a surcharge could be levied on creditors on the making of an involuntary application to cover at least initial costs and performance of the basic functions. A further issue was review of remuneration and, while it was noted that that issue was addressed in part in paragraphs 220 and 221 of the commentary, it should perhaps be addressed specifically in the insolvency representative section and also include provision for periodic review during the course of proceedings. This would allow problems to be addressed and resolved (perhaps by arbitration between the insolvency representative and creditors) as they arose. It was also noted that the question of assetless estates (paras. 175 and 176) should be linked to the remuneration issue and could perhaps be expanded by including reference to the use of simplified procedures in assetless cases.

Paragraph 7: grounds for removal and replacement

128. The view was expressed that the reasons for removal listed in paragraph 7 were too restrictive and should be expanded to reflect the needs of the procedure, such as being able to replace the insolvency representative when it was found that the proceedings required a particular or different competency that the appointed representative did not have. It was suggested that the reasons for removal should indicate clearly the standard of care to be observed whether by reference to professional qualifications or some other factor and that the reasons enumerated might need to be extended to include illegal acts, acting in a situation where there was a conflict of interest and other acts that would justify removal.

129. It was observed that while the paragraph made provision for creditors to apply to the court for removal of the insolvency representative, it was often the case that small creditors in large cases could be essentially disenfranchised because they did not have sufficient economic interest in the proceedings to justify the cost of the application. To overcome that difficulty, it might be possible to pay the costs from the estate if the application was successful.

Paragraph 8: appointment of a successor insolvency representative

130. Some reservations were expressed as to the need to include the second sentence of the paragraph, although it was pointed out that since different approaches were taken to that issue and that in some systems the assets were vested in the insolvency representative, the issue of succession would need to be addressed.

131. It was suggested that paragraph 8 could be combined as a subparagraph of paragraph 7 and that additional reasons could be added to include illness and any other reason for which the insolvency representative might have to cease performing its duties. It was also suggested that in any case where the insolvency representative was replaced or removed, an obligation might be required to ensure books, records and other information were handed over to the successor.

C. Post-commencement financing⁵

132. With regard to post-commencement financing it was generally agreed that the draft guide should address the importance of facilitating the availability of that finance in the context of reorganization, sale of the debtor as an ongoing concern or liquidation of the assets of the debtor, while taking into account the various approaches to the provision of priority taken by different jurisdictions.

Paragraph 1: purpose clause

133. A number of suggestions were made regarding the stated purpose of obtaining post-commencement finance. It

⁵Ibid., paras. 187-191 and related summary and recommendations.

was suggested that elements to be mentioned in paragraph 1 should include the facilitation of obtaining post-commencement finance for the continued operation or survival of the business of the debtor the preservation or enhancement of the value of the assets of the debtor and to provide appropriate protection for persons who provided such finance or those persons whose rights were affected by its provision. In that regard it was suggested that the draft guide should state that a purpose of the provisions was to strike a balance between granting payment priorities as an incentive to attracting post-commencement finance and the rights of existing creditors. It was further suggested that the draft guide should clarify that the decision to obtain post-commencement finance should also extend to the provision of trade credit.

Paragraph 2: availability of post-commencement finance

134. It was suggested that paragraph 2 should not only recognize the need for post-commencement finance, but should encourage a determination to be made at an early stage as to whether the new finance was warranted or whether the business should be liquidated, since that decision was in fact the most important decision. It was noted that paragraph 191 of the commentary recalled the discussion at the twenty-fourth session of the Working Group concerning the desirability of distinguishing between the different phases of the insolvency process in terms of the need to provide finance. It was observed that the availability of new credit might be of particular importance in the period between the making of the insolvency application and the commencement of the proceedings in order to keep the business operating. One example was noted where new credit could be obtained in that period provided it was determined to be “indispensable” to the debtor. It was suggested that the availability in that period might differ depending upon whether the proceedings were voluntary or involuntary; where the proceedings were involuntary, it was suggested that there was no need to consider the issue until commencement of the proceedings. The view was expressed that post-commencement finance was also important, for similar reasons, in the period between commencement and consideration of a reorganization plan. The availability of finance for the period after approval of the plan was a matter to be addressed in the plan.

135. In the context of liquidation, it was suggested that the availability of finance should not be limited to those situations where the business was to be sold as a going concern, but more generally in order to ensure payment of wages or insurance renewals, rent, maintenance of contracts and other debts that might be justified by the ongoing conduct of the business or the need to protect the value of assets.

136. In addition to distinguishing the different stages of the process at which new finance might be required, it was suggested that there might be a difference in the body that could authorize such finance. Prior to approval of the plan, the insolvency representative might be given the authority to approve, while after approval decisions could be subject to oversight by creditors or by the court. It was observed that the rationale of limiting the availability of post-commencement finance and requiring its authorization was

based upon possible creditor prejudice and it should be made clear in the draft guide that the existing rights of secured creditors should not be adversely effected by the provision of new credit. In any event, it was suggested that the requirement for authorization should be linked to the damage that might occur or the benefit that might be provided as the result of the provision of new finance and that only those parties likely to be affected should be given an opportunity to object and to be heard.

Paragraph 3: insolvency representative's powers

137. A number of suggestions were made regarding the substance of paragraph 3. As an initial matter, the view was expressed that paragraph 3 should be broader and provide that the insolvency representative could obtain post-commencement finance if it was determined to be necessary for the preservation or enhancement of assets not just for the continued operation of the business as provided in the current draft.

138. The view was stated that paragraph 3 as currently drafted seemed to vest broad discretion in the insolvency representative regarding decisions to authorize post-commencement finance and to grant security. It was generally observed that in many jurisdictions those decisions were a matter for the court, not the insolvency representative, although it was pointed out that the court would in any event have to rely on the information provided by the insolvency representative as to the need for additional finance. Requiring the court to be involved in those circumstances simply added an extra step to the process. As to the provision of security, it was suggested that that would only be a problem in cases where the loan was not repaid. Another view was that having the draft guide provide for early court involvement in decisions to obtain post-commencement financing could promote transparency and provide additional assurance to potential lenders. To address those differences, it was suggested that a threshold as to the amount of financing could perhaps be set above which authorization would be required or that authorization would be required only in those situations where there was objection to what was proposed by the insolvency representative with respect to obtaining finance.

Paragraph 4: priority

139. The Working Group agreed that the issue of the type of priority to be granted in the case of post-commencement finance was not a matter for the insolvency representative, but rather one that should be established in the insolvency law. As a general view, it was suggested that the priority to be accorded to new finance should be an administrative priority, although it was observed that suppliers of goods and services to the insolvent business should be encouraged to continue providing supplies and therefore be paid for what they supplied ahead of secured creditors. In terms of goods and services, it was also suggested that the reference to “credit” was too narrow and needed to be expanded. It was noted that paragraph 4 should recommend to those jurisdictions that granted a higher priority to certain classes of claims (such as payments to employees) than to

administrative claims or unsecured creditors, that those priorities should be set forth or referred to in the insolvency law.

Paragraph 5: treatment of existing securities

140. At the outset of the discussion it was suggested that the difference between paragraphs 4 and 5 needed to be clarified; paragraph 4 did not address existing securities, while paragraph 5 was only related to those securities. The view was stated that since existing secured creditors were generally unlikely to consent to granting another creditor a priority over the same security, paragraph 5 seemed to give existing security holders a veto that could operate to promote liquidation by posing an obstacle to the obtaining of post-commencement finance. A different view was that in some systems secured creditors would grant that priority because it served their best interests to do so to facilitate the reorganization, avoid litigation and enhance their prospects of payment. It was suggested that the difference in approach might depend upon whether or not secured creditors were left to enforce their security outside of the insolvency process.

141. It was observed that in some jurisdictions, the court could grant such a priority if it determined that the secured creditor had sufficient security in the assets that it would not be harmed by the priority to be given to the post-commencement finance. In other jurisdictions the court had to be satisfied that additional conditions were fulfilled including that the secured creditor was given notice and the opportunity to be heard by the court, that the debtor could prove it could not obtain the necessary finance in any other way and that the interests of the secured creditor would be adequately protected. Another view was that paragraph 5 should establish the general principle that existing security interests should not be effected by post-commencement securities without the consent of the secured parties, but where that consent was withheld, the draft guide should indicate alternative approaches for obtaining post-commencement finance. It was further suggested that the requirement of the form of the consent should be a matter for general domestic law rather than being addressed in the draft guide.

D. Creditor committees⁶

Paragraph 1: purpose clause

142. It was suggested that the purpose of provisions on creditor committees should include at least (a) to facilitate the involvement of the general body of creditors by way of representation and (b) to provide for appointment and functions of the committee.

Paragraph 2: appointment of the creditor committee

143. The Working Group agreed that the presence of a creditor committee might contribute to the transparency of

the procedure and that it was therefore desirable to encourage its appointment and to enhance its role. Accordingly, it was suggested that the word “may” should be replaced by the word “shall”. Another view was that the focus should be upon representation of creditors rather than on facilitation of the conduct of the proceeding.

144. Whilst agreeing on the general formulation of the provision, several views were however expressed to the effect that the terms “representation” and “to represent” should be avoided. It was pointed out that in many legal systems that word would identify specific legal devices and effects that would not apply to creditor committees. The use of a more neutral phrase conveying the idea of representation, such as “for the purposes of the proceedings vis-à-vis the insolvency representative and the court”, was therefore suggested.

145. It was observed that different categories of creditors were likely to have different and possibly conflicting interests and that it would not therefore be appropriate to provide for participation in a single committee of all types of creditors on an equal standing. Furthermore, since the most significant portion of debt, both in terms of number of creditors and amount of debt, was likely to be held by secured creditors, it was also likely that a unitary body would allow the latter to prevail and override unsecured creditors, irrespective of whether voting rights were based on number of creditors or amount of claims. Accordingly, for the purposes of preserving both the representative character and the effective functioning of the committee, different bodies should be provided in respect of the different classes of creditors. It was also noted that there might be small cases where creditors were often unwilling to serve or the number of creditors did not suggest the need for a committee, in which case the general body of creditors could perform the functions otherwise performed by a committee.

Paragraph 3: functions of the creditor committee

146. Despite the differences that might occur in various legal systems, the Working Group agreed that the two functions typically performed by the creditor committee (that is, the advisory and supervisory function) should be clearly set forth and elaborated to indicate what those functions might entail. One concern was that the committee should be able actively to represent and pursue the views of creditors, and should not be limited in its performance of those functions by the insolvency representative, only by the court. As a matter of drafting, a suggestion was that the reference to “expert” as a qualification of the advice to be given by the committee was inconsistent with the general scope of the advisory function that the committee was expected to perform and should therefore be deleted.

147. A proposal was that the phrase “as directed by” appearing in the last sentence should be replaced by the phrase “in cooperation with”, in order to reflect more accurately the relationship between the creditor committee and the insolvency representative. Related suggestions included that the draft guide could (a) clarify that in some systems the committee would operate in direct cooperation with and

⁶Ibid., paras. 192-212 and related summary and recommendations.

under the control of the court, and (b) identify what mechanisms, if any, would apply in the event of a conflict between the committee and the insolvency representative.

Paragraph 5: composition of the creditor committee and selection of members

148. As regards the order of the recommendations, it was observed that matters concerning the structure of the committee should be addressed prior to those relating to functions and that, accordingly, the order between paragraphs 3 and 5 should be reversed.

149. As a general remark, it was pointed out that the draft guide should clarify the distinction between the creditor committee on the one hand, irrespective of the structure and prerogatives it might be given in various legal systems, and the general body of creditors or creditor's assembly as a whole, and that powers and functions given to the first should not impair the rights of the creditors as a whole to participate or otherwise act in the insolvency proceedings.

150. Support was expressed for the view that participation should be restricted to a limited number of creditors, to be determined by national legislators, in order to preserve the effective functioning of the committee. The proposal that creditors in a situation of conflict of interest should be excluded from participation in order to ensure the independence of the body received support. In that connection, however, it was pointed out that that exclusion should apply not only to creditors related to the debtor but to any creditor who might have a personal interest with the potential to affect its impartiality in carrying out the functions of the committee, such as a competitor of the debtor.

151. Support was expressed for the view that the draft guide should identify the mechanism for appointment of the committee, which could perhaps include election by the general body of creditors or appointment by the court, and provide for replacement of members lacking the necessary skills or who acted negligently or inefficiently. It was, however, pointed out that in some legal systems the replacement of members of the creditors committee was limited to situations of gross negligence and that a stricter rule might result in participation in the committee being discouraged.

152. Reference to "willingness to serve" appearing in the first sentence of the paragraph was felt to be redundant, since it would be inconceivable to appoint as a member of the committee a creditor not willing or ready to serve on it.

Paragraph 4: appointment of expert advisers

153. The Working Group agreed that it was for the court and not for the insolvency representative to approve the employment of specialist advisers upon a proposal of the creditor committee. It was noted that providing for accountability of the creditor committee vis-à-vis the court, as opposed to the insolvency representative, was important to preserve the independence of the body. Further suggestions included adding a mention of the positive economic

impact that the appointment and the involvement of an expert would have on the proceedings.

Paragraph 6: duties and liability of the members of the creditor committee

154. The prevailing view was that it was not necessary to mention explicitly the duty of the members of the creditor committee to act in good faith, since good faith, as a general principle of law, would apply to the performance of all duties. The concern was reiterated that the standard of liability imposed on members of the creditor committee should not be too high, in order not to discourage participation.

155. The suggestion that creditors having a conflict of interest should be explicitly excluded from participation in the committee was also reiterated. It was pointed out that the issue might be especially relevant in respect of the claims sold after commencement of the proceedings on the secondary market, whose holders' interests would likely differ from those of the original creditors. In that connection, it was suggested that where a member of the committee sold its claim, the purchaser should not automatically succeed to the membership of the creditor committee, but that participation in the committee would be conditional upon the purchaser satisfying all relevant requirements.

156. Reference to the "fiduciary duty" of the members of the committee, vis-à-vis either the creditors or the shareholders or owners of the debtor, was found to be misleading in respect of some legal systems. Accordingly, it was suggested that it should be replaced by a more neutral phrase conveying the basis of the possible liability of those members. Another view was that the last sentence of the paragraph, providing for the exclusion of any duty of the creditor committee to shareholders or owners of the debtor, might not accurately reflect some situations arising in the context of reorganization where there would be a return to shareholders or owners and an exception for creditors having an economic stake in the outcome of the proceedings should be included.

Paragraph 7: decision-making of the creditor committee

157. Although it was suggested that it might be inappropriate for the draft guide to recommend a specific mechanism for the voting of the committee, support was expressed for the view that the creditor committee should be required to establish by-laws governing its functioning and its decision-making process, possibly providing for different rules in respect of various types of decisions. It was noted, for example, that the creditor committee might be given the task of negotiating a plan on behalf of the general creditor body and their decision as to whether a particular plan might be appropriate to refer to the general creditor body might require a different majority to other types of decision taken by the creditor committee. A related proposal was that in establishing rules that might provide for the proportion that would constitute a majority vote, there should be no requirement for unanimity, since that might impair the functioning of the committee and ultimately the

flexibility of the proceedings. A different view was that the provision should be deleted, given the variety of solutions that might be given under the various legal systems.

158. It was pointed out that paragraph 7 addressed only decisions falling within the scope of the powers and functions of the creditor committee and was not intended to make those decisions binding on or otherwise able to affect the powers of the general body of creditors, such as the power to approve a plan for reorganization. In that connection, it was reaffirmed that the powers of the creditor committee derived from those vested with the general body of creditors as a whole. It was suggested that the relationship between the general body of creditors and the creditor committee should be reflected in the structure of the recommendations, by reversing the order of the paragraphs respectively addressing the general body of creditors (current paragraph 8) and the creditor committee.

Paragraph 8: vote by the general body of creditors

159. Without prejudice to the decision set forth above as to the order of the paragraphs, a suggestion was that the recommendation on the general body of creditors should allow for the provision of different majority rules in respect of different types of decisions. While an ordinary majority rule might be sound in respect of most decisions, a qualified majority would be more appropriate for more significant decisions, such as decisions concerning the insolvency representative or issues of post-commencement financing.

160. Support was expressed for addressing the powers and functioning of the general body of creditors in a separate section of the draft guide, possibly in a chapter on issues relating to creditors.

E. Claims of creditors and their treatment⁷

Paragraph 1: purpose clause

161. General support was expressed for the purpose of the provisions on treatment of creditors' claims as set forth in paragraph 1 of the summary and recommendations. It was suggested that subparagraph 1 (d) might be more appropriate for the purpose clause under the section on distribution priorities (chap. V.A).

162. The Working Group agreed that paragraph 1 (a) should be drafted in broader terms than the reference to the insolvency representative, with a view to reflecting the various available options as to who was to consider claims.

163. Reference to the provisions for "appeals" appearing in paragraph 1 (b) and in other paragraphs of the summary and recommendations section was felt to be inappropriate. Since in a number of legal systems that term pointed to a specific procedural means of judicial recourse, the use of a more neutral phrase, such as "judicial recourse", was supported.

164. As to paragraph 1 (c), a suggestion was made that reference to similar classes of claims, such as disputed, conditional or non-monetary claims, should also be included, provided, however, that the list would not purport to be exhaustive.

Paragraph 2: treatment of foreign creditors

165. A drafting suggestion was that the provision could be aligned with the terminology of the UNCITRAL Model Law on Cross-border Insolvency, where the distinction between national and foreign creditors was based on residence rather than nationality.

166. With a view to preserving the equal treatment of foreign creditors, the Working Group agreed that the notification of the proceeding should explicitly set forth not only the deadline for submission but any and all procedures and form requirements necessary for the submission of the claim, provided that the identification of those procedures was to be left to national laws. Nevertheless, it was felt that the purpose of equal treatment of foreign creditors might be frustrated if a personal appearance of the creditor before the insolvency representative was required and it should therefore be discouraged with respect to the submission of the claim.

167. A suggestion, particularly for the benefit of foreign creditors, was that the notification should indicate whether the value of the claim would be considered by reference to the application for, rather than commencement of, the proceedings since that might affect the conversion of the currency in which the claim was expressed.

Paragraphs 3 and 5: submission of claims

168. The Working Group agreed that the issue of the time for the submission of the claim addressed in paragraph 3 was also dealt with in the first sentences of paragraph 5 and that, accordingly, the two provisions should be discussed jointly.

169. Support was expressed for the suggestion that national legislators should be encouraged to provide for the submission of claims either within a specific time after commencement or at any time prior to distribution. It was pointed out that the consequences applying upon failure to submit the claim within the provided time should be explicitly addressed and identified in the law, since many options, including subordination of those claims, were available. With a view to highlighting the need for the provision of sanctions in the insolvency law, it was suggested that paragraph 3 should be amended by replacing "may" with "must". It was also suggested that contractually subordinated claims should be addressed.

170. It was also suggested that it was not for the insolvency law to establish the substantial or procedural treatment that would apply to a claim that was not submitted to the insolvency proceeding, but rather a matter to be addressed under other relevant national laws. While forfeiture of unsubmitted claims would be acceptable where

⁷Ibid., paras. 213-252 and related summary and recommendations.

the insolvency law provided for discharge of the debtor upon closing of the proceedings, failure to submit would not otherwise affect the possibility of enforcing those claims, or the part of them that had not been satisfied in the procedure, under general substantive and procedural rules once the insolvency proceeding was completed. A similar proposal was that the issue should be dealt with in the context of the discussion of discharge, currently addressed in paragraph 298 of the commentary. A suggestion was also made that claims, including claims by secured creditors, should be submitted early in the proceeding to enable the debtor and the insolvency representative to determine the scope of the pre-commencement claims against the insolvency estate.

171. Several concerns were expressed in respect of the last sentence of the paragraph, providing for submission of a claim by a secured creditor only when that creditor had surrendered its security or the claim was under-secured. It was observed that submission that was conditional upon the value of the claim exceeding the security might result in great uncertainty, since that evaluation could be made on the basis of different standards (for example, insolvency or market value) and at different points in time. It was further noted that providing that the obligation to submit a claim applied to all creditors, whether secured or unsecured, was necessary to ensure that the insolvency representative would be aware of all secured claims and the amount of outstanding debt. Another view was that submission of secured claims could be avoided in respect of those securities resulting from a public registry only. The Working Group agreed that the draft guide should recommend that the treatment of secured creditors for the purposes of the submission of claims should be clearly set forth in the insolvency law.

172. A concern was expressed that reference to claims to be made “against the estate” appearing in the first sentence of paragraph 5 might be misleading, since it might suggest the need for submission of claims for post-commencement debts. In response, it was clarified that paragraph 5 was only meant to address the filing of claims having arisen prior to commencement and the phrase “against the estate” should be deleted.

173. It was suggested that reference to the treatment of foreign creditors in the third sentence of the paragraph should appear as a separate paragraph.

Paragraph 4: list of creditors and statement of claims

174. One view was that the debtor should assist the insolvency representative in drafting the list of creditors, as a significant aspect of its general duty to cooperate in the insolvency proceedings in respect of both liquidation and reorganization. It was observed that in some legal systems a list of creditors was a requirement for the filing of a voluntary application.

175. Several views were expressed as to the consequences that would apply to those creditors which the debtor failed to include in the list. In that connection, it was suggested that the draft guide might clarify that the list, as

drafted either by the debtor or by the insolvency representative relying on the information provided by the debtor upon commencement, would be subject to revision and amendment in a subsequent phase of the proceedings. In that respect, the Working Group agreed that the control of the list by the insolvency representative and ultimately the court should be preserved.

176. A question was raised as to whether a creditor needed to file a claim where the debtor filed a list that admitted the claim. It was suggested that to regard a claim as admitted on that basis would entail the risk that the debtor might use its power to recognize one or more specific debts to the detriment of the equal treatment of creditors.

Paragraph 6: excluded claims

177. As a general remark, it was clarified that it was for general substantive and procedural law, as opposed to insolvency law or the insolvency representative, to determine which claims should be excluded. A suggestion was that the insolvency representative should consider all outstanding claims to be included in the list pursuant to applicable substantive and procedural law. A drafting suggestion was to delete the word “may”, which might inappropriately suggest that the insolvency representative had a discretionary power with regard to those claims.

178. The example of gambling debts was felt to be inappropriate, since the treatment of gambling was different under the substantive law of various legal systems. It was suggested that foreign revenue claims should be treated in a manner consistent with the UNCITRAL Model Law on Cross-Border Insolvency.

179. Several views were expressed as to the desirability of the draft guide addressing the treatment of specific classes of claims, including (a) fines or other (administrative) claims that might be excluded from the insolvency proceedings because the amount would overwhelm the insolvency estate; (b) claims that were not due upon commencement; (c) punitive damages; (d) claims not determined in their amount upon commencement, such as tort claims or contingent claims for environmental violations; and (e) disputed claims.

180. After discussion, the Working Group agreed that the draft guide should avoid providing a list of excluded claims, but rather recommend that those claims should be clearly identified and set forth in national law.

Paragraph 7: evidence of claims

181. As to the right of the creditor to give evidence of its claim by way of declaration or affidavit, one view was that that approach would be an exception to the general rule requiring each creditor to give evidence of the submitted claim, a matter that should rather be addressed and governed by national procedural laws. Another view was that the provision, if retained, would need to be supplemented by qualifications as to the circumstances entailing

its application. A further view was that the addressee of a declaration or affidavit stating a claim would be the court and not the insolvency representative.

182. It was observed that not all legal systems were familiar with the use of affidavits and similar declarations as a means of evidence. It was further noted that as a means of evidence an affidavit was expensive and therefore less and less used even in those systems where it would be admitted. As a general remark, the Working Group was reminded that the more the detail included in the draft guide, especially in respect of procedural issues, the greater the difficulty of making it acceptable in different legal systems. Accordingly, it was proposed that the provision should be given a wider scope, by enabling each creditor to give evidence of its claim in writing without personally appearing before the insolvency representative or the court. In that connection, it was reaffirmed that specific directions as to the way in which evidence of claims was to be given, as well as on any other applicable procedural requirement, should be provided to creditors within the context of notification of commencement of proceedings.

183. A further suggestion was that the filing of false claims should be explicitly sanctioned.

Paragraph 8: admission and rejection of claims

184. As regards the issue of admission of claims, there was agreement that admission should not occur automatically, but would require a decision by the insolvency representative. Accordingly, the reference to claims that might be admitted automatically in the first sentence of the paragraph should be deleted. Some support was voiced for the suggestion that the draft guide should recommend that the decision by the insolvency representative should be taken in a timely manner, especially when the claim was supported by adequate documentation. The view that automatic admission should be provided as an exception for claims registered in a public registry was not supported, nor was the suggestion that a distinction should be drawn depending upon whether the claim could be immediately executed or not.

185. A further concern was that it would be inappropriate to rely on accounting records for the purposes of admission of claims, since it was unlikely that those records would be kept in a proper manner, at least as far as those of the debtor were concerned. It was observed that the reference to accounting records might also include those of the creditor and that they might be used for evidentiary purposes pursuant to the general rules on evidence, provided that admission would always be conditional upon approval by the insolvency representative. It was suggested that where claims were sufficiently established by accounting records, that would facilitate a quick decision by the insolvency representative as to admission or rejection.

186. As to the right to challenge the admission or rejection of a claim, evoked in the final part of the first sentence of paragraph 8, the view that reference to that right might encourage litigation was not shared. Support was expressed in favour of the right to challenge not being limited to

creditors or the insolvency representative, but rather to include any interested party, such as creditors whose claims were disputed, the creditor committee and the debtor. In that connection, it was further clarified that creditors whose claims had been admitted were entitled to challenge the admission of other claims. The inclusion in the draft guide of some detail as to the procedures for such a challenge, including providing for a hearing before a judge, was also suggested.

Paragraph 9: provisional admission of claims

187. The Working Group agreed that since provisional admission of claims could have a significant impact on the proceedings, especially when voting rights were vested in creditors whose claims were admitted on a provisional basis, the issue warranted specific attention in the draft guide.

188. Several views were expressed as to the scope of the various categories of claims mentioned in paragraph 9 as subject to provisional admission. It was agreed that the draft guide should provide clarification as to whether (a) the notion of “claims of undetermined value” would encompass non-monetary claims; and (b) whether “disputed claims” referred to claims that were subject to pending litigation outside of the insolvency, or rather to claims contested within the context of the insolvency proceedings.

189. Support was expressed for provisional admission of conditional claims, contingent claims and claims not yet mature at the time of commencement. In respect of the latter however, it was clarified that admission should occur not on the basis of the face value of the claim, but rather on the basis of a deduction relating to the unexpired period of time before the claim matured.

190. With a view to enhancing clarity, support was expressed for the proposal that a general discussion of the claims qualifying for admission should be included in the draft guide, to be followed by a discussion of those claims which, though lacking relevant characteristics, might be admitted on a provisional basis. In addition, it was pointed out that each category mentioned in paragraph 9 raised different issues of substantial and procedural treatment that might need to be addressed.

191. Strong support was expressed for placing the burden of the initial decision on the provisional admission of claims on the insolvency representative rather than on the court, without prejudice to the right of a dissenting party to have recourse to the latter. To enhance the expedition of the proceedings, it was suggested that the draft guide should adopt a general principle that the court should only be involved where strictly necessary.

192. As to the effects of provisional admission, the view was shared that the draft guide should identify the rights vested in a creditor whose claim was admitted on a provisional basis. One suggestion was that those rights should be limited to the right to be heard before the court. In no event, it was felt, should provisionally admitted creditors be entitled to participate in a distribution.

193. With respect to the right of review of a valuation, it was observed that it was related to the right to review in paragraph 8 and it might be preferable to address the issue of review in a single provision. Whilst recognizing that paragraph 9 did not purport to address procedures for valuation, it was suggested that it would be appropriate for the draft guide to deal with those issues and to indicate appropriate criteria.

Paragraph 10: effects of the admission of a claim

194. As a preliminary remark, it was observed that the chapeau of the paragraph might suggest that all rights of the creditors were conditional upon the admission of their claims. That result would be inconsistent with the fact that all creditors having submitted a claim were at least entitled to participate in the first meeting of creditors and, accordingly, the text should be amended to that effect.

195. As to the scope of the paragraph, it was suggested that it should be made clear that the reference to meetings of creditors was to the general assembly of creditors and that a creditor with an admitted claim should have all the rights and functions of that body, not simply the right to vote. General support was expressed for the view that those rights and functions should include at least the following: (a) approval or rejection of a reorganization plan; (b) election of the creditor committee; and (c) providing advice on the appointment of the insolvency representative.

196. Further suggestions included the power of the general assembly of creditors to decide upon the following issues: (a) the relationship between the liquidation and the reorganization processes; (b) the distribution of the assets of the insolvency estate; (c) post-commencement financing; (d) compensation of professionals; (e) treatment of judicial proceedings that were pending and to which the debtor was a party upon commencement of the proceeding; (f) the continuation of the business by the debtor; or (g) the agreement on expedited restructuring. Finally, a view was that it would be advisable to include a general provision allowing national legislators to provide for further functions of the assembly of creditors, without prejudice to the need to balance those powers and functions against those of the other bodies and to preserve the flexibility of the proceedings.

197. In addition to addressing the functions of the general assembly of creditors, it was suggested that the draft guide could address the relationship between that body and the creditor committee (where that body was constituted in the insolvency process) and which of the powers of the general assembly could be delegated to the committee.

198. In respect of paragraph 10 (a), a proposal was that reference to the right of an admitted creditor to participate in the appointment of a creditor committee should be added.

199. Various comments were expressed in respect of paragraph 10 (b). A concern was raised that reference to "payment to the creditor in a distribution" might point only to a liquidation and that payment pursuant to a reorganization

plan should also be included. A further view was that reference to admission establishing the "amount" of the claim to be paid by the insolvency representative was incomplete and needed to be supplemented by a reference to the "priority" of the claim.

Paragraph 11: right to set-off

200. Different views were expressed as to whether it was necessary to address the right to set-off in the context of the insolvency estate (as reflected in paras. 116-120 of the commentary) or in both sections.

201. In response to the suggestion that set-off should be subject to the stay to allow the insolvency representative an opportunity to review the respective claims, it was noted that different substantive rules and procedural mechanisms addressing set-off were provided in the various legal systems. Given the sensitive nature of the issue, it was felt that an agreement on a unique solution would not be feasible. Nevertheless, it was pointed out that set-off entailed a significant exception to equal treatment of creditors and needed to be addressed. After discussion, the Working Group agreed that the draft guide should clarify if and to what extent the general rules on set-off might be affected by insolvency law, by presenting the various available options without suggesting a specific rule. A specific mention of the need to preserve the operation of set-off for the purposes of financial netting was noted.

Paragraph 12: claims by insiders and shareholders

202. Several views were expressed to the effect that the reference to "shareholders" of the debtor was too narrow, since it pointed at one specific form of incorporation of a company, and that a broader term capable of encompassing all possible types of stakeholders (for example, either in companies or partnerships) was needed. As to the meaning of insiders, it was suggested that that term needed some clarification as to who it was intended should be included.

203. As to the substantive treatment to be provided in respect of those persons, one view was that their voting rights should be restricted. A different view was that all claims held by insiders or stakeholders should be subordinated. In response, it was suggested that subordination of all of those claims might discourage insiders and stakeholders from providing finance for the benefit of the debtor, a result that would significantly reduce the chances for many debtors to obtain fresh funds and redress their financial situation. Accordingly, it was suggested that subordination should apply only upon evidence of improper behaviour. A further suggestion was that a decision in that respect should be taken by either the insolvency representative or the court upon examination of the circumstances under which the loan had been granted. Another suggestion was that subordination could be provided in respect of claims related to inadequate capitalization of the debtor rather than to loans granted to a company in financial distress.

204. After discussion, the Working Group agreed that the issue should be discussed further at a later stage when a specific text had been drafted.

5. Liquidation and distribution

A. Distribution priorities^g

205. As an initial matter it was suggested that the title of the section on liquidation and distribution should be revised to clarify that its focus was on the distribution of assets realized upon liquidation, rather than on specific liquidation issues, which were not addressed in the section. The view was expressed that the draft guide should draw a distinction between those cases where the business had ceased operations and the assets were sold and those cases where the business was kept in operation but components were sold off as going concerns, and focus only on the forced sale situation. The other alternative should be addressed in the context of sale of assets, a topic not addressed elsewhere in the draft guide in any detail. It was suggested that the draft guide should make clear that the insolvency representative should make distribution promptly, rather than delaying disbursement in order to attempt to maximize the amount available for distribution as a result of fluctuations in the relevant market, and that distributions could be made on an interim basis.

206. A number of suggestions were made regarding the order in which payments would be made to various categories of claims. Some concern was expressed about the inclusion of secured claims and what was actually intended in that regard. A related concern was that the categories of claims listed in paragraph 2 should be reordered to provide that the expenses of the insolvency representative should be listed first, followed by other administrative claims that arose as a consequence of the insolvency proceedings, and then claims that arose prior to the commencement of the insolvency, such as secured claims. It was also suggested that no distinction should be made between different types of administrative claims. It was noted that other categories of claim should be considered, such as those of third parties whose property was held by the debtor, claims that were given special recognition under domestic law, such as employee and tax claims, and claims that might be satisfied otherwise than by payment of money. The view was stated that the draft guide should include a general recommendation to the effect that priorities should be kept to a minimum and that where they were granted by operation of law other than insolvency law, legislators should be encouraged to list those priorities in the insolvency law to enhance predictability. A further issue raised was the need to address the treatment of surplus funds in those cases where the debtor was solvent and there might be a distribution to owners, shareholders and others and whether interest on other claims would rank ahead of such a distribution. After discussion, the Working Group generally agreed that the draft guide should not present a hierarchy of claims for distribution, but rather illustrate types of claims that legislators might wish to consider.

207. It was noted that the provisions in paragraph 3 regarding the equality of claims within a claims class and the payment of a class in full before the next class was to be paid, although applicable in respect of some types of claims, were inapplicable in the case of secured claims.

B. Discharge^h

208. It was noted that the position as to the discharge of the debts of an individual debtor following the conclusion of insolvency proceedings varied among jurisdictions. The view was stated that the draft guide should reflect the range of policy choices between, on the one hand, the automatic discharge of the debtor and, on the other hand, the possibility of continued court supervision. It was suggested that more examples of different approaches should be discussed in paragraph 258 of the commentary. With regard to some of the different factors which might determine how a particular debt was treated, it was noted that the conduct of the debtor in the insolvency proceedings might be one of a number of such factors and that a direct link to the debtor's obligation to cooperate could be made. That approach might result in certain categories of debt not being subject to the discharge for reasons such as that they were not disclosed by the debtor.

6. Reorganization plans^g

Paragraph 1: purpose clause

209. Various views were expressed on the purposes of the provisions relating to the reorganization plan, as set forth in paragraph 1 of the summary and recommendations. Support was expressed in favour of addressing the need to provide adequate information in respect of both the situation of the debtor and the treatment of creditors under the plan, to allow creditors to make an informed decision on the plan.

210. Another view was that the provision as drafted might be redundant, since most of the issues mentioned in paragraphs 1 (a)-1 (f) were specifically addressed in the recommendations that followed. It was further pointed out that many of those issues pertained to the technical mechanisms and devices concerning the implementation of the plan rather than to the purposes of the provision. Accordingly, it was suggested that the provision should be replaced by a general statement to the effect that the provisions on the reorganization plan were aimed at facilitating the proposal, submission and approval of a reorganization plan.

211. Support was expressed for the suggestion that the provision on the purpose of reorganization should be based on the general statements contained in the preamble to the UNCITRAL Model Law on Cross-Border Insolvency, providing for "Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving

^gIbid., paras. 253-255 and related summary and recommendations.

^hIbid., paras. 256-260 and related summary and recommendations.

ⁱIbid., paras. 261-299 and related summary and recommendations.

employment.” A further view was that reference to the objective of maximization of assets should also be included.

212. On the assumption that the structure of the paragraph would be retained, support was expressed for an additional provision as to the binding effect of the plan being conditional upon its approval, to be placed between paragraphs 1 (a) and (b).

213. As to paragraph 1 (a), a drafting suggestion was that explicit reference to both secured and unsecured creditors should be added.

214. As to paragraph 1 (b), a proposal was that stakeholders of the debtor should be included among the categories possibly affected under a plan. Another suggestion was that reference to “all” creditors was inaccurate, since not all creditors would necessarily have their rights or positions modified under a plan. A different view, however, was that the term “all” might usefully point to the binding effect of an approved plan on dissenting creditors.

215. Several views were expressed to the effect that mention of discharge of debts and claims in subparagraph 1 (f) was inappropriate, since discharge was only one of the various solutions which might be proposed under a reorganization plan and would not qualify as an objective for reorganization.

216. After discussion, the Working Group agreed that the structure of the provision should be retained, provided a clear distinction was drawn between purposes and implementation techniques and that reference to all relevant issues that might arise in the context of a plan was addressed.

Paragraph 2: time of submission of the plan

217. As a preliminary remark, it was suggested that the draft guide should clarify that both paragraphs 2 and 3 dealt with plans prior to approval and should therefore more appropriately refer to a “proposal for a plan”. A contrary view was that the word was commonly understood as encompassing a reorganization plan throughout the different phases of the procedure and that no amendment to that language in the draft guide was desirable provided its usage was made clear.

218. The Working Group agreed that the issue of the time of submission of the plan should be dealt with in a separate paragraph from the issue of who was entitled to formulate a plan.

219. The view that the draft guide should recommend the timely submission of the plan was shared by the Working Group, although different views were expressed as to the desirability of establishing a fixed time period for submission. Support was expressed in favour of a deadline being determined by the law, with a view to preserving the overall goals of predictability and transparency. A different view was that a more flexible approach, allowing the court or the insolvency representative to determine that deadline,

would be preferable. Intermediate proposals were that the court might be allowed to establish that term within a maximum period established by the law, or that the court could be allowed to extend the deadlines provided in the law.

Paragraph 3: preparation of the plan

220. As to the mechanism for determining who might prepare a plan, one suggestion was that allowing proposals to be contemporaneously presented by different parties might lead to the procedure being more efficient, while a procedure that provided for a sequenced approach could lengthen the procedure unnecessarily. A contrary view was that to establish order in the process, one party, be it the debtor or some other party, should be given a short exclusive period to file, after which other parties could be given the opportunity if no plan was forthcoming or the plan proposed was likely to be unsuccessful. The view was expressed that in order to encourage the debtor to apply for commencement of proceedings at an early stage, it should be the debtor who was given the exclusive opportunity.

221. Although the view was expressed that the formulation of a plan by the debtor was not provided under all legal systems and was therefore inappropriate, the prevailing view was that the draft guide should reflect various options, including presentation by the debtor, the creditors, the insolvency representative, either alone or in cooperation with the debtor, as well as by any other interested party, such as a competitor of the debtor. It was suggested that the provision referring to the filing of the plan on application should be permissive, not mandatory.

222. A concern was raised as to the debtor being entitled or required to consult “with the creditors and the insolvency representative” prior to proposing a plan, as envisaged in the second sentence of paragraph 3. It was felt that consultations with the creditors might create situations of conflict of interest and that only consultations with the insolvency representative should be considered. A similar view was that, although prior consultation with the creditors might enhance the chances of the proposed plan being approved, it would be more appropriate for the insolvency representative rather than the debtor to conduct those consultations. A further view was that a collaborative process might lead to the best result in terms of an acceptable plan.

223. On the question of establishing a link between a reorganization plan negotiated and agreed upon by the debtor and the creditors in an out-of-court context and the filing of a reorganization plan within an insolvency procedure by the debtor, it was suggested that the two issues should be separately addressed in the draft guide because of the financial situation of the debtor: in some insolvency systems, out-of-court procedures were only possible if the debtor was not insolvent.

Paragraph 4: contents of the plan

224. General support was expressed for the view that the insolvency law should specify the contents of a

reorganization plan, with a view to ensuring that essential detail as to the consequences entailed for the various classes of creditors, as well as for other parties in interest, be provided. As to the specific contents, a number of suggestions were made, including that the plan should address issues such as (a) the classes of creditors and the treatment respectively provided for each of them (including timing of payment where that was provided); (b) the treatment of contracts, including employment contracts; and (c) the possible sale of the business as a whole or of any envisaged changes in the capital of the insolvent company.

225. Support was also expressed for the suggestion that the descriptive information appearing in square brackets and italics in the second sentence of the paragraph should be required to be included in a disclosure statement to be filed jointly with the plan, rather than be included in the plan itself. The disclosure statement should include, among other things, details as to the debtor's assets and liabilities, proposed treatment of creditors, proposed payment to creditors and the post-reorganization plan of the debtor as to the operation of the business or liquidation of the debtor's assets.

Paragraph 5: classes of creditors

226. A concern was expressed that reference to the "nature and content" of the rights as the criteria for division of creditors in classes might be too narrow and that a reference to priorities or debt obligations or the nature and extent of debt should be included.

227. It was pointed out that since in some legal systems the often large number of creditors holding small claims were grouped in a single class, a solution that often enhanced the expeditiousness of the procedure, that approach could be mentioned in the draft guide.

Paragraph 6: approval of the plan

228. In respect of paragraphs 6 (a) and (b), support was expressed for the view that the reference to classes was misleading, since it might raise doubts as to the relationship among classes, an issue addressed under paragraph 8, and would need to be clarified.

229. A suggestion was that the provision should clarify that only creditors whose claims had been admitted could vote.

230. A view was that the term "affected" in paragraph 6 (a) was not appropriate because while all creditors were affected by the insolvency proceedings, what was intended here was to refer to those cases where the rights of secured and priority creditors might be modified either because the law provided that they could be or because the creditors agreed to modification. That modification might relate, for example, to extending the period of repayment of the debt and interest.

231. A suggestion was that the term "secured creditor" should be clarified by introducing a definition, since the

expression might point at different situations within the various legal systems. It was also suggested that the rights and obligations of secured creditors were essentially individual and it might perhaps not be appropriate to refer to them as a distinct class.

232. In respect of paragraph 6 (b), a suggestion was that the reference should be to "ordinary" rather than to "unsecured" creditors.

233. A view was that approval by the majority of shareholders provided under paragraph 6 (c) would only be appropriate for those situations where the debtor proved to be solvent, since otherwise shareholders would have no stake and would not be entitled to vote or to otherwise participate in any distribution of the assets. Accordingly, it was suggested that the provision should be deleted. A different view was that the voting right of shareholders should be preserved as a means of control on the directors and managers of the company. A further view was that treatment of shareholders might be addressed in a comprehensive manner in a broader section dealing with the treatment of their claims.

234. Recalling an earlier discussion in relation to paragraph 12 of the section on creditors' claims (see para. 202 above), the Working Group agreed that reference to the term "shareholders" should be modified to a term capable of encompassing all possible types of stakeholders (for example, in companies or partnerships).

Paragraph 7: voting majorities

235. Some support was expressed for the view that the paragraph as drafted was too specific and that the draft guide should rather concentrate on providing alternatives, along the lines set forth in paragraph 279 of the commentary, and indicate those solutions which were not desirable, such as unanimity or simple majorities based on number of creditors. In addition to establishing what might constitute a sufficient vote for approval of the plan, it was suggested that the summary and recommendations section should also address the manner in which that vote might be obtained (whether by physical attendance at a meeting of the general body of creditors or by mail or some other means). It was observed that the method of voting might in turn influence the majority required; if the vote was obtained by mail, a simple majority might be sufficient, while if voting occurred at a meeting of creditors, a qualified majority might be necessary. A further suggestion was that the insolvency representative might have a role to play in achieving the necessary vote and perhaps providing a balance to the interests of the majority creditors.

Paragraph 8: binding dissenting creditors

236. It was observed that as drafted the paragraph did not clearly distinguish between the situations where creditors in a particular class dissented from the majority vote of that class and where a class or classes of creditors dissented from the vote of the majority of classes. It was suggested that those two issues should be treated in separate

paragraphs, the first addressing how dissenting creditors in a particular class might be treated and the second, which related to the role of the court in paragraph 9, how dissenting classes of creditors might be treated.

237. Although recognizing that the ability to bind creditors to a reorganization plan that was approved by the requisite majority was essential to the implementation of the reorganization, different approaches were noted with regard to how that occurred. Under some insolvency laws the vote of the requisite majority, both of creditors within a class and of classes of creditors, was binding upon all creditors without the need for any further step, such as court confirmation or approval. Under other laws, it was noted that since the reorganization plan was a contract, it could only be made binding on all creditors, particularly those who did not support it and those who did not vote on it, by virtue of a court order.

Paragraph 9: confirmation of the plan

238. Recognizing the different approaches indicated in the context of the discussion of paragraph 8 on the need for court confirmation of the plan, the Working Group discussed what the court might be required to consider in performing that confirmation. One view was that the court should confine itself to matters such as the proper conduct of the approval process; that creditors would receive at least as much under the plan as they would have received in liquidation; where dissenting classes of creditors could be bound to the plan, that senior classes of creditors would be paid in full before payments to more junior classes unless they had agreed to some different approach; and the legality of the plan. Some concern was expressed at the suggestion that the court might be asked to consider the economic feasibility of the plan, especially where that might require the court to hire experts and consider economic matters in some detail. That situation should be distinguished from the question of the court considering the feasibility of the plan as discussed in paragraph 289 of the commentary without considering economic issues in any detail.

239. It was observed that where confirmation of the plan was required for purposes of enforcement, the process was not necessarily one that required lengthy procedures or a full and complete analysis of the plan, but could be arranged so as to minimize costs and facilitate expedition.

Paragraph 10: objection of creditors

240. It was observed that in some systems which did not provide for court confirmation, paragraph 10 provided a necessary opportunity for aggrieved creditors to challenge the approval of the plan. It was also suggested that the paragraph might address the question of review of the court's confirmation of an approved plan.

241. Some support was expressed for the view that the paragraph should include grounds on which the plan might be challenged, such as that the requirements for confirmation had not been met; that the plan provided for a lower

return than liquidation; or that the approval process was improper. A further view was that those grounds should be limited to cases of fraud so as to avoid the potential for undue interruption to the implementation of the plan. It was also observed that the paragraph should clearly indicate the time at which objections could be raised (that is, post-approval and pre-confirmation or post-confirmation).

Paragraph 11: supervision of implementation of the plan

242. It was suggested that some provision might be made to limit the time over which the court or some other supervisor might be involved where implementation was to occur over a lengthy number of years.

Paragraph 14: termination of the plan

243. With regard to conversion to liquidation proceedings, some concern was expressed that that should not involve a completely new filing involving more delay and unnecessary procedures. One solution suggested was to allow a liquidating plan providing for the sale of assets to be filed in the reorganization. It was noted however, that where implementation of the plan failed after a considerable elapse of time since the reorganization proceedings had been commenced, new proceedings might be necessary. It was also suggested that the question of conversion should be addressed more generally as applying at any time during the reorganization proceedings and to cover situations such as where the debtor had no honest intent in commencing reorganization; where there was a continuing loss of assets and no prospect of reorganization; or where the debtor failed to observe its obligations with respect to the proceedings.

7. Consideration of other issues

A. Out-of-court and expedited court reorganization

244. The Working Group considered a note by the Secretariat on out-of-court and expedited court reorganization, which had been prepared on the basis of the Working Group's earlier deliberations as follows:

"Out-of-court restructurings and expedited court reorganization procedures have proven to be a cost-efficient method of restructuring the financial obligations of financially troubled entities and as such can prove to be valuable tools in the range of insolvency processes available to a country's commercial and business sector. An out-of-court restructuring typically involves negotiations between the debtor and one or more classes of creditors. If a minority of affected creditors dissent or "hold-out", the dissenters can only be bound if reorganization proceedings are commenced under insolvency law and a reorganization incorporating the terms of the restructuring is approved by the court. The benefits of the out-of-court restructuring process can be preserved if the reorganization proceedings can be expedited in such a situation.

“Encouraging out-of-court restructurings need not stem from the fact that a country’s formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such restructurings can offer as an adjunct to a formal insolvency system that delivers fairness and certainty. Expedited court procedures could be utilized when a substantial number of creditors have reached agreement with the debtor but unanimity has not been achieved.

“Out-of-court processes

“It has been suggested that the draft guide on insolvency law should include a discussion of the various processes other than full reorganization proceedings under insolvency law that should normally be available to deal with the financial difficulty or insolvency of a commercial enterprise. This discussion should incorporate reference to texts that have been developed to assist the conduct of the out-of-court portion of these processes, such as the INSOL Principles for a global approach to multi-creditor workouts, and also discuss the interrelationship between such informal processes and reorganization proceedings under insolvency law.

“Out-of-court restructurings predominantly involve restructuring of debt due to lenders and other institutional creditors. They also however, frequently involve major non-institutional creditors, typically where such creditors’ involvement is so considerable that an effective restructuring is not possible without their participation.

“Another essential characteristic of out-of-court restructurings is that they do not generally involve all categories of creditors. It is usual for non-institutional creditors (other than those referred to in the previous paragraph) to be paid either in the ordinary course of business or in full under the reorganization plan. Those creditors are not likely to have any objection to the proposed restructuring and do not need a voice in the process.

“Expedited reorganization proceedings

“A need for court involvement to implement a restructuring that has been negotiated in an out-of-court process arises from the existence of a dissenting minority of creditors that the debtor and the majority wish to bind. This requires a non-consensual modification of contractual rights that can only be achieved by due process requirements that protect the creditors in a court proceeding.

“Under most existing legal systems, a modification of contractual rights requires the out-of-court restructuring to be converted to a full reorganization proceeding under the insolvency law, involving all creditors. Timing is typically critical in business reorganization and delay (usually inherent in full insolvency proceedings) can frequently be fatal to an effective reorganization. It is therefore important that the court takes advantage of any negotiations and work done prior to the commencement of reorganization proceedings under the insolvency law

and that the insolvency law permits the court to expedite those reorganization proceedings.

“The draft guide should include the procedure for implementing a restructuring that has been previously negotiated in an out-of-court process by means of a formal proceedings and develop provisions under the insolvency law to facilitate expedited reorganization proceedings by providing:

“(a) For a quicker process. For example, if an informal plan and other documentation that complies with the formal requirements of insolvency law have been negotiated informally and there is a substantial majority in favour, it would be possible for the court to order an immediate meeting or hearing as applicable, saving time and expense;

“(b) For an exemption to be granted from part of the formal process. For example, if an informal plan has been agreed by a sufficient majority of creditors of a particular class to approve a reorganization under the voting requirements of the insolvency law—typically the institutional creditors—and the rights of other creditors will not be impaired by the implementation of the plan, it might be possible for the court to order a meeting or hearing of that particular class of creditors only.

“There is no intention, however, to recommend less protection for non-assenting creditors and other parties under expedited court reorganization procedures than insolvency laws provide in full reorganization proceedings. The procedural requirements for expedited reorganization proceedings must contain substantially the same safeguards and protections as provided in full reorganization proceedings.

“Other laws may need to be modified to encourage or accommodate out-of-court restructuring and expedited reorganization proceedings. Examples of such laws would include those that require unanimous consent to adjust indebtedness outside of insolvency proceedings, that expose directors to liability for trading during the period when an out-of-court restructuring is being negotiated, that do not recognize obligations for credit extended during such a period and that restrict conversion of debt to equity.”

245. The proposal to address those processes in the draft guide was generally supported. In particular, support was expressed for including in the draft guide a discussion of out-of-court processes, including a consideration of the circumstances in which such processes might be used, the parties that might be involved and the existing mechanisms for facilitating their conduct. With respect to the expedited court procedures, support was expressed for establishing how the out-of-court process could be integrated into the expedited reorganization proceedings and it was suggested that what needed to be developed were the details of the proposal including the situations in which such a procedure might be used, the criteria that would trigger its use and the safeguards for creditors that would need to be included.

246. The Secretariat was requested to develop the details of the proposal for consideration by the Working Group at a later meeting.

B. Scope of the insolvency law

247. The Working Group considered paragraphs on the scope of the insolvency law, which had been revised on the basis of its earlier deliberations as follows:

“The purpose of provisions on eligibility and jurisdiction is to determine:

“(a) Which types of debtors can be subject to the insolvency law;

“(b) Which types of debtors require specialized treatment and should therefore be covered by a specialized insolvency regime and excluded from the general regime;

“[(c) Which debtors have sufficient connection to this State to be subject to its insolvency laws.]

“(1) Eligibility

“(a) An insolvency law should govern insolvency proceedings of all debtors engaged in commercial activities [including State-owned enterprises engaged in commercial activities].

“(b) Banks, insurance companies and other specified entities that are subject to special regulation and a specialized insolvency regime may be excluded from the application of the general insolvency law.

“(2) Jurisdiction

“(a) Insolvency proceedings may be commenced by or against a debtor if the debtor has its centre of main interests or its establishment in the enacting State.

“(b) In the absence of proof to the contrary, a legal person is presumed to have its centre of main interests in the State in which it has its registered office.

“(c) In the absence of proof to the contrary, a natural person is presumed to have its centre of main interests in the State in which it has its habitual residence.”

248. It was suggested that in the section addressing jurisdiction, the words “by or against” the debtor should be replaced with “vis-à-vis” the debtor because the connecting factor was simply the debtor. The notion of the voluntary or involuntary nature of the application was addressed in the paragraphs on application and commencement of proceedings.

C. Application and commencement

249. The Working Group considered paragraphs on application and commencement of proceedings, which had been revised on the basis of its earlier deliberations as follows:

“The purpose of provisions on application and commencement criteria is to:

“(a) Facilitate easy access to the insolvency law by debtors, creditors and government agencies;

“(b) Enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and inexpensive manner;

“(c) Facilitate access to the insolvency procedures that are most relevant to the debtor’s financial situation;

“(d) Protect both debtors and creditors from possible wrongful use of the insolvency law and establish basic safeguards.

“(1) An application to commence insolvency proceedings shall be made to the court by:

“(a) A debtor that can show that it is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets];

“(b) One or more creditors with claims against the debtor that are [mature and have not been paid by the debtor] or who can show that the debtor [is unable to pay its debts as and when they fall due or that its liabilities exceed the value of its assets];

“[(c) A prescribed government or non-government authority on the basis of [. . .].

“(2) An application for commencement of proceedings should establish that the debtor is insolvent and, in the case of an application to commence reorganization proceedings, should show that the debtor has a reasonable prospect of reorganization.

“(a) In the case of a voluntary application by the debtor the [application should function as automatic commencement of proceedings] [the court shall promptly determine whether the insolvency proceeding should be commenced].

“(b) In the case of an involuntary application,

“(i) Notice shall promptly be given to the debtor;

“(ii) The debtor shall be allowed to respond to the application; and

“(iii) The court shall promptly determine whether the insolvency proceeding should be commenced.

“(3) The court may dismiss a proceedings [or convert it] if it is determined to be an abuse of the process.

“(4) In the case of a voluntary application by a debtor, notice of the commencement of the proceedings should be provided to creditors.

“(a) Notification of commencement of proceedings should be given to creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. [Notification should also be given to the known creditors that do not have addresses in this State. No letters rogatory or other, similar formality is required.] [*Note to the Working Group: Do the provisions of the Model Law need to be repeated here?*]

“(b) The notification to creditors should:

“(i) Indicate any applicable time period for making a claim and specify the place at which it can be made;

“(ii) Indicate whether secured creditors need to make a claim to the extent to which their claims are or are not covered by the value of the security; and

“(iii) Contain any other information required to be included in such a notification to creditors pursuant to [*the law of the State and the orders of the court*].”

250. Some concern was expressed in relation to the inclusion in paragraph 2 of the requirement to show that the

debtor had a reasonable prospect of reorganization. It was suggested that paragraph 3 should include the possibility of sanctions where applications were made without good cause.

251. For lack of time, the Working Group did not complete its consideration of the revised paragraphs on application and commencement.

E. Report of the Secretary-General on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-fifth session: (A/CN.9/WG.V/WP.57) [Original: English]

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[Part two, chaps. II-VI of the draft legislative guide appear in document A/CN.9/WG.V/WP.58.]

BACKGROUND REMARKS

1. The United Nations Commission on International Trade Law (UNCITRAL), at its thirty-second session, in 1999, had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission of the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a "front line" factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work at an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and

Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the UNCITRAL secretariat, in cooperation with INSOL International and IBA, organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4 to 6 December 2000.

6. At its thirty-fourth session, in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished thus far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

8. The twenty-fourth session of the Working Group on Insolvency Law, which was held in New York from 23 July to 3 August 2001, commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504.

9. The present report sets forth the introduction, glossary, part one, containing key objectives, and chapter I, part two, containing core provision of an effective and efficient insolvency regime, of the draft legislative guide on insolvency law. Chapters II-VI of part two appear in document A/CN.9/WG.V/WP.58.

DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

Introduction

1. *Organization and scope of the Guide*

10. The purpose of the present Guide is to assist in the development of efficient and effective legal frameworks for insolvency. The advice provided in the Guide aims at achieving a balance between provisions necessary to encourage the early use of and access to an insolvency regime in order to maximize the utility of the tangible and intangible assets of a business entity on a fair and balanced basis to the stakeholders and avoid the erosion of value through delay, on the one hand, and various public interest concerns on the other.

11. The present report and document A/CN.9/WG.V/WP.58 set forth the draft legislative guide on insolvency law. The present report contains the introduction, a note on terminology, a glossary, key objectives and chapter I of part two, containing an introduction to insolvency procedures. Part two, chapters II-VI, which are set forth in document A/CN.9/WG.V/WP.58, deal with substantive core provisions of an effective and efficient insolvency regime. Each subject area is divided into two sections. The first section offers an analytical introduction to the issues raised by each core subject area in respect of both liquidation and reorganization proceedings and discusses policy issues and comparative approaches. The second section provides a summary of the goals of legislative provisions on each core subject area and recommendations as to the approaches that could be taken. It is intended that the second section will also contain legislative provisions indicating how the recommendations can be implemented.

12. The Guide does not address questions of relevance to cross-border aspects of insolvency law, such as the treatment of foreign creditors. These matters are addressed in the UNCITRAL Model Law on Cross-Border Insolvency and it is recommended that that text be considered in addition to this Guide. The Guide is not intended in any way to modify or amend any provision of the Model Law.

2. Terminology used in the Guide and role of definitions

13. The following terms are intended to provide orientation to the reader of the Guide; many terms such as “secured creditor”, “liquidation” and “reorganization” may have fundamentally different meanings in different jurisdictions and the inclusion of a definition in the Guide may assist in ensuring that the concepts as included in the draft Guide are clear and widely understood. The terms included in the draft Guide have not yet been discussed by the Working Group and contain a number of possible alternatives, which appear between square brackets.

References in the Guide to the “court”

14. The draft Guide assumes that there is reliance on court supervision throughout the insolvency proceedings, which may include the power to commence insolvency proceedings, to appoint the insolvency representative and to supervise its activities and to take decisions in the course of the proceedings. Although this reliance may be appropriate as a general principle, alternatives may be considered where, for example, the courts are unable to handle insolvency work (whether for reason of lack of resources or lack of requisite experience) or supervision by an administrative agency is preferred. For the purpose of simplicity, the draft Guide uses the word “court” in the same way as article 2 (e) of the UNCITRAL Model Law on Cross-Border Insolvency to refer to a judicial or other authority competent to control or supervise an insolvency proceeding.

3. Glossary

Avoidance action: Action which allows transactions to be cancelled or otherwise rendered ineffective. Transactions that may be avoided include those (a) between a debtor and a creditor having the effect of creating a preference in favour of that creditor to the prejudice of the general body of creditors [other than in the normal course of trade], having taken place within [a specified period of time] before the commencement of the proceedings; or (b) in which a debtor’s assets were transferred for unfair value; or (c) in which a debtor’s assets were transferred fraudulently.

Centre of main interests: The place where the debtor conducts the administration of its interests on a regular basis, as such ascertainable by third parties.

Claim: Enforceable right to money or assets.

Collateral: Asset subject to a security interest to the benefit of one or more creditors, who are entitled to sell the asset in the event of default (see secured claim).

Commencement of proceedings: [Date as of which the effects of insolvency are applicable] or [Date as of which the judicial decision commencing insolvency proceedings becomes effective, whether it is a final decision or not].

Composition: [Within the context of reorganization,] agreement between the debtor and the [majority of] creditors where the creditors agree with the debtor and between themselves to accept from the debtor payment of less than the amount due to them in full satisfaction of their claims or to a reduction or postponement of debts or the redefinition of payment terms.

Court: A judicial or other authority competent to control or supervise an insolvency proceeding (UNCITRAL Model Law on Cross-Border Insolvency, art. 2(e)).

Cram-down provision: A mechanism that will enable the support of one class of creditors for a reorganization plan to be used to make the plan binding on other classes without their consent

Creditor committee: Representative body appointed by [the court] [the insolvency representative] [creditors as a whole] to act on behalf and in the interests of the creditors and having consultative and other powers as specified in the insolvency law.

Debtor: Person or entity engaged in a business and that meets the criteria for, and is subject to, insolvency proceedings, with the exception of entities subject to a special insolvency regime [including banking and financial institutions, insurance companies and *[other]*].

Discharge: A court order releasing a debtor from all liabilities that were, or could have been, addressed in the insolvency proceedings, including contracts that were modified as part of a reorganization.

Establishment: Any place of operations where the debtor carries out a non-transitory economic activity with human

means and goods or services (UNCITRAL Model Law on Cross-Border Insolvency art. 2(f)).

Going concern: The basis upon which a business is continued and sold as a working whole in liquidation, as opposed to a piecemeal sale of individual assets of the business

Initiation of proceedings: The making of an application for commencement of insolvency proceedings by the debtor; one or more creditors; the general public attorney; the insolvency court of its own motion.

Insolvency: [When the debtor is [likely to become] unable or is no longer able to pay its debts and other liabilities as they fall due] or [When the value of debts and liabilities of the debtor exceeds the value of assets] or [when the debtor generally ceases to pay or suspends payment of its debts and other liabilities as they fall due, the cash assets being insufficient] or [When the debtor ceases to pay important and sensitive debts, such as rent, wages and social security payments].

Insolvency estate: Assets of the debtor controlled by the insolvency representative and subject to the insolvency proceedings; [Goods and rights pertaining to the debtor as of and after the commencement of the proceedings which can be evaluated in money [and which constitute assets available for payment of creditors' claims] or [goods and rights pertaining to the debtor which can be evaluated in money [and are available for creditors as their security].

Insolvency proceedings: Collective proceedings that involve the [partial or total] divestment of the debtor and the appointment of an insolvency representative [for the purpose of either liquidation or reorganization of the business] [including both liquidation and reorganization proceedings].

Insolvency representative: [Person [or entity] appointed by the court that is in charge of administering the debtor's estate [and assisting and watching over the management of the business] with a view to either liquidation or reorganization of the business; or person [or entity] appointed by the insolvency court to whom the powers of the debtor's management] to administer, sell or dispose of [assets included in] the insolvency estate are transferred as of the commencement of the proceeding, acting under the supervision of the court. Such powers include without limitation the following: determining or assisting in determination of creditors' claims; realizing the [assets pertaining to the] insolvency estate; making distributions of proceeds among creditors; taking avoidance actions.

Insolvency decision: Decision of the court to commence an insolvency proceeding [and to appoint an insolvency representative] (see also commencement of proceedings).

Involuntary proceedings: Insolvency proceedings commenced on the application of creditors or by the general public attorney's office or [other].

Liquidation: Process whereby a debtor has its assets assembled, disposed of and distributed for the benefit of

[the insolvency estate and] the creditors, including shareholders [followed by the dissolution of the legal entity], either by way of a piecemeal sale or a sale of all or most of the debtor's assets in productive operating units or as a going concern.

Netting: In one form it can consist of set-off (see "set-off") of non-monetary fungibles (such as securities or commodities deliverable on the same day, known as settlement netting) and in its more important form it consists of a cancellation by a counterparty of open contracts with the debtor, followed by a set-off of losses and gains either way (close-out netting).

Observation period: [Within the context of a unitary (see part two) insolvency proceeding], the possibility or otherwise of successful reorganization must be established.

Pari passu: Principle according to which creditors of the same class are treated equally [and are paid proportionately out of the assets of the estate].

Pending contracts: Contracts outstanding [and not or not fully performed] as of the commencement of the proceedings.

Post-commencement creditor: Creditor whose claim has arisen after commencement of the insolvency proceedings.

Preference: A payment or other transactions made by an insolvent entity that place a creditor in a better position than it would have been otherwise.

Preliminary insolvency representative: Person or entity appointed by the insolvency court in case of a serious crisis of the debtor that prevents the normal operation of its business, required to ensure temporarily further carrying on the business in connection with suspension of the debtor or of the debtor's management (possibly in connection with reorganization).

Priming lien: A priority given to lenders of post-commencement credit, which ranks ahead of all creditors, including secured creditors.

Priority claim: A claim that will be paid out of available assets before payment of general unsecured creditors.

Priority rules: The rules by which distributions are ordered among creditors and equity interests.

Reorganization: Process of restructuring an insolvent entity in order to [rescue the debtor and] restore the financial well-being and the viability of the business, by way of various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business or parts of it as a going concern.

Reorganization plan: A plan to reorganize the business [and redress the debtor] submitted by [the debtor][the creditors] [the insolvency representative] [and confirmed by the court], addressing issues such as timing of the process, commitments to be undertaken, terms of payment and securities to be offered to creditors, avoidance actions

to be filed and treatment of pending contracts including employment contracts.

Reservation of title (title financing): Provision of a contract for the supply of goods that purports to reserve ownership of the goods with the supplier until the goods are paid for.

Secured claim: A claim assisted by a security taken as a guarantee for a debt enforceable in case of the debtor's default when the debt falls due.

Secured creditor: A creditor holding either a security covering all or part of the debtor's assets or a security over a specific asset entitling the creditor to preference ahead of other creditors with respect to the encumbered assets.

Secured debt: [Aggregate amount of secured claims] or [claims pertaining to secured creditors].

Set-off: Where a claim for a sum of money owed to a person is "set-off" (balanced) against a claim by the other party for a sum of money owed by that first person. May operate as a defence in whole or part to a claim for a sum of money.

Stay of proceedings: Suspension of the power of the creditors to commence or continue judicial, administrative or other individual actions for enforcement and recovery of their claims, or for obtaining possession of assets pertaining to the insolvency estate, or for creating, perfecting or enforcing any security over assets pertaining to the insolvency estate.

Super-priority: A priority that will result in claims to which the priority attaches being paid before administrative claims.

Unsecured debt: Aggregate amount of claims not supported by security.

Voluntary proceedings: Insolvency proceedings commenced on the application of the debtor.

Part One. Key objectives of an effective and efficient insolvency regime

1. Maximize value of assets

15. Insolvency law should provide for the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized by allowing it to continue. The maximum value for creditors can often be obtained through reorganization rather than liquidation.

2. Strike a balance between liquidation and reorganization

16. An insolvency regime needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against maintaining the

debtor as a viable business through reorganization (often the preference of unsecured creditors) and other social policy considerations such as encouraging the development of an entrepreneurial class and protecting employment. A broadly phrased "arrangement" or "method" that aims at maximizing the return and minimizing the effects of insolvency and includes a range of possible insolvency techniques, would avoid implied preference for one technique over the other.

3. Ensure equitable treatment of similarly situated creditors

17. An insolvency regime should treat similarly situated creditors, including both foreign and domestic creditors, equitably. Equitable treatment recognizes that all creditors do not need to be treated equally, but in a manner that reflects the different bargains they have struck with the debtor, as well as the prerogatives pertaining to holders of claims or interests that arise by operation of the law. The insolvency regime should address problems of fraud and favouritism that may arise in cases of financial distress, by providing that acts detrimental to equitable treatment of creditors can be avoided.

4. Provide for timely and efficient commencement of proceedings and for impartial resolution of insolvency

18. Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business and the activities of the debtor and to minimizing the cost of the proceedings. The law should facilitate easy access to the insolvency process by reference to clear and objective criteria, provide a convenient means of identifying, collecting, preserving and recovering property that should be applied towards payment of the debts and liabilities of the debtor, facilitate participation of the debtor and its creditors with the least possible delay and expense, provide an appropriate structure for supervision and administration of the process and provide, as an end result, effective relief to the financial obligations and liabilities of the debtor.

5. Prevent premature dismemberment of the debtor's assets by creditors

19. An insolvency regime should be orderly and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts. Such activity often reduces the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganization. A stay of creditor action provides a breathing space for the debtor, enabling a proper examination of its financial situation and facilitating both maximization of the value of the estate and equitable treatment of creditors. A mechanism may be required to ensure that the rights of secured creditors are not impaired by a stay.

6. *Provide for a procedure that is transparent and contains incentives for gathering and dispensing information*

20. An efficient and effective insolvency procedure will enable those responsible for administering and supervising the insolvency process (courts or administrative agencies, the insolvency representative) and creditors to assess the financial situation of the debtor and determine the most appropriate solution. The insolvency law should ensure that adequate information is available in respect of the debtor's situation, providing incentives to encourage the debtor to reveal its positions or, where appropriate, sanctions for failure to do so. The insolvency law should be transparent and predictable, to enable potential lenders and creditors to understand how the insolvency process operates and to assess the risk associated with their position as a creditor in the event of insolvency. As far as possible, an insolvency law should clearly indicate all provisions of other laws that may affect the conduct of the insolvency proceedings.

7. *Recognize existing creditor rights and respect priority claims with a predictable process*

21. Recognition and enforcement within the insolvency process of the differing rights that creditors have outside of insolvency will create certainty in the market and facilitate the provision of credit. Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide clarity to lenders, to ensure that they can be consistently applied and that there is confidence in the process and that all participants are able to adopt appropriate measures to manage risk.

8. *Establish a framework for cross-border insolvency*

22. To promote coordination among jurisdictions and facilitate the provision of assistance in the administration of insolvency proceedings originating in a foreign country, insolvency laws should provide rules on cross-border insolvency, including the recognition of foreign proceedings, by adopting the UNCITRAL Model Law on Cross-Border Insolvency.

Part Two. Core provisions of an effective and efficient insolvency regime

I. *Introduction to insolvency procedures*¹

A. *General features of an insolvency regime*

23. When a debtor is unable to pay its debts and liabilities as they become due, the need arises to provide for a legal mechanism to address the collective satisfaction of the outstanding claims on all assets (whether tangible or intangible) of the debtor. A range of interests needs to be

accommodated by that legal mechanism: the debtor, the owners and management of the debtor, the creditors who may be secured to varying degrees, employees, fiscal creditors, guarantors of debt and unsecured creditors, as well as government, commercial and social institutions and practices that are relevant to the design of the mechanism and to the institutional framework required for its operation. Most legal systems contain rules on various types of proceedings (which may be referred to by the generic term "insolvency proceedings") that can be initiated to resolve that situation. While addressing a common goal of resolving the debtor's financial difficulties, these proceedings take a number of different forms, including both formal and informal elements, for which uniform terminology is not always used.

24. Designing an effective and efficient insolvency law will require consideration of a common set of issues, both of a substantive and institutional nature. The substantive issues, which are discussed in detail in part two of the present Guide, include:

(a) Identifying the debtors that may be subject to insolvency proceedings and those debtors which may be subject to a special insolvency regime;

(b) Determining when insolvency proceedings may be commenced and the type of proceedings that may be commenced, the party that may request commencement and whether the commencement criteria should differ depending upon who is requesting commencement;

(c) The extent to which the debtor should be allowed to retain control of the business once proceedings commence or whether it should be displaced and an independent party (in this Guide referred to as the insolvency representative) appointed to supervise and manage the debtor;

(d) Protection of the assets of the debtor against the actions of creditors, the debtor itself and the insolvency representative. Where a stay applies to commencement and continuation of actions by creditors once insolvency proceedings commence, should it also apply to secured creditors and if so, how will the value of their secured interest be protected during the insolvency proceedings;

(e) The extent to which the insolvency representative will have the authority to interfere with the terms of contracts entered into by the debtor before the commencement of proceedings and either not or not fully performed;

(f) The extent to which the insolvency representative can avoid certain types of transactions that are fraudulent, or otherwise result in the interest of creditors being prejudiced;

(g) Preparation of the reorganization plan and the limitations, if any, that will be imposed on the content of the plan, the preparer of the plan and the conditions required for its approval and implementation;

(h) The ranking of creditors for the purposes of distributing the proceeds of liquidation; and

(i) [...].

25. In addition to these specific subject areas, a more general issue to be addressed is whether an insolvency law will effectively modify other substantive laws. For example,

¹The material in chapter I draws on the work of the Asian Development Bank, the International Monetary Fund and the World Bank.

whether an insolvency law will affect employment laws that provide certain protections to employees, laws that limit the availability of set-off and netting, laws that limit debt-for-equity conversions and laws that impose foreign exchange and foreign investment controls that may affect the content of a reorganization plan (see A/CN.9/WG.V/WP.58, paras. 113 and 114, Employment contracts, paras. 228-230, Employees, paras. 116-123, Set-off, netting and financial contracts, and paras. 272-274, Content [of the reorganization plan]).

B. Types of insolvency proceedings

26. Two main types of proceedings can be identified: liquidation (typically formal proceedings) and reorganization (which may be either formal proceedings, informal proceedings or in some cases a combination of informal and formal procedures). The traditional division between these two types of processes, however, is somewhat artificial and can create unnecessary polarization and inflexibility. It does not accommodate, for example, cases not easily situated at the poles—those cases where a flexible approach to the debtor's financial situation is likely to achieve the best result for both the debtor and the creditors in terms of maximizing the value of the insolvency estate (which may require a combination of processes, sometimes both formal and informal). In addition, the distinction between conventional liquidation and reorganization procedures is not always clear-cut. The term "reorganization", for example, is sometimes used to refer to a particular way of ensuring preservation and possible enhancement of the value of the insolvency estate in the context of liquidation proceedings. This is the case, for instance, whenever the law provides for liquidation to be carried out by transferring the business to another entity as a going concern. In that situation, the term "reorganization" merely points to a technique other than traditional liquidation (that is, straightforward sale of the assets), being used in order to obtain as much value as possible from the insolvency estate.

27. For these reasons, it is desirable that an insolvency law provide more than a choice between a strictly traditional liquidation process and a single type of reorganization process. The concept of reorganization can accommodate a variety of arrangements that do not need to be specifically detailed in an insolvency law. It may be sufficient for the reorganization regime to permit a result that would achieve more than if the entity was liquidated (in fact, the reorganization may contemplate an eventual liquidation or sale of the business).

28. In discussing the core provisions of an effective and efficient insolvency regime, this Guide focuses on a liquidation procedure on the one hand and a reorganization procedure on the other. However, the adoption of this approach is not intended to indicate a preference for particular types of processes nor a preference for how the different processes should be integrated into an insolvency law. Rather, the Guide seeks to compare and contrast the core elements of the different types of procedures and to promote an approach that focuses on maximizing the result for the parties involved in an insolvency process. This may

be achieved by designing an insolvency law that incorporates the traditional formal elements in a way that promotes both maximum flexibility and the use of informal processes where they will be most effective.

1. Liquidation

29. The type of proceedings referred to as "liquidation" typically provides for a public authority (typically, although not necessarily, a judicial court acting through a person appointed for the purpose) to take charge of the debtor's assets, with a view to terminating the commercial activity of the debtor, transforming non-monetary assets into monetary form and subsequently distributing the proceeds proportionately to creditors. These proceedings usually result in liquidation or disappearance of the debtor as a commercial legal entity, although in some instances the assets may be sold together as an operating business. Other terms used for this type of proceedings include bankruptcy, winding-up, *faillite*, *quiebra* and *Konkursverfahren*.

30. This type of proceedings tends to be close to "universal" in its concept, acceptance and application. It normally follows a pattern that includes:²

- (a) An application to a court or other competent body either by the entity or by creditor(s);
- (b) An order or judgement that the entity be liquidated;
- (c) Appointment of an independent person to conduct and administer the liquidation;
- (d) Closure of the business activities of the entity;
- (e) Termination of the powers of owners and management and the employment of employees;
- (f) Sale of the entity's assets;
- (g) Adjudication of claims of creditors;
- (h) Distribution of available funds to creditors (under some form of priority); and
- (i) Dissolution of the entity.

31. There are a number of legal and economic justifications for the liquidation process. Broadly speaking, a commercial entity that is unable to compete in a competitive market economy arguably has no place in and should be removed from the market place. A principal identifying mark of an uncompetitive entity is that it becomes insolvent. More specifically, the need for liquidation procedures can be viewed as addressing inter-creditor problems (when an insolvent debtor's assets are insufficient to meet the claims of all creditors it will be in the creditor's own best interests to take action to recover its claim before other creditors can take similar action) and as a disciplinary force that is an essential element of a sustainable debtor-creditor relationship. An orderly and effective liquidation procedure addresses the inter-creditor problem by setting in motion collective proceedings that seek to avoid those actions that, while viewed by individual creditors as in their own best

²See "Law and policy reform at the Asian Development Bank", report on RETA 5795: insolvency law reforms in the Asian and Pacific region, Asian Development Bank, 2000, para. 35.

self-interest, essentially lead to the loss of value for all creditors. Collective proceedings are designed to provide equitable treatment to creditors and to maximize the value of the debtor's assets for the benefit of all creditors. This is normally achieved by the imposition of a stay on the ability of creditors to enforce their individual rights against the debtor and the appointment of an independent person whose primary duty is to maximize the value of the debtor's assets for distribution to creditors.

32. Liquidation procedures also constitute an important disciplinary force that is an essential element of a sustainable debtor-creditor relationship. They can provide, for example, an orderly and relatively predictable mechanism by which the rights of creditors can be enforced. These procedures not only provide creditors with an element of predictability when they make their lending decisions, but also more generally promote the interest of all participants in the economy by facilitating the provision of credit and the development of financial markets.

2. Reorganization

(a) Formal reorganization proceedings

33. An alternative to liquidation is a process that is designed to save a business rather than terminate it. This process, which may take one of several forms and may be less universal in its concept, acceptance and application than liquidation, is referred to by a number of different names including reorganization, rescue, restructuring, turnaround, rehabilitation, arrangement, composition, *concordat préventif de faillite*, *suspensión de pagos*, *administración judicial de empresas*, and *Vergleichsverfahren*. For the sake of simplicity, the term "reorganization" is used in the draft Guide in a broad sense to refer to the type of proceedings whose ultimate purpose is to allow the debtor to overcome its financial difficulties and resume or continue normal commercial operations.

34. One of the justifications for including a reorganization procedure in an insolvency law is to balance the rationale of a liquidation regime since not all entities that fail in a competitive marketplace should necessarily be liquidated. An entity with a reasonable prospect of survival (such as one that has a potentially profitable business) should be given that opportunity, especially where it can be demonstrated that there is greater value (and, by deduction, greater benefit for creditors in the long term) in keeping the essential business and other component parts of the entity together. Reorganization procedures are designed to give an entity some breathing space to recover from its temporary liquidity difficulties or more permanent over-indebtedness and, where necessary, provide it with an opportunity to restructure its operations and its relations with creditors. Where reorganization is possible, generally it will be preferred by creditors if the value derived from the continued operation of the entity will enhance the value of their claims. Reorganization, however, does not imply that the entity will be completely restored or its creditors paid in full. Nor does it necessarily mean that ownership and management of an insolvent entity will maintain and preserve their respective positions. In general, however,

reorganization does imply that whatever form of plan, scheme or arrangement is agreed, the creditors will eventually receive more than if the entity was to be liquidated.

35. That result may be achieved by using procedures that take a number of different forms. These may include a simple agreement concerning debts (referred to as a composition) where, for example, the creditors agree to receive a certain percentage of the debts owed to them in full, complete and final satisfaction of their claims against the debtor. The debts are thus reduced and the entity becomes solvent and can continue to trade. They may also include a complex reorganization under which, for example, the debts of the insolvent entity are restructured (for example, by extending the length of the loan and the period in which payment may be made, deferring payment of interest or changing the identity of the lenders); some debt may be converted to equity together with a reduction (or even extinguishment) of existing equity; the non-core assets may be sold; and the unprofitable business activities closed. The choice of the way in which reorganization is carried out is typically a response to the size of the business and the degree of complexity of the debtor's specific situation.

36. Although the reorganization process is not as universal as liquidation, and may not therefore follow such a common pattern, there are a number of key or essential elements that can be determined:³

(a) Voluntary submission of the entity to the process, which may or may not involve judicial proceedings and judicial control or supervision;

(b) Automatic and mandatory stay or suspension of actions and proceedings against the assets of the entity affecting all creditors for a limited period of time;

(c) Continuation of the business of the entity, either by existing management, an independent manager or a combination of both;

(d) Formulation of a plan that proposes the manner in which creditors, equity holders and the entity itself will be treated;

(e) Consideration of, and voting on, acceptance of the plan by creditors; possibly, the judicial sanction of an accepted plan; and

(f) Implementation of the plan.

37. While the benefits of reorganization are generally accepted, the extent to which formal reorganization procedures are relied upon to achieve the objectives of reorganization varies between countries. It is generally recognized that the existence of a liquidation procedure can facilitate the reorganization of an entity, whether by formal reorganization proceedings or informal means through an out-of-court process (the existence of the formal regime operating as an incentive to both creditors and debtors to reach an appropriate agreement). Indeed, in many economies, reorganization largely takes place informally "in the shadow" of the formal insolvency regime. There is often, however, a correlation between the degree of financial difficulty being experienced by the debtor and the difficulty of

³Ibid., para. 41.

the appropriate solution. Where, for example, a single bank is involved, it is likely that the debtor can negotiate informally with that bank and resolve its difficulties without involving trade creditors. Where the financial situation is more complex and requires the involvement of a large number of different types of creditors, a greater degree of formality may be needed to find a solution that addresses the disparate interests and objectives of these creditors.

38. Notwithstanding the prevalence of informal processes, formal reorganization procedures can provide a mechanism for enterprise reorganization that serves the interests of all participants in the economy. First, since out-of-court reorganization requires unanimity of creditors, recourse to formal reorganization procedures may assist in achieving restructuring where they enable the debtor and a majority of creditors to impose a plan upon a dissenting minority of creditors, especially where there are creditors who “hold-out” during out-of-court negotiations. Secondly, the modern economy has significantly reduced the degree to which an entity’s value can be maximized through liquidation. In cases where technical know-how and goodwill are more important than physical assets, the preservation of human resources and business relations are essential elements of value that cannot be realized through liquidation. Thirdly, long-term economic benefit is more likely to be achieved through reorganization procedures, since they encourage debtors to take action before their financial difficulties become severe. Lastly, there are social and political considerations, which are served by the existence of reorganization procedures that protect, for example, the employees of a troubled entity.

(b) *Informal reorganization proceedings*

39. Informal processes were developed some years ago by the banking sector, as an alternative to formal reorganization processes. Led and influenced by internationally active banks and financiers, the informal process has gradually spread to a considerable number of jurisdictions. The application of the informal process has generally been limited to cases of corporate financial difficulty or insolvency in which there is a significant amount of debt owed to banks and financiers. The process is aimed at securing an agreement both between the lenders themselves and the lender and the debtor for the reorganization of the debtor entity, with or without the rearrangement of the financing. An informal reorganization can provide a means of introducing flexibility into an insolvency system by reducing reliance on judicial infrastructure, facilitating an earlier proactive response from creditors than would normally be possible under formal regimes and avoiding the stigma that often attaches to insolvency. It does, however, rely on the existence of the formal insolvency framework to provide sanctions that assist to make the informal process successful. Unless the debtor and its bank and finance creditors take the opportunity to join together and commence the informal process, the debtor or the creditors can invoke the formal insolvency law, with the potent for detriment to both the debtor and its creditors.

40. Informal processes may take various forms, ranging from a completely informal process based upon non-binding principles that support a collective negotiating

framework and do not involve the judicial system (although relying on the existence of an efficient and effective formal system for leverage), to those which utilize a judicial administration mechanism to enforce a plan reached by informal negotiations and to bind creditors to that plan. Where the negotiations take place out of court and the debtor and the majority of creditors agree to the plan, a fast track mechanism can be used for the approval process.

41. Issues to be addressed:

[Conditions necessary for effective informal procedures and processes required to conduct informal proceedings]

[A/CN.9/504, para. 161: It was noted that some of those considerations intersected with the Working Group’s development of a legislative guide on a formal insolvency regime and consideration would need to be given to how that intersection could be achieved. In particular, it was suggested that the draft Guide should consider the different options, offering a discussion of the advantages and disadvantages of each and indicating how they could be integrated into a reorganization regime. It was noted in that regard that there was a correlation between the degree of financial difficulty being experienced by the debtor and the difficulty of the appropriate solution. Where, for example, a single bank was involved, it was likely that the debtor could negotiate informally with that bank and resolve its difficulties without involving trade creditors. Where the financial situation was more complex and required the involvement of a large number of different types of creditors, a greater degree of formality might be needed. It was suggested that that approach might be a way of presenting the different procedures to legislators. It was agreed that those considerations should be taken into account in the Working Group’s consideration of the reorganization sections of the draft Guide, and in particular that the subject of expedited reorganization procedures to implement restructurings of the type addressed in document A/CN.9/WG.V/WP.55 (including both cross-border and domestic arrangements) should be addressed in the draft Guide.]

(i) *Completely Informal processes*

42. Issues to be addressed:

[A/CN.9/504, para. 159: With respect to the completely informal processes, it was suggested that the Working Group should consider the work being undertaken by other organizations, such as the INSOL Lenders Group’s Statement of Principles for a global approach to multi-creditor workouts (set forth in document A/CN.9/WG.V/WP.55), and other similar types of guidelines.]

43. One method is the “London approach” which is based on non-binding guidelines issued by the Bank of England to commercial banks. Banks are urged to take a supportive attitude toward their debtors that are in financial difficulties. Decisions about the debtor’s longer-term future should only be made on the basis of comprehensive information, which is shared among all the banks and other parties that

would be involved in any agreement as to the future of the debtor. Interim financing is facilitated by a standstill and subordination agreement, and banks work together with other creditors to reach a collective view on whether and on what terms a debtor entity should be given a financial lifeline.

(ii) *Administrative processes*

44. Issues to be addressed:

[A/CN.9/504, para. 160: *With regard to administrative frameworks, three types of experience were noted and it was suggested that the draft Guide should consider the relevant examples and the circumstances in which they had proven to be useful and where they might appropriately be used in the future. In particular, it was pointed out that they had been of assistance in situations where the courts were inadequate to deal with the issues or simply overwhelmed by the extent of systemic failure.*]

45. In recent years a number of crisis-affected jurisdictions have developed semi-official “structured” forms of informal processes, largely inspired by government or central banks, to deal with systemic financial problems within the banking sector. These processes have been developed on a similar pattern. First, each has a facilitating agency to encourage and, in part, coordinate and administer informal reorganization to provide the incentive and motivation necessary for development of the informal processes. Second, each process is underpinned by an agreement between commercial banks in which the participants agree to follow a set of “rules” in respect of corporate debtors who are indebted to one or more of the banks and which may participate in the process. The rules provide the procedures to be followed and the conditions to be imposed in cases where corporate reorganization is attempted. In some of the jurisdictions, a debtor corporation that seeks to negotiate an informal reorganization is required to agree to the application of these rules. Third, time limits are provided for various parts of the procedures and, in some cases, agreements in principle can be referred to the relevant court for a formal reorganization to occur under the law. In addition, one jurisdiction established a statutory agency which has extremely wide powers to acquire non-performing loans from the banking and finance sector and then to impose extrajudicial processes upon a defaulting corporate debtor, including a forced or imposed reorganization.

(iii) *Hybrid processes*

46. Issues to be addressed:

[A/CN.9/504, para. 159: *In regard to those processes that combined informal and formal elements, the Working Group might consider how those processes had been developed around the world and in particular examine the role that was taken by judicial and administrative authorities and the point at which intervention occurred.*]

47. Some countries have adopted what can be described as “pre-insolvency” procedures that are, in effect, a hybrid

of out-of-court reorganization and formal reorganization procedures. Under one insolvency law, regulations have been issued that allow the court to approve a reorganization plan under the insolvency law even though the support required from creditors as a condition for court approval under the insolvency law was obtained through a vote that occurred before the actual commencement of the formal reorganization proceedings. Such “pre-packaged” insolvency regulations are designed to minimize the cost and delay associated with formal reorganization procedures while providing a means by which a reorganization plan can be approved absent unanimous support of the creditors.

48. Another insolvency law provides that in order to facilitate the conclusion of an amicable settlement with its creditors, a debtor may ask the court to appoint a “conciliator”. The conciliator has no particular powers but may request the court to impose a stay of execution against all creditors if, in his or her judgement, a stay would facilitate the conclusion of a settlement agreement. During the stay, the debtor may not make any payments to discharge prior claims (except salaries) or dispose of any assets other than in the regular course of business. The procedure ends when agreement is reached either with all creditors or (subject to court approval) with the main creditors; in the latter case, the court may continue the stay against non-participating creditors by providing a grace period of up to two years to the debtor.

49. Issues to be addressed:

[A/CN.9/WG.V/WP.55, paras. 22 and 23: *[Another approach is based upon] a statutory framework that would provide for expedited insolvency proceedings to implement a voluntary restructuring of borrowed money indebtedness (institutional lender debt and bonds) of insolvent international business enterprises based upon approval of the restructuring by a requisite super-majority of each affected class, and judicial review of the adequacy of the restructuring assessed against appropriate international restructuring standards. The principle features of that approach include the ability to declare a brief moratorium to permit voluntary restructuring discussions to be completed; solicitation of creditor approvals for a restructuring before the commencement of legal proceedings; an approval requirement of 75 per cent in number and value of affected classes of creditors; expedited insolvency procedures for approval of the restructuring by an insolvency court to make it binding on dissenting creditors; and minimum legal criteria for court approval of the restructuring.*]

C. *Relationship between liquidation and reorganization proceedings*

50. Under certain circumstances, the needs arising in connection with the insolvency of a debtor are best addressed by the liquidation of all of the debtor’s assets and the subsequent distribution of proceeds among creditors. Under other circumstances, however, liquidation may not be the best way to maximize the value of the resources of

the insolvent debtor. In reality, as noted above, straight liquidation of the assets often results in creditors receiving only a portion of the nominal value of their claims. In those cases, the reorganization of the business to preserve its human resources and goodwill may prove more effective in maximizing the value of the creditors' claims, allowing them to receive more favourable treatment or even to be paid in full. This may be especially true when, for example, the value of the business relies on intangibles (such as intellectual property rights) rather than tangible assets.

51. Reasons for preferring reorganization as opposed to liquidation may also arise in connection with the political and social background of a legal system. Some countries consider reorganization proceedings as serving a broad social interest, not only encouraging debtors to resort to reorganization before their financial difficulties become too severe, but also offering them a "second chance", thus ultimately enhancing economic development and growth. Similarly, protection of the employees of a troubled business may be an important consideration that influences both the design of the insolvency law and the choice of reorganization over liquidation. Because of the importance attached to these political and social objectives in some legal systems, many countries recognize that a functioning and effective insolvency regime needs to include both liquidation and reorganization procedures.

52. Although many insolvency laws include both liquidation and reorganization proceedings, approaches differ widely as to the structure of the procedure that leads to the choice one of these outcomes. Some insolvency laws provide for unitary, flexible insolvency proceedings, alternatively resulting in liquidation or reorganization depending on the circumstances of the case. Other laws provide for two distinct proceedings, each setting forth its own access and commencement requirements, with different possibilities for conversion between the two proceedings.

53. Those laws which treat liquidation and reorganization procedures as distinct from each other do so on the basis of different social and commercial policy considerations and with a view to achieving different objectives. However, a significant number of issues are common to both liquidation and reorganization, resulting in considerable overlaps and linkages between them, in terms of both procedural steps and substantive issues, as will become evident from the discussion in part two which follows.

54. Where two distinct procedures are provided in the insolvency law, the determination of whether the business of the insolvent debtor is viable should determine, at least in theory, which procedure will be used. As a matter of practice, however, at the time of commencement of either procedure, it is often impossible to make a final evaluation as to the financial viability of the business. Hence the need for the law to provide linkages between the two proceedings, with a view to allowing conversion of one type of proceeding to the other in certain specific circumstances, and to include devices designed to prevent the abuse of insolvency process, such as commencing

reorganization proceedings as a means of avoiding or delaying liquidation.

55. As to the question of choice of procedures, some countries provide that the party applying for the insolvency proceedings will have the initial choice between liquidation and reorganization. When liquidation proceedings are initiated by one or more creditors, the law will often provide a mechanism that enables the debtor to request conversion into reorganization proceedings where this is feasible. When the debtor applies for reorganization proceedings, whether on its own motion or as a consequence of an application for liquidation by a creditor, the application for reorganization should logically be decided first. With a view to protecting creditors, however, some insolvency laws will provide for a mechanism enabling reorganization to be converted into liquidation upon a determination that reorganization is not likely to succeed. Another mechanism of protection for creditors may consist of setting forth the maximum period for which reorganization against the will of the creditors may be granted.

56. As a general principle, although usually presented as separate procedures, liquidation and reorganization procedures are normally carried out sequentially, that is, a liquidation procedure will only run its course if reorganization is unlikely to be successful or if reorganization efforts have failed. In some insolvency systems, the general presumption is that a business should be reorganized and liquidation procedures may be commenced only when all attempts to reorganize the entity have failed. In insolvency systems providing for conversion, a request for reorganization to be converted into liquidation may be made by the debtor, the creditors or the insolvency representative, depending upon the circumstances set forth by the law. These circumstances may include where the debtor is unable to pay post-petition debts as they fall due; the reorganization plan is not approved by creditors or the court; where the debtor fails to fulfil its obligations under an approved plan; or where the debtor attempts to defraud creditors. Whilst it is often possible for reorganization proceedings to be converted to liquidation proceedings, most insolvency systems do not allow reconversion to reorganization once conversion of reorganization to liquidation has already occurred.

57. Difficulties of determining at the very outset whether the debtor should be liquidated rather than reorganized have led some countries to revise their insolvency laws by replacing separate proceedings with "unitary" proceedings. Under the "unitary" approach there is an initial period (usually referred to as an "observation period", which in existing examples of unitary laws may last up to three months), during which no presumption as to whether the business will be eventually reorganized or liquidated is made. The choice between liquidation or reorganization proceedings only occurs once a determination as to whether reorganization is actually possible has been made. The basic advantage offered by this approach relies on its procedural simplicity. A simple, unitary procedure, allowing both reorganization and rehabilitation, may result also in encouraging early recourse to the proceedings by debtors facing financial difficulties, thus enhancing the chances of successful rehabilitation.

F. Report of the Secretary-General on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-fifth session (A/CN.9/WG.V/WP.58) [Original: English]

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[The introduction, part one and part two, chapter I, of the draft Guide appear in document A/CN.9/WG.V/WP.57]

Part Two. Core provisions of an effective and efficient insolvency regime

II. Application for and commencement of insolvency proceedings

A. Scope of the insolvency law

1. General remarks

(a) Debtors to be covered by an insolvency regime

1. An important threshold issue in designing a general insolvency regime is determining which debtors can be subjected to the law. To the extent that any debtor is excluded from the process, it will not enjoy the protections offered by the process, nor will it be subject to the discipline of the process. The eligibility provisions will identify the types of debtors whose businesses may be liquidated or reorganized and any businesses that are to be excluded from the application of the law. This raises the question of whether the law should distinguish between individual debtors and debtors that are commercial entities, each of which will raise not only different policy considerations, but also social and other attitudes. Policies towards individual or personal debt and insolvency often evidence cultural attitudes that are not as relevant to commercial debtors. They include attitudes towards the incurring of personal debt; the provision of relief for unmanageable debt; the effect of bankruptcy on the status of individuals; and providing for discharge from debts and claims. Policies applicable to the insolvency of commercial entities will be based, in comparison, on economic and commercial considerations such as the important role that those entities play in the economy and the need for such considerations to be reflected in the applicable insolvency procedures.

2. For these reasons, the insolvency law may need to consider drawing a distinction between the different types of entities involved in commercial business activities and indicating into which branch of insolvency law (personal or commercial) individual or personal business activities (including, for example, partnerships of individuals and sole traders) will fall. Different tests may be developed to facilitate that determination, such as focusing on the nature of the activity being undertaken, the level of debt and the connection between the debt and the business activity. However, the experience of a number of countries suggests

that although individual business activities form part of commercial activity, such cases often are best dealt with under the regime for individual insolvency, because ultimately the proprietor of a personal business [unincorporated business] is personally liable without limitation for the debts of the business. Those cases also raise difficult issues of discharge (release of the debtor from liability for part or all of certain debts after the conclusion of the proceedings) and attachment of post-insolvency wages, as well as personal matters such as settlements in divorce proceedings. Additionally, the inclusion of such individual insolvency within the commercial insolvency regime has the potential to hinder the application of that regime because of a general perception of the undesirability of insolvency. It is desirable that these concerns be considered in designing an insolvency law to address business insolvency. The present Guide does not address those distinctions but focuses on the conduct of trade and business, irrespective of the vehicle through which the business activities may be conducted.

3. A general insolvency regime can apply to all forms of entity engaged in business activities, both private and state-owned, especially those state-owned enterprises which compete in the market place as distinct commercial or business entities and are otherwise subject to the same commercial and economic processes as privately owned entities. Government ownership of an enterprise may not, in and of itself, provide a sufficient basis for excluding an enterprise from the coverage of the general insolvency law. Inclusion of these entities has the advantages of subjecting them to the discipline of the marketplace and sending a clear signal that government financial support will not be unlimited. An exception to a general policy of inclusion may arise where the Government has adopted a policy of extending an explicit guarantee in respect of the liabilities of such enterprises. In cases where the treatment of state enterprises is part of a change in macroeconomic policy, such as large-scale privatization programmes, independent legislation dealing with relevant issues, including insolvency, may be warranted.

4. Although it may be desirable to extend the protections and discipline of an insolvency regime to as wide a range of entities as possible, separate treatment may be provided for certain entities. That special treatment may be desirable, for example, on the basis of public policy concerns, in the

case of consumers. It may also be desirable in the case of certain entities of a specialized nature, such as banking and insurance institutions, utility companies and stock or commodity brokers, because of the detailed regulatory legal regimes to which they are often subject. The special considerations arising from the insolvency of such entities are not specifically addressed in the present Guide.

(b) Applicability of the insolvency law

(i) Centre of main interests

5. In addition to embodying the necessary business attributes, a debtor must have a sufficient connection to the host State to be subject to its insolvency laws.

6. Although some insolvency laws use tests such as the principal place of business, UNCITRAL has adopted, in the Model Law on Cross-Border Insolvency (the “UNCITRAL Model Law”), what is termed the “centre of main interests” of the debtor to determine the proper location of the “main proceedings” for that debtor. In addition to the UNCITRAL Model Law, that term is used in the [draft] United Nations Convention on the Assignment of Receivables in International Trade and in European Council regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings. The UNCITRAL Model Law does not define the term; the Council regulation (13th recital) indicates that the term should correspond to “the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.” An appropriate test would be that provided in article 16, paragraph 3, of the UNCITRAL Model Law and article 3 of the Council regulation: the debtor’s registered office, or habitual residence in the case of an individual, is presumed to be the centre of main interests, unless it can be shown that the centre of main interests is elsewhere. A debtor that has the centre of its main interests in a State should be subject to that State’s insolvency law.

7. Notwithstanding the adoption of the centre of main interests test, a debtor that has assets in more than one State may find itself satisfying the requirements to be subject to the insolvency law of more than one State because of the different tests of debtor competency or different interpretations of the same test, with the possibility of separate insolvency proceedings in those countries. In such cases, it will be appropriate to have in place legislation based on the UNCITRAL Model Law to address questions of coordination and cooperation.

(ii) Establishment

8. Some laws provide that insolvency proceedings may be commenced in a jurisdiction where the debtor has an establishment. The term “establishment” is defined in article 2 of the UNCITRAL Model Law to mean “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.” Article 2 of the European Council regulation includes a similar definition but omits the reference to “services”. Essentially then, an establishment is a place of business but not necessarily the centre of main interests. The definition is important to the overall structure of the

UNCITRAL Model Law as it determines those proceedings that may be recognized only as non-main proceedings; main proceedings require the presence of a centre of main interests. The Council regulation similarly provides that secondary insolvency proceedings may be opened in a jurisdiction where a debtor has an establishment, but that those proceedings will be restricted in their application to the assets of the debtor situated in the territory of that State.

(iii) Presence of assets

9. Some laws provide that insolvency proceedings may be commenced by or against a debtor that has assets within the jurisdiction or has had assets within the jurisdiction without requiring an establishment or centre of main interests within the jurisdiction. In this regard, a distinction should be made between liquidation and reorganization proceedings; while presence of assets may be an appropriate basis for commencement of liquidation proceedings involving the assets located in that State, it would not be sufficient to justify commencement of reorganization proceedings. The test of presence of assets potentially raises multi-jurisdictional issues, including multiple proceedings and questions of coordination and cooperation between proceedings that relate to the UNCITRAL Model Law.

2. Summary and recommendations: scope of the insolvency law

(1) The purpose of provisions on the scope of the insolvency law is to determine:

(a) Which debtors can be subject to the insolvency law;

(b) Which debtors require specialized treatment and should therefore be covered by a specialized insolvency regime and excluded from the general regime;

(c) Criteria for commencement of insolvency proceedings in the enacting State.

(2) An insolvency law should govern insolvency proceedings of all [debtors] [corporate or commercial entities] engaged in business activities [including state-owned enterprises engaged in [business][commercial] activities].

(3) Banks, insurance companies and other specified entities that are subject to special regulation and a specialized insolvency regime may be excluded from the application of the general insolvency law.

(4) Insolvency proceedings may be commenced by or against a debtor if the debtor has its centre of main interests in the enacting State.

(5) In the absence of proof to the contrary, a legal person is presumed to have its centre of main interests in the State in which it has its registered office.

(6) In the absence of proof to the contrary, a natural person is presumed to have its centre of main interests in the State in which it has its habitual residence.

(7) Liquidation proceedings may be commenced by or against a debtor if the debtor has an establishment in the enacting State, but those proceedings should be limited to the assets of the debtor situated in that State.

B. Application and commencement criteria

1. General remarks

10. Application and commencement criteria are central to the design of an insolvency law. By providing the basis on which an application for the commencement of insolvency proceedings can be made, these criteria are instrumental to identifying the entities that can be brought within the protective and disciplinary mechanisms of the insolvency process and to determining who may make an application.

11. As a general principle, it is desirable that access to the insolvency process should be convenient, inexpensive and quick in order to encourage financially distressed or insolvent businesses to voluntarily submit themselves to the process. It is also desirable that access should be flexible in terms of the types of procedures available, the ease with which the procedure most relevant to a particular debtor can be accessed and conversion between the different types of procedures can be achieved. Restrictive access can deter both debtors and creditors from commencing procedures, while delay can be harmful in terms of its effect on the value of assets and the successful completion of the process, particularly in cases of reorganization. Ease of access needs to be balanced with proper and adequate safeguards to prevent abuse of the process. A debtor that is not in financial difficulties may apply for the commencement of insolvency proceedings in order to take advantage of the protections provided by the law, such as the automatic stay, not because it cannot pay its creditors in full and therefore requires the protections of the insolvency law. Creditors who are competitors of the debtor may take advantage of the process to disrupt the debtor's business and thus gain a competitive edge.

12. Laws differ on the specific criteria that must be satisfied before the proceedings can commence. A number of laws include alternative criteria and distinguish between the criteria applicable to commencement of liquidation and reorganization proceedings, as well as between applications by a debtor and a creditor.

(a) Liquidation

13. Insolvency laws generally provide for an application for liquidation proceedings to be made by the debtor (often described as voluntary proceedings), by one or more creditors (often described as involuntary proceedings) or by operation of the law where failure by the debtor to meet some statutory requirement automatically triggers insolvency proceedings (also described as involuntary).

14. A criterion that is used extensively for commencement of liquidation proceedings is the liquidity or cash flow standard, which requires that the debtor has generally ceased making payments or cannot or will not be able to pay its debts as they become due. Reliance on this standard

is designed to activate proceedings sufficiently early in the period of the debtor's financial distress to minimize dissipation of assets and avoid a race by creditors to grab assets that would cause dismemberment of the debtor to the collective disadvantage of creditors. Allowing commencement to take place only at a later stage when the debtor can demonstrate greater financial distress, such as balance sheet insolvency (when the balance sheet of the entity shows that the value of the debtor's liabilities exceeds its assets), may only serve to interrupt the race by creditors that is already taking place.

15. One problem associated with the general cessation of payments standard—the commencement of liquidation proceedings in respect of an entity with only a temporary cash flow or liquidity problem—may be resolved by providing that the proceedings can be dismissed or converted to other proceedings (for example, liquidation to reorganization, see sect. I.C, para. 56). Other potential abuses of the process may be addressed by providing for the proceedings to be dismissed or converted, providing for sanctions to be imposed on a party that abuses the process or that the party improperly using the process should pay costs and damages to the other party. Actions attracting those measures may include a debtor using insolvency as a shield against a single creditor or as a means of prevaricating and depriving creditors of prompt payment of debts in full, or a creditor using the insolvency application as a substitute for debt enforcement procedures (which may not be well developed) or to attempt to force a viable business out of the market place or to obtain preferential payments.

16. The ways in which the general cessation of payments standard is used in insolvency laws vary. In some countries it provides the basis for commencement of either a liquidation or reorganization procedure and, where liquidation is chosen, it can later be converted to reorganization. In other countries, only a reorganization procedure may be commenced on the basis of this standard and the procedure may be converted to liquidation only when it is shown that the entity cannot be reorganized. Under a third approach, the standard is relied upon to commence a unitary procedure (see sect. I.C, para. 57) and the choice between liquidation and reorganization is made only after a period of assessment.

17. An alternative to the general cessation of payments standard would be the balance sheet approach of excess of liabilities over assets as an indication of greater financial distress. This approach can be an inaccurate measure of insolvency where accounting standards and valuation techniques give rise to values that do not reflect the fair market value of a debtor's assets or where markets are not sufficiently developed or stable to enable that value to be established. Furthermore, as a test for commencement of insolvency it can lead to delay and difficulties of proof as an expert would generally be required to review books, records and financial data to reach a determination of the entity's fair market value. This is especially difficult where those records are not properly maintained or readily available. For those reasons it often leads to proceedings being commenced after the possibilities of reorganization have disappeared. As a test for commencement of insolvency it is not necessarily meaningful to the debtor's ability to deal

collectively with its creditors when the debtor maintains an operating business and it may also circumvent the objective of maximization of value. While the balance sheet approach may be used to assist in defining insolvency, for the reasons outlined above it may not be sufficiently reliable to constitute the sole basis of that definition.

(i) *Debtor application*

18. Many insolvency laws adopt the general cessation of payments requirement for debtor applications for liquidation. Where the standard is one of imminent insolvency, the ability to apply may be limited to the debtor. As a matter of practice, an application by a debtor will generally be a last resort where it is unable to pay its debts and the satisfaction of the criterion is often not strictly followed. That practice is reflected in some laws that allow debtors to make an application on the basis of a simple declaration of its financial condition (which in the case of a legal person may be made by the directors or other members of a governing body) without specifying any particular test of financial difficulty.

19. A matter related to debtor applications is the question of whether or not the debtor should have an obligation to make an application for commencement of proceedings at a certain stage of its financial difficulty. There is no widely agreed approach to the adoption of such a provision. In the case of liquidation, the imposition of such a duty may protect creditors' interests by preventing further dissipation of the debtor's assets and, in the case of reorganization, increase the chances of success by encouraging early action. Establishing such an obligation, however, may raise difficult practical questions of how and when it should apply, particularly where a delay in applying for formal proceedings could lead to personal liability of members of the debtor, its governing body or its managers. In those circumstances it may operate to discourage the debtor from pursuing alternative solutions to its financial difficulties, such as an out-of-court reorganization agreement, which may be a more appropriate alternative in particular cases. The adoption of incentives (such as protection from enforcement actions) may be a more effective means of encouraging debtors to initiate proceedings at an early stage.

(ii) *Creditor application*

20. Where the standard of general cessation of payments is adopted for creditor applications, problems of proof may arise. While creditors may be able to show that the debtor has failed to pay their own claim or claims, providing evidence of a general cessation of payments may not be so easy. There is a practical need for a creditor to be able to present proof, in a relatively simple form, that establishes a presumption of insolvency on the part of the debtor, without placing an unreasonably heavy burden of proof on creditors. To refine the standard of general cessation of payments in order to establish a threshold of proof that creditors may satisfy, a reasonably convenient and objective test may be the failure of a debtor to pay a matured debt within a specified period of time after a written demand for payment has been made. However, creditors holding immature claims clearly have a legitimate interest

in the commencement of insolvency proceedings. A particular concern may be in the case of holders of long-term debt who might never be eligible to seek commencement of proceedings where the test is one of maturity of debt, but whose debt may nevertheless be affected by the activities of the debtor. However, developing a test that would allow such a creditor to make an application may raise difficult issues of proof, particularly in connection with the debtor's financial status. Where an insolvency law provides that applications may be made by creditors not holding mature debt, the issues of proof may need to be balanced against the objective of convenient, inexpensive and quick access.

21. Insolvency laws address the issue of creditor applications in a number of ways. Some laws require that the application is to be made by more than one creditor (which may be required to be an unsecured creditor that holds an undisputed claim); other laws require that the creditors hold mature claims and that they represent a specified composite value of claims (or a combination of both a specified number of creditors and a composite value of claims). A third approach requires (in the case of an application by a single creditor) that the debtor is to furnish information to the court that will enable it to determine whether the non-payment is the result of a dispute with the creditor or is evidence of a lack of liquid assets.

22. The rationale of requiring that more than one creditor must make the application is often based upon the desire to minimize possible abuse by a single creditor who may seek to use the insolvency process as a substitute for a debt enforcement mechanism, particularly where the debt in question is small. That concern may need to be balanced, however, against the objective of facilitating quick and easy access to the insolvency process. Furthermore, the concern may be addressed by taking into account the value of the claim of the single creditor (although specifying a particular value for claims may not always be an optimal drafting technique since changes in the value of the currency may necessitate amendment of the law) or adopting a procedure as outlined above, which requires the debtor to provide information to the court. It can also be addressed by providing for certain consequences, such as damages for harm done to the debtor, where the creditor application is an abuse of the insolvency process.

23. Where the commencement criteria require that the claims of creditors are mature before an application can be made, some degree of flexibility may be desirable in order to cover exceptional circumstances where there is no mature claim but insolvency proceedings should nevertheless be commenced. Those circumstances may include where there is evidence that the debtor is treating some creditors preferentially or where the debtor is acting fraudulently with regard to its financial situation and, in the case of reorganization, where proceedings are being commenced to implement a pre-negotiated arrangement.

(iii) *Application by governmental authority*

24. An insolvency law may give a governmental agency (normally the public prosecutor's office or the equivalent) or other supervisory authority non-exclusive authority to initiate liquidation proceedings against any entity if it

ceases to make payments or, more broadly in some countries, if initiation is considered to be in the public interest. In the latter case, a demonstration of illiquidity may not be necessary, thus enabling the Government to terminate the operations of otherwise healthy businesses that have been engaged in certain activities, for example, of a fraudulent or criminal nature. While the exercise of such police powers may be appropriate in certain circumstances, it is clearly desirable that they are not abused (such as by being regularly used) and that they are exercised in accordance with clear guidelines. The powers would generally only be available to commence liquidation proceedings, although there may be circumstances where liquidation could be converted to reorganization, subject to certain controls, such as that the business activity is lawful and that management of the entity is taken over by an insolvency representative or governmental agency.

[A/CN.9/504, para. 35: Accordingly, the Working Group agreed that some criteria providing guidance as to the situations triggering that power and the manner in which it should be exercised, with a view to restricting the discretion of the relevant authority, should be provided.]

(b) Reorganization

(i) Debtor application

25. One of the objectives of reorganization proceedings is to establish a framework that will encourage debtors to address their financial difficulties at an early stage. A commencement criterion that is consistent with that objective may be one that does not require the debtor to wait until it has ceased making payments generally (that is, wait until it is illiquid) before making an application, but allows an application in financial circumstances that, if not addressed, will result in a state of insolvency. Approaches to debtor applications vary between insolvency laws. In some laws, the reorganization procedure does not actually involve the application of any substantive criterion: the debtor may make an application whenever it wishes. Other laws, including those which have a unitary approach (see sect. I.C, para. 57), specify that the debtor may make an application if it envisages that, in the future, it will not be in a position to pay its debts when they come due.

26. It may be suggested that a relaxation of the commencement criteria could invite abuse of the procedure. For example, a debtor that is not in financial difficulty may apply to commence proceedings and submit a reorganization plan that is designed to allow it to shed onerous obligations, such as employment contracts, or to prevaricate and deprive creditors of prompt payment of debts in full. Whether such abuse could arise is a question of how the elements of the reorganization procedure are designed, including commencement criteria, preparation of the reorganization plan and debtor control of the business after commencement. Means of addressing possible abuse by the debtor could include providing in the insolvency law that the relevant court has the power to dismiss the application or that the debtor should be liable to creditors for the costs associated with resisting the application and any damages for harm caused by it.

(ii) Creditor application

27. Although insolvency laws generally provide for liquidation proceedings to be initiated by either a creditor or a debtor, there is no consensus as to whether reorganization proceedings can also be initiated by a creditor. Given that one of the objectives of reorganization proceedings is to provide an opportunity for creditors to enhance the value of their claims through the continued operation and reorganization of the entity, it may be desirable that the debtor not be given exclusive authority to make an application. The ability of creditors to apply for reorganization is also central to the question of whether creditors can propose a reorganization plan (see sect. VI, Reorganization plan, below). A number of countries take the position that, since in many cases creditors are the primary beneficiaries of a successful reorganization, creditors should have an opportunity to propose the plan. If that approach is followed, it seems reasonable to provide that creditors can make an application for reorganization proceedings.

28. Where creditors can make an application for reorganization of the debtor, different views are taken as to the commencement criteria. One view of the commencement criteria is that applying the same standard to applications by creditors as applies in the case of debtor applications is difficult to justify. This is not only because of the difficulties associated with creditors being able to prove that a standard of prospective illiquidity has been met. It is also because, as a general matter, it would seem unreasonable for any form of insolvency proceedings to be commenced against the debtor's will, unless creditors can demonstrate that their rights have already been impaired. Commencement criteria could require creditors to demonstrate, for example, that ongoing cash will be available to pay for the day-to-day running of the business, that the value of the assets will support reorganization and that the return to creditors in a reorganization is likely to exceed the return in liquidation. One disadvantage of that approach is that it requires the creditors to have made, or be able to make, a thorough assessment of the business before making an application. To overcome the difficulties associated with creditors gaining access to relevant information, an insolvency law could provide, on the making of an application by creditors, for an assessment of the debtor's financial situation to be undertaken by an independent authority. Such a procedure may have the advantage of ensuring that proceedings are only commenced in appropriate cases, but care may be needed to ensure that the additional requirements do not delay commencement of the proceedings with consequences for maximization of value of the assets and the likelihood of successful completion of the reorganization.

29. The question of the complexity or simplicity of commencement standards is closely linked to the consequences of commencement and the conduct of the insolvency proceedings. In insolvency laws that apply a stay automatically on commencement of the proceedings, the ability of the business to continue trading and be successfully reorganized can be assessed after commencement. In other systems, that information may be needed before an application is made because the choice of reorganization presupposes that it will lead to a greater return to creditors than liquidation.

30. For those reasons, it may be appropriate to apply the same commencement criterion to applications by creditors for both liquidation and reorganization of the debtor (that is, general cessation of payments, see paras. 14-20 above). Such a standard would appear to be consistent with both the two-track approach and the unitary approach (see sect. I.C), where the application of a different commencement standard is not so much a function of the type of proceedings being initiated, but rather whether the applicant is the debtor or a creditor. The exception to the approach of having the same commencement criteria for both liquidation and reorganization would be those systems where either a debtor or a creditor is precluded from initiating liquidation proceedings until it has been determined that reorganization is impossible. In that case, the commencement criterion for liquidation would not be general cessation of payments, but a determination that reorganization cannot succeed.

31. As in the case of liquidation proceedings, the criteria applicable to creditor applications for reorganization may include a requirement for the application to be made by a certain number of creditors or by creditors holding a certain value of matured claims, or both.

(c) *Procedural issues*

(i) *The decision to commence insolvency proceedings*

32. Insolvency proceedings raise a number of procedural issues. A preliminary point is the manner in which the proceedings are commenced once the application has been made. In many countries the normal practice is for a court of competent jurisdiction to determine, on the basis of the application for commencement, if the requisite conditions for commencement have been met. In some countries, that determination is also made by the appropriate administrative agency, where that agency plays a central supervisory role in the insolvency process. The central issue, however, is not so much who makes the decision to commence proceedings but rather what that body is required to do in order to reach its decision. Entry conditions that are designed to facilitate early and easy access to the insolvency process not only will facilitate the court's consideration of the application by reducing complexity and assisting it in reaching a decision in a timely manner, but also have the potential to reduce the cost of proceedings and increase transparency and predictability (see Part One, Key objectives). The issue of cost may be of particular importance in the case of the insolvency of small and medium business entities.

33. Some insolvency laws draw a distinction between voluntary and involuntary applications. A voluntary application by a debtor may function as an acknowledgement of insolvency and lead to an automatic commencement of proceedings, unless it can be shown that the process is being abused by the debtor to evade its creditors. In the case of an involuntary application, the court is required to consider whether the commencement criteria have been met before making its decision. In other laws, irrespective of whether the application is voluntary or involuntary, the court is required not only to determine whether the entry conditions have been met, but also to assess the financial

situation of the debtor to determine whether the type of proceedings applied for are appropriate to the particular circumstances of the debtor. One means of reducing the potential complexity of that assessment is to provide, firstly, for the assessment to be made after commencement where the court can be assisted by the insolvency representative and other experts and, secondly, for conversion between liquidation and reorganization. If the assessment to be made is complex and there is a potential for a delay between application and commencement, there is also the potential for further debts to be incurred in that period as the debtor continues to trade and may allow trade debts to increase to preserve cash flow.

(ii) *Establishing a time limit for making the commencement decision*

34. Where a court is required to make a decision as to commencement, it is desirable that that decision be made in a timely manner to ensure both certainty and predictability of the decision-making process and the efficient conduct of the proceedings without delay. One means of achieving those key objectives may be to provide a specified period of time after the making of an application within which the commencement decision must be made. Although that approach may serve the objectives of providing certainty and transparency for both the debtor and creditors, the achievement of these objectives needs to be balanced against possible disadvantages. A fixed time limit may be insufficiently flexible to take account of the circumstances of the particular case, it may establish an arbitrary time limit that takes no account of the resources available to the body responsible for supervision of the insolvency process or of local priorities and it may prove difficult to ensure that the decision-making body adheres to the established limit. For these reasons, it is desirable that the insolvency law adopt a flexible approach that emphasizes the advantages of quick decision-making and provides guidance as to what is reasonable, but also recognizes local constraints and priorities.

[*Note to the Working Group: Is there any distinction between voluntary and involuntary applications in terms of timing for consideration by the court?*]

(iii) *Notice of commencement*

35. Provision of notice of the commencement of insolvency proceedings is central to several key objectives of an insolvency regime: it ensures the transparency of the process and equality in the provision of information to creditors in the case of voluntary proceedings. Nevertheless, there may be exceptional circumstances where provision could be made, with the consent of the court, for notice to the debtor to be dispensed with on the basis that it may be impossible to provide or may thwart the purpose of a particular application.

36. In the event of a voluntary application by a debtor, creditors or other interested persons have a direct interest in receiving notice of the proceedings and an opportunity to dispute the presumptions of eligibility and insolvency (perhaps within a specified time period to prevent the proceedings from being prolonged unnecessarily). The question

arises, however, as to the time at which creditors should be notified, on the making of the application or on commencement. The interests of creditors in knowing that the application has been made may need to be balanced, in certain circumstances, against the possibility that the position of the debtor may be unnecessarily affected in the event that the application is rejected or that creditors may be encouraged to take last minute action to enforce their claims. These concerns may be addressed by providing creditors to be notified on commencement of the proceedings.

37. In the event of an involuntary creditor application for insolvency proceedings, however, the debtor should be entitled to immediate notice of the application and should have an opportunity to be heard and to dispute the creditors' claims as to its financial position (see sect. IV.A, Debtor's rights and obligations, below).

38. In addition to the question of the time at which notice should be given, an insolvency law may need to address the manner in which notice is provided and the information to be included in the notification to ensure that the notice is effective. The manner of providing the notice could address both the party required to give the notice (for example, the court or the party making the application) and how the information can be made available. While notice may be provided directly to known creditors, for example, the need to inform unknown creditors has led legislators to include a provision requiring publication in an official government publication or a commercial or widely circulated national newspaper (see art. 14, UNCITRAL Model Law on Cross-Border Insolvency). The information to be included in the notice may include the time limit for creditors to make claims, how and where those claims may be made and which creditors should make claims (that is, whether secured creditors need to file a claim, see Creditor claims, paras. 234-239, below).

(iv) Costs

[Note to the Working Group: Should issues relating to costs be included in the Guide?]

39. Applications by both debtors and creditors for insolvency proceedings may be subject to the payment of fees. Different approaches may be taken to the level of fee imposed. One approach may be to set a fee that can be used to help defray the costs of the insolvency system. Where the resultant fee is high, however, it may operate as a deterrent and run counter to the objective of convenient, inexpensive and quick access to the insolvency process. A very low fee, on the other hand, may not be sufficient to deter frivolous applications and it is therefore desirable that a balance between these objectives be reached.

2. Summary and recommendations: application and commencement criteria

(1) The purpose of provisions in an insolvency law on application and commencement criteria is to:

(a) Provide easy access to the insolvency law by insolvent debtors, creditors and government agencies;

(b) Enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and inexpensive manner;

(c) Facilitate access to the insolvency procedures that are most relevant to the debtor's financial situation;

(d) Establish basic safeguards to protect both debtors and creditors from possible wrongful use of the insolvency law.

(2) An application for liquidation proceedings may be made by:

(a) A debtor, in which case the debtor should show that it is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets];

(b) One or more creditors that hold claims that are [mature and have not been paid by the debtor] [presently due and owing]; or by one or more creditors that do not hold claims that are mature but who can show that the debtor [is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets]];

[(c) A prescribed government or non-government authority on the basis of [. . .]].

(3) An application for reorganization proceedings may be made by:

(a) A debtor, in which case the debtor should show that it is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets];

(b) One or more creditors that hold claims that are [mature and have not been paid by the debtor] [presently due and owing] [and the creditors can show that the business can continue to trade and can be successfully reorganized] or by one or more creditors that do not hold claims that are mature but who can show that the debtor [is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets]];

[(c) A prescribed government or non-government authority on the basis of [. . .]].

(4) An application for commencement of proceedings should be made to the court. In the case of a voluntary application, the application should establish a prima facie case of insolvency and function as automatic commencement of proceedings. In the case of an involuntary application, the court should make a decision on that application as soon as possible and in any event within [. . .] days from the date of the application. The court may dismiss a proceedings [or convert it] if it is determined to be an abuse of the process.

(5) In the case of an application by one or more creditors or a governmental authority under paragraphs (1) and (2) above, notice of the application should be provided to the debtor and to other creditors at the time the application is made. Notification to the debtor should include: [. . .]. *[Notification to creditors: see (8).]*

(6) In the case of an application by a debtor, notice of the commencement of the proceedings should be provided to creditors.

(7) Notification of commencement of proceedings should be given to creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. [Notification should also be given to the known creditors that do not have addresses in this State. No letters rogatory or other, similar formality is required.] [*Note to the Working Group: Do the provisions of the Model Law need to be repeated here?*]

(8) The notification to creditors should:

(a) Indicate any applicable time period for making a claim and specify the place at which it can be made;

(b) Indicate whether secured creditors need to make a claim to the extent to which their claims are or are not covered by the value of the security; and

(c) Contain any other information required to be included in such a notification to creditors pursuant to [*the law of the State and the orders of the court*].

III. Consequences of commencement of insolvency proceedings

A. The insolvency estate

1. General remarks

40. Fundamental to the insolvency process is the need to identify, collect, preserve and dispose of assets belonging to the debtor. Many insolvency systems place the assets of the insolvent debtor under a special regime. The present Guide uses the term “estate” in its functional sense to refer to assets of the debtor that are controlled by the insolvency representative and are subject to the insolvency proceedings. There are some important differences in the way in which the concept of the insolvency estate is understood in various jurisdictions. In some countries, the insolvency law provides that legal title over the assets is transferred to the designated official. In other countries, the debtor continues to be the legal owner of the assets, but its powers to administer and dispose of the assets is limited (for example, disposition, including by the creation of security rights, may require the consent of the insolvency representative).

41. Irrespective of the applicable legal tradition, an insolvency law will need to define clearly the assets that are subject to the insolvency proceedings (and therefore included within the concept of the “estate” where that term is used) and how they will be affected by those proceedings, as this will affect the scope and conduct of the proceedings and, in particular in reorganization, will have a significant bearing on their likely success. A clear statement will ensure transparency and certainty for both creditors and the debtor.

(a) Assets to be included in the estate

42. The estate may be expected to include the assets of the debtor as of the date of commencement of the

insolvency proceedings as well as assets acquired by the insolvency representative and the debtor after that date, whether in the exercise of avoidance powers (see sect. III.D, Avoidance actions) or in the normal course of operating the debtor’s business.

43. The estate may be expected to include all assets in which the debtor has an interest, whether or not they are in the possession of the debtor at the time of commencement, including all tangible and intangible assets. Tangible assets should be readily found on the debtor’s balance sheets, such as cash, equipment, inventory, works in progress, bank accounts, accounts receivable and real estate. The assets to be included within the category of intangible assets may be defined differently in different States, depending upon the law, but may include intellectual property, contract rights, securities and financial instruments, and [. . .] [to the extent of the debtor’s interest]. In the case of natural persons, the estate may also include assets such as inheritance rights in which the debtor has an interest or to which the debtor is entitled at the commencement of the insolvency or which come into existence during the insolvency proceedings.

44. Issues to be addressed:

[A/CN.9/504, para. 46: [. . .] *It was further suggested that specific contractual arrangements, such as transfers created for the purpose of security, trusts or fiduciary arrangements and consigned goods, needed to be addressed.*]

(b) Assets that may be excluded from the estate

(i) Where the insolvent is a natural person

45. In the case of the insolvency of a natural person the estate may exclude certain assets such as those relating to post-application earnings from the provision of personal services, assets that are necessary for the debtor to earn a living and personal and household assets. Where the insolvency law provides exclusions in respect of the assets of a natural person, those exclusions should be clearly identified and their number limited to the minimum necessary to preserve the personal rights of the debtor and allow the debtor to lead a productive life.

(ii) Secured assets

46. Insolvency laws adopt different approaches to the treatment of assets subject to security interests. Many laws provide that secured assets are included in the debtor’s estate, with the commencement of proceedings giving rise to different effects. Some insolvency laws restrict the exercise of security rights held by creditors or third parties (such as by application of a stay and other effects of commencement), while others provide that the security right is unaffected by the insolvency and creditors may proceed to enforce their legal and contractual rights (see sect. III.B, Protecting the insolvency estate, below). Some insolvency laws that require all assets to be subject to the proceedings in the first instance allow them to be separated where there is proof of harm or prejudice. Where secured assets are to be included within the estate, the insolvency law should

make it clear that secured creditors will not be deprived of their rights by such an inclusion.

47. Exclusion of secured assets may have the advantage of enhancing the availability of credit because secured creditors would be reassured that their interests would not be adversely affected by the commencement of insolvency proceedings. This advantage, however, may need to be weighed against the advantages to be derived, particularly in the case of reorganization and also where the business is to be sold as a going concern in liquidation, from having all assets of the debtor available to the insolvency proceedings from the time of commencement. This approach may assist not only in ensuring equal treatment of creditors, but may be essential to the reorganization proceedings where the secured asset is central to the business; where manufacturing equipment, for example, is central to the debtor's business operations, reorganization cannot take place unless it can be retained for the proceedings. Where issues arise as to whether particular assets are essential to the business, that determination could be made by the insolvency representative or perhaps the creditor committee.

(iii) *Third-party-owned assets*

48. Complex issues may be raised in determining whether an asset is owned by the debtor or by another party and whether assets of a third party that are in the possession of the debtor, subject to use, lease or licensing arrangements, at the time of commencement should be included within the assets of the estate. In some insolvency cases those assets may be crucial to the continued operation of the business, in particular in reorganization proceedings but also to a lesser extent in some liquidation proceedings, and it will be advantageous for the insolvency law to provide some mechanism that will enable those assets to remain at the disposal of the insolvency proceedings. Some insolvency laws address this issue in terms of the types of assets to be included within the scope of the insolvency estate. Other insolvency laws, where the possession of the asset by the debtor is subject to a contractual arrangement, address it in the context of the treatment of contracts. This may include, for example, imposing restrictions on the termination of the contract pursuant to which the debtor holds the assets or preventing the owner from reclaiming its assets in the insolvency (see sect. III.C, Treatment of contracts, below).

49. Those assets being used by the debtor but which are subject to a lease agreement where the lessor retains legal title may require special attention. In countries where title financing (where the provider of finance has title or ownership of the asset as opposed to a mortgage or security interest) is of considerable importance, there may be a need to respect the creditor's legal title in the asset and allow it to be separated from the estate (subject to the rules on treatment of contracts: the right to separate may be limited if the insolvency representative ratifies the lease contract). By way of comparison, there are also examples of laws that provide for a court-ordered moratorium that prevents third parties from claiming their assets for a limited period of time after commencement. A balance between these two approaches may be desirable, with a view to achieving maximization of value and ensuring that the sale of the

business as a going concern or a reorganization may not be rendered impossible by the free separation of the relevant asset. There may also be circumstances where these type of financing arrangements should be scrutinized in order to determine whether the lease is, in fact, a disguised secured lending arrangement. In that case the lessor would be subject to the same restrictions as the secured lender.

(c) *Recovery of assets*

50. Identifying the assets that will be subject to the proceedings may require action by the insolvency representative to recover assets of the estate that were improperly transferred or transferred at a time of insolvency with the result that the *pari passu* principle (that is, that creditors of the same class are treated equally and are paid in proportion to their claim out of the assets of the estate) has been violated. Most legal systems provide a means of setting aside and recovering the value of antecedent transactions that result in preferential treatment to some creditors or were fraudulent in nature or made in an effort to defeat the rights of creditors (see sect. III.D, Avoidance actions, below). The power to recover assets or their value may also extend to transfers made by the debtor after commencement of the proceedings where the transfer was not authorized by the insolvency representative.

(d) *Disposal of assets*

51. Where assets have a negative or insignificant value, or are not essential to a reorganization, it may be consistent with the objective of maximizing value to allow the insolvency representative to abandon them, provided such abandonment does not violate any compelling public interest. Abandoning assets in this way will assist to reduce the costs of the proceedings to the estate.

52. Issues to be addressed:

[Methods for sale of assets and ability to sell free and clear of security interest, charges and other encumbrances.]

2. *Summary and recommendations:
the insolvency estate*

(1) The purpose of provisions in an insolvency law relating to the insolvency estate is to identify those assets which will be subject to the control of the insolvency representative and subject to the insolvency proceedings.

(2) On commencement of insolvency proceedings, the insolvency estate should include:

(a) Assets in which the debtor has an interest as at the date of commencement of the insolvency proceedings. This would include both tangible and intangible assets, irrespective of whether it is in the possession of the debtor or subject to a security interest in favour of a creditor;

(b) Assets acquired after commencement of the insolvency proceedings, whether acquired in the exercise of avoidance powers or in the normal course of business.

(3) Where the debtor is a natural person, the insolvency law may specify assets required to preserve the personal rights of the debtor that should be excluded from the insolvency estate.

(4) The insolvency law should provide a mechanism for retaining in the estate assets owned by a third party that are in the possession of the debtor at the date of commencement and secured assets where those assets are essential to the insolvency proceedings. The insolvency law should make provision for protection of the owner of the assets in situations where there is proof of harm or prejudice. [Assets owned by a third party in the possession of the debtor but subject to a contractual arrangement may be included subject to other provisions of the insolvency law such as those dealing with continuation and termination of contracts and application of the stay.]

B. Protecting the insolvency estate

1. General remarks

53. An essential objective of an effective insolvency system is the establishment of a protective mechanism to ensure that the value of the estate's assets is not diminished by the actions of the various parties in interest. The parties from whom the estate needs the greatest protection are the debtor and its creditors. The manner in which the estate can be protected from the actions of the debtor are considered under sect. IV.A, Debtor's rights and obligations, below.

(a) Protection of the estate against creditors and third parties

54. With regard to creditors, one of the fundamental principles of insolvency law is that the proceedings are collective, which requires the interests of all creditors to be protected against individual action by one of them. Many insolvency systems provide for the imposition of a mechanism that prevents creditors from enforcing their rights through legal remedies during some or all of the period of the liquidation or reorganization proceedings, recognizing the collective nature of the proceedings and operating to enhance the collective interests of the creditors. This mechanism is variously termed a moratorium, suspension or stay, depending on the scope of the mechanism. For the purposes of the present Guide, the term "stay" is used in a broad sense to refer to both suspension of actions and a moratorium against the commencement of actions.

55. As a general principle, the imposition of a stay in liquidation can ensure a fair and orderly administration of the insolvency proceedings, providing the insolvency representative with adequate time to avoid making a forced sale that fails to maximize the value of the assets being liquidated and also an opportunity to see if the business can be sold as a going concern. In reorganization proceedings, a stay of proceedings allows the debtor a breathing space to organize its affairs and time for preparation of a reorganization plan and to take the other steps necessary to ensure success of the reorganization, such as shedding unprofitable activities and onerous contracts. As such, the impact of

the stay is greater and therefore more crucial in reorganization than in liquidation and can provide an important incentive to encourage debtors to initiate reorganization proceedings. At the same time, the commencement of proceedings and the imposition of the stay put on notice all those who do business with the debtor that the future of the business is uncertain. This can cause a crisis of confidence and uncertainty as to what impact the insolvency will have on them as suppliers, customers and employees of the business.

56. One of the key issues in the design of an effective insolvency law is how to balance the immediate benefits that accrue to the entity by having a broad stay quickly imposed to limit the actions of creditors and the longer-term benefits that are derived from limiting the degree to which the stay interferes with contractual relations with creditors.

57. The scope of rights that are affected by the stay varies considerably among countries. There is little debate regarding the need for the suspension of actions by unsecured creditors against the debtor or its assets. The application of the stay to secured creditors, however, is potentially more difficult and requires a number of competing interests to be balanced. These include, for example, observing commercial bargains and contracts; respecting priorities of secured creditors as regards their rights over the security; protecting the value of secured interests; ensuring that creditors are paid out of the assets of the estate in proportion to their claim; maximizing asset values for all creditors; and, in cases of reorganization, ensuring the successful reorganization of a viable entity.

(b) Provisional measures

58. Between the time when the debtor or creditor makes an application for commencement of insolvency proceedings and the time when the proceedings actually commence, there is the potential for dissipation of the debtor's assets. Upon the making of the application, the debtor may be tempted to transfer assets out of the business and creditors, on learning of the application, may take remedial action against the debtor to pre-empt the effect of any stay that may be imposed upon commencement.

59. Some insolvency laws allow the court to order protective measures to protect the estate in the period between application and commencement of proceedings, either on the application of creditors or on its own motion. Where these provisional measures are available they may include appointing a preliminary insolvency representative; prohibiting the debtor from disposing of assets; sequestering some or all of the debtor's assets; suspending enforcement of security interests against the debtor; staying any action to separate a debtor's assets, such as by a secured creditor or holder of a retained title; or preventing the commencement of individual actions by creditors to enforce their claims. Since these measures are provisional in nature and are provided before the decision that the commencement criteria have been met, applying creditors may be required by the court to provide evidence that the measure is necessary and, in some cases, some form of security for costs or damages that may be incurred.

(c) *Application of a stay: procedural issues*(i) *Scope of the stay*

60. Some countries adopt the approach that to ensure the effectiveness of the stay, it must be very wide, applying to all remedies and proceedings against the debtor and its assets, whether administrative, judicial or self-help, and restraining both unsecured and secured creditors from exercising enforcement rights, as well as Governments from exercising priority rights. [*To be expanded: extent to which government entities are immune from court action or distinction made between State action to enforce police or regulatory powers and to enforce pecuniary interests.*] Examples of the types of actions that may be stayed could include the commencement or continuance of actions or proceedings against the debtor or in relation to its assets; the commencement or continuance of enforcement proceedings in relation to assets of the debtor, including the execution of a judgement and a security enforcement process; recovery by any owner or lessor of property that is used or occupied by or is in the possession of the debtor; payment or provision of security in respect of a debt incurred by the debtor prior to the commencement date; the right to transfer, encumber or otherwise dispose of any assets of the debtor; and termination, suspension or interruption of supplies of essential services (for example, water, gas, electricity and telephone) to the debtor. Article 20 of the UNCITRAL Model Law on Cross-Border Insolvency, for example, provides that commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities and execution against the debtor's assets is stayed.

61. In liquidation, where legal proceedings against the debtor are often included within the scope of the stay, provision is made in some insolvency laws for those proceedings to be continued if necessary. Article 20, paragraph 3, of the UNCITRAL Model Law on Cross-Border Insolvency, for example, provides that the application of the stay to commencement or continuation of individual actions or proceedings against the debtor is not to affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor. In contrast, some insolvency laws exclude legal proceedings from the scope of the stay in reorganization. In some countries, employee actions against the debtor are not included within the stay, but any enforcement action resulting from those proceedings will be included.

62. The inclusion or exclusion of actions from the scope of the stay should be stated clearly in the insolvency law, irrespective of who may commence those actions, whether creditors (including preferential creditors such as employees, legislative lienholders or Governments) or third parties (such as a lessor or owner of property in the possession or use of the debtor or occupied by the debtor).

63. The need for other exemptions, such as for set-off rights and netting of financial contracts (see sect. III.C, Treatment of contracts, below), or exemptions to protect public policy interests or to prevent abuse, such as the use of insolvency proceedings as a shield for illegal activities, may also need to be considered.

(ii) *Discretionary or automatic application of the stay*

64. A preliminary question is whether the stay applies automatically or at the discretion of the court. Local policy concerns and factors such as the availability of reliable financial information and the ability of the debtor and creditors to have access to an independent judiciary with insolvency experience may affect the decision as to whether the stay is applied automatically or granted by the courts on a discretionary basis. Applying the stay on a discretionary basis may allow the stay to be tailored to the needs of the specific case (as regards the debtor, its assets and its creditors) and avoid both unnecessary applications of the stay and unnecessary interference with the rights of secured creditors. However, to avoid delay and the need for an application to the court, to assist the achievement of the maximization of the value of the assets and to ensure that the insolvency process is fair and ordered as well as transparent and predictable, it may be argued that the stay should apply automatically; the automatic stay is a feature of many modern insolvency law regimes.

(iii) *Time of application of the stay*

65. A concern related to how the stay should be applied is the time at which the stay will apply in both liquidation and reorganization proceedings and whether the insolvency law should draw any distinction, for that purpose, between applications made by a debtor and applications made by a creditor.

66. Different approaches may be taken to address these issues. One approach may be for the stay to apply on the making of an application for both liquidation and reorganization proceedings, irrespective of whether it is a debtor or creditor application, thus avoiding the need to consider the availability of interim or provisional measures of protection to cover the period between application and commencement. Once the proceedings commence, the stay would continue to apply in the case of reorganization. In the case of liquidation, continued application of the stay could be discretionary where the assets were to be sold in a piecemeal manner. Where the business was to be sold as a going concern, however, it may be advantageous to the administration of the proceedings for the stay to continue to apply after commencement.

67. A second approach may distinguish between debtor and creditor applications. This approach would provide for the stay to apply on a creditor application for both liquidation and reorganization proceedings, after commencement of the proceedings, with protective or interim measures being available from the court to cover the period between application and commencement. Where the debtor applies for insolvency proceedings (whether liquidation or reorganization), the stay could apply automatically on application to avoid the possibility of creditors taking action, particularly enforcement action, against the debtor in the period before commencement.

(d) *Application of the stay to unsecured creditors*

68. Many insolvency laws provide that the stay applies to unsecured creditors in both liquidation and reorganization proceedings for the duration of the proceedings.

(e) *Application of the stay to secured creditors*

69. Creditors generally seek security for the purpose of protecting their interests in the event that the debtor fails to repay. If security is to achieve this objective, it can be argued that, upon commencement of insolvency proceedings, the secured creditor should not be delayed or prevented from immediately realizing its security. The secured creditor has, after all, bargained for security in exchange for value that reflects the reliance on the security. For that reason, the introduction of any measure that will diminish certainty in the ability to recover debt or erode the value of security interests, such as applying the stay to secured creditors, may need to be carefully considered. Such a measure may ultimately undermine not only party autonomy and the importance of observing commercial bargains, but also the availability of affordable credit: as the protection provided by security interests declines, the price of credit may need to increase to offset the greater risk.

70. Nevertheless, some insolvency laws recognize that in some cases permitting secured creditors freely to separate their security from the other assets that are subject to the insolvency proceedings can frustrate the basic objectives of those proceedings. In reorganization proceedings, where assets essential to the operation of the debtor's business are encumbered by security interests, enforcement by secured creditors of their claims at the commencement of the proceedings may make it impossible for the debtor to keep the business operating while it formulates a reorganization plan. This is also true, although to a lesser extent, in liquidation proceedings. As a general principle, where the insolvency representative's function is to collect and realize assets and distribute proceeds among creditors by way of dividend, the secured creditor may be permitted freely to realize its security despite the liquidation. However, there will be cases where the insolvency representative may be able to achieve a better result that maximizes the value of the assets for the collective benefit of all creditors if the stay is applied to restrict free separation of the security. This is particularly relevant where there is the possibility of selling the business as a going concern. It may also be true in some cases where even though assets are to be sold in a piecemeal manner, some time is needed to arrange a sale that will give the highest return for the benefit of all unsecured creditors.

71. Where secured interests are included within the scope of the stay, the insolvency law can adopt measures that will ensure the secured rights are not negated by the stay. These measures may relate to the duration of the stay, protection of the value of the security, payment of interest and by providing that the stay can be lifted where the secured interests are not sufficiently protected or where the security is not necessary to the sale of the entire business or a productive part of it.

(i) *Liquidation*

72. Insolvency laws take different approaches to the application of the stay to secured creditors in liquidation

proceedings. Some insolvency laws exclude secured creditors from the scope of the stay on the basis that where the assets are to be liquidated the balance should weigh in favour of upholding the rights of secured creditors to enforce their rights. Where that approach is adopted, some flexibility may be needed, however, to address the situation where the business can be sold as a going concern within the context of the liquidation proceedings. Some of the insolvency laws that exclude secured creditors from the stay, focus on encouraging pre-commencement negotiations between the debtor and creditors to achieve agreement on how to proceed. Where that process is effective, a stay applying to secured creditors may not be required. Other laws adopt the approach that the stay automatically applies upon commencement of liquidation proceedings to secured creditors but only for a brief period, such as 30 or 60 days, except in those cases where the security is essential to the sale of the business as a going concern (in which case the stay may be extended). This period would allow the insolvency representative to assume its duties and take stock of the assets and liabilities of the estate. Another approach extends the stay to secured creditors for the duration of the liquidation proceedings, subject to a court order for relief where it can be shown that the value of the security is being adversely affected.

73. Where the stay is limited to a specified period, the law may include provision for extension of the stay. This could be on application by the insolvency representative when it can be demonstrated that an extension is required in order to maximize value (there is a reasonable possibility that the entity, or units of the entity, can be sold as a going concern) provided that secured creditors will not suffer unreasonable harm. To provide additional protection and avoid the stay being applied for an uncertain or unnecessarily lengthy period, an insolvency law may limit the period for which the stay can be extended.

(ii) *Reorganization*

74. In proceedings where there is a genuine possibility of effecting a reorganization, it is desirable that the extent of the stay should be very wide and all embracing. In some cases it may also be desirable for the stay to apply to secured creditors for the duration of the proceedings to ensure that the reorganization can proceed in an orderly manner without the possibility of assets being separated before the reorganization can be finalized. However, to avoid delay and encourage a speedy resolution of the proceedings, there may also be some advantage in limiting the application of the stay to the time that it may reasonably take for a reorganization plan to be approved; it is not desirable that the stay apply for an uncertain or unnecessarily lengthy period. Such a limitation would also have the advantage of providing secured creditors with a degree of certainty and predictability as to the duration of the period of interference with their rights. Where the particular security is not essential to the reorganization or where the creditor can demonstrate other reasons, provision may be made in the insolvency law for the stay to be lifted (see para. 81 below).

(f) *Protection of secured creditors*(i) *Maintaining the economic value of secured claims*

75. Although some minor erosion of secured creditors' security positions is to be expected in conjunction with reorganization proceedings, it is undesirable that a single secured creditor or group of secured creditors solely or primarily bear the burden.

76. One of the sets of measures designed to address the negative impact of the stay on secured creditors in liquidation is that directed at maintaining the economic value of secured claims during the period of the stay (in some jurisdictions referred to as "adequate protection"). One approach is to protect the value of the security itself on the understanding that, upon liquidation, the proceeds of the sale of the security will be distributed directly to the creditor to the extent of the value of the secured portion of its claim. This approach may require a number of steps to be taken.

77. During the period of the stay it is possible that the value of the creditor's security will depreciate. This potentially will affect the priority afforded to the creditor at the time of distribution, since the priority will be limited by the value of the security. Some insolvency laws provide that the insolvency representative should compensate secured creditors for the amount of this depreciation by providing substitute security or making periodic cash payments corresponding to the amount of the depreciation. Some countries that preserve the value of the security as outlined also allow for payment of interest during the period of the stay, but only to the extent that the value of the security exceeds the value of the secured claim. Such an approach may encourage lenders to seek adequate security that will exceed the value of their claims. In some cases the insolvency representative may find it necessary to use or sell encumbered assets prior to liquidation in order to maximize the value of the estate. For example, to the extent that the insolvency representative is of the view that the value of the estate can best be maximized if the business continues to operate for a temporary period, it may wish to sell inventory that is partially encumbered. Thus, in cases where secured creditors are protected by preserving the value of the security, it may be desirable for the insolvency law to allow the insolvency representative the choice of providing the creditor with substitute equivalent security or paying out the full amount of the secured claim.

78. Another approach to protecting the interests of secured creditors will be to protect the value of the secured portion of the claim. Immediately upon commencement, the encumbered asset is valued and, based on that valuation, the value of the secured portion of the creditor's claim is determined. This value remains fixed throughout the proceedings and, upon distribution following liquidation, the secured creditor receives a first-priority claim to the extent of that value. During the proceedings, the secured creditor could also receive the contractual rate of interest on the secured portion of the claim to compensate for delay imposed by the proceedings. Provision of interest is limited in some insolvency laws to situations where the value of

the security exceeds the amount claimed. Otherwise, compensation for delay may deplete the assets available to unsecured creditors.

79. The desirability of the types of approaches that provide protection for the security may need to be weighed against the potential complexity and cost of those measures and the need for the court to be able to make difficult commercial decisions on the question of appropriate protection. Where such an approach is adopted, it may be desirable for an insolvency law to provide guidance to determine when and how creditors holding some type of security over the debtor's assets would be entitled to the types of protection described above.

(ii) *Surrender of the security*

80. In liquidation [and reorganization], provision may be needed to allow secured assets to be surrendered to the secured creditor, where its security is determined to be valid and the secured assets have no value to the insolvent estate, or cannot be realized in a reasonable period of time by the insolvency representative.

(iii) *Lifting the stay*

81. In liquidation and reorganization proceedings, circumstances may arise where it is appropriate to provide relief from the application of the stay by allowing the stay to be lifted or cease to apply. Those circumstances may include where the secured creditor is not receiving protection for the value of its security, where the provision of protection may not be feasible or would be overly burdensome to the estate or where the security is not needed for the reorganization. To accommodate such circumstances, an insolvency law may provide that the secured creditor can apply for the stay to be removed or the insolvency representative can be given the power to release the security without needing approval of the court.

82. While provisions on the lifting of the stay principally address the interests of secured creditors, there are examples of insolvency laws that provide that relief from the stay may be granted to an unsecured creditor to allow, for example, a claim to be determined in another forum where litigation may be well advanced and it would be efficient for it to be completed or a claim against an insurer of the debtor to be pursued.

(g) *Limitations on disposal of assets by the debtor*

83. In addition to measures designed to protect the insolvency estate against the actions of creditors and third parties, insolvency laws generally adopt measures that are intended to limit the extent to which the debtor and the insolvency representative can deal with the assets of the estate. These issues are addressed in the following sections on treatment of contracts, the debtor's rights and obligations and the insolvency representative's rights and obligations.

2. Summary and recommendations: protecting the insolvency estate

(1) The purpose of these provisions is to:

(a) Provide a mechanism, such as a stay, that will ensure that the value of the estate is not diminished by the actions of the various parties in interest;

(b) Determine the scope of the activities to be affected by the stay;

(c) Identify the parties to whom the stay will apply and the conditions of its application, including method, time and duration of application;

(d) [...].

Variant 1: Discretionary application of the stay

(2) In both liquidation and reorganization proceedings, the court may, upon the application of an interested party, safeguard the interests of creditors and other persons by making appropriate orders specifying the actions against the debtor that are to be stayed. The stay could be applied at the discretion of the court to both unsecured and secured creditors, or a discretionary stay of secured creditors could be combined with an automatic application to unsecured creditors.

(3) Where application of the stay is discretionary, the insolvency law may need to include measures to encourage the use of pre-commencement negotiation to achieve the best result for all creditors.

Variant 2: Automatic application of the stay

Liquidation

(2) A stay would [automatically] come into effect against secured and unsecured creditors:

(a) Where the application is made by the debtor, on [the making of the application] [commencement of the proceedings];

(b) Where the application is made by one or more creditors, on [the making of the application] [commencement of the proceedings].

(3) Where the stay applies on commencement of proceedings, the court may, on the application of an interested party, safeguard the interests of creditors and other persons by making appropriate provisional orders. Those orders may include [...].

(4) A stay applicable to unsecured creditors should apply for the duration of the liquidation proceedings.

(5) Where the stay comes into effect upon the making of the application, the court may order, on commencement of proceedings, the continued application of the stay to secured creditors for [between 30 and 60 days]. After that time the insolvency representative may apply for the stay to be extended for a further period of [...] days] provided it can show that the extension is necessary to maximize the value of the assets for the benefit of all creditors and that secured creditors will suffer no unreasonable harm.

(6) A secured creditor may apply to the court for relief from the application of the stay where it can demonstrate severe prejudice (for example, it is not receiving appropriate protection of the economic value of the security). An insolvency representative may release the security where it determines that the protection of the value of the security is not feasible or will be overly burdensome to the insolvency proceedings; where the secured asset has no value for the estate or cannot be realized in a reasonable period of time; and where the security is not essential to the sale of the business as a whole.

Reorganization

(7) The considerations as to the time at which the stay is effective are the same for reorganization as for liquidation.

(8) Where the stay comes into effect upon the making of the application it would continue automatically after commencement of proceedings and not be subject to the discretion of the court, except as to lifting of the stay with respect to individual creditors.

(9) The stay should apply equally to both secured and unsecured creditors, subject to provision for relief and [for the duration of the proceedings] [for the time that it may reasonably take for the reorganization plan to be approved].

(10) A secured creditor may apply to have the stay lifted where it can demonstrate severe prejudice (for example, it is not receiving appropriate protection of the economic value of the security). The stay may cease to apply where the insolvency representative determines that protection of the value of the security is not feasible or will be overly burdensome; that the secured asset has no value for the estate or cannot be realized in a reasonable period of time; or that the security is not required for the reorganization proceedings.

(11) Where the stay applies to secured creditors, the insolvency law should adopt specific measures addressing protection of the security.

C. Treatment of contracts

1. General remarks

84. It is almost inevitable that, at the commencement of insolvency proceedings, the debtor will be a party to at least one contract that has not yet been fully performed by either party or by both parties.

85. No special rules are required for the situation where one party has fully performed its obligations. If it is the debtor that has not or not fully performed, the other party's claim for performance or damages will be an insolvency claim that should be made in the proceedings. If it is the counterparty that has not or not fully performed its obligations, the insolvency representative can demand performance or damages from that party. Where both parties have

not or not fully performed their obligations, it is a common feature of many insolvency laws that the insolvency representative may interfere in those contracts, electing to either reject and terminate or continue (and possibly subsequently assign) those contracts. Pending continuation or termination of a contract, it is desirable that the insolvency representative [the estate] be required to pay for any benefits received under the contract.

86. As an economy develops, more and more of its wealth is apt to be contained in or controlled by contracts, rather than contained in land. As a result, the treatment of contracts in insolvency is of overriding importance. There are two overall difficulties in developing legal policies in that regard. The first difficulty is that contracts are unlike all other assets of the insolvent estate in that usually they are tied to liabilities or claims. That is, it is often the case that the estate must perform or pay in order to enjoy the rights that are potentially valuable assets. The result is that difficult decisions must be made about the treatment of a contract so as to produce the most value for the estate. Typically, the insolvency representative is charged with making this evaluation. In some jurisdictions, court approval is also required.

87. Achieving the objectives of maximizing the value of the estate and reducing liabilities and, in reorganization, enabling the entity to survive and continue its affairs to the maximum extent possible in an uninterrupted manner may involve taking advantage of those contracts which are beneficial and contribute value and rejecting those which are burdensome, or those where the ongoing cost exceeds the benefit of the contract. As an example, in a contract where the debtor had agreed to purchase a particular good at a price which is half the market price at the time of the insolvency, obviously it would be advantageous to the insolvency representative to continue to purchase at the lower price and sell at the market price. The counterparty would naturally like to get out of what is now an unprofitable agreement, but in many systems it will not be permitted to do so, although it may be entitled to an assurance that it will be paid the contract price in full.

88. There are, however, a number of competing interests against which achievement of these objectives may need to be balanced. These include the social concerns raised by some types of contracts such as employment contracts (see paras. 113 and 114 below), and the effect of the insolvency representative's ability to interfere with the terms of unperformed contracts on the predictability of commercial and financial relations and on the cost and availability of credit (the wider the power of the insolvency representative to interfere in contracts, the higher the cost and the lower the availability of credit is likely to be). The insolvency representative's ability to terminate employment contracts, for example, may be limited by concerns that liquidation can be used as a means of expressly eliminating the protections afforded to employees by such contracts. Other types of contracts requiring special treatment include financial market transactions (see para. 121 below) and contracts for personal services, where the identity of the party to perform the agreement, whether the debtor or an employee of the debtor, is of particular importance. A related issue is the circumstances in which an insolvency representative may

alter the terms and conditions of contracts of the type requiring special treatment.

89. The second difficulty is that contracts are of many different types. They include simple contracts for the sale of goods; short-term or long-term leases of land or of personal property; and immensely complicated contracts for franchises or for the construction and operation of major facilities, among many others. Additionally, the debtor could be involved in the contract as buyer or seller, lessor or lessee, licensor or licensee or provider or receiver and the problems presented in insolvency may be very different when viewed from different sides. A common solution is to provide general rules for all kinds of contracts and exceptions for certain special contracts, as discussed below.

90. Contracts in bankruptcy fall into two categories: contracts made before insolvency by the debtor and contracts entered into after the start of insolvency proceedings. In many laws breach of a contract in the first category (pre-insolvency contracts) gives rise to an unsecured claim that is usually paid on a pro rata basis. Breach of a contract in the second category (post-insolvency contract) is usually a first claim on the available funds and therefore is paid in full as an expense of the insolvency administration (see sect. V.A, Distribution priorities, below). The line between these two types of contract is crossed when the insolvency representative seeks to perform a pre-insolvency contract based on an evaluation that performance of the contract will yield greater net returns than its breach. If the contract is thus continued, it is effectively adopted and in many insolvency laws any later breach will also be a first-priority administration claim.

91. Whatever rules are adopted with respect to continuation and termination, it is desirable that any right to continue or terminate a contract should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue certain parts of a contract and terminate others.

(a) Continuation

92. Different approaches to the continuation of contracts are evident in different insolvency laws. Some insolvency laws require the insolvency representative to make a decision as to continuation and set a deadline by which this must be done; failure to act within the specified time results in the contract being deemed to have been rejected. Under other laws, contracts are unaffected by the commencement of insolvency proceedings so that contractual obligations remain binding and the general rules of contract law will continue to apply unless the insolvency law expressly provides for different rules to be applied, as in the case of termination and overriding automatic termination clauses (see paras. 103-109 below).

93. Continued contracts are treated as ongoing obligations of the insolvent entity that must be performed and all contractual obligations of the estate become post-commencement obligations. Where the debtor is in default under a contract at the time of the application for insolvency, the policy issue is whether it is fair to require the counterparty to continue to deal with an insolvent debtor when there was

already a pre-insolvency default. Some insolvency laws require, as a condition of continuation, that the insolvency representative cure any defaults under the contract and provide assurance as to future performance by providing, for example, a bond or guarantee.

94. Claims arising from the performance of the contract after the commencement of insolvency proceedings are treated in a number of insolvency laws as an administrative expense (see sect. IV.C, Post-commencement financing, below) and given priority in distribution. Since the granting of such a priority constitutes a potential risk for other creditors (who will be paid after the priority creditors), it is desirable that only contracts that will be profitable and contracts that are essential to the continued operation of the debtor be continued. Where the insolvency representative breaches an agreement after it has been continued, the party that has been damaged as a result of the breach may be entitled to pursue its rights and remedies under the agreement in accordance with applicable non-insolvency law and to the payment of damages, which may also rank as an administrative claim (as opposed to an unsecured claim).

(i) *Reorganization*

95. In reorganization, where the objective is to enable the entity to survive and continue its affairs to the extent possible, the continuation of contracts that are beneficial to the business and contribute value may be crucial.

96. Many contracts include a clause providing that commencement of insolvency proceedings constitutes an event of default that gives the counterparty an unconditional right of termination or acceleration or some other right. Some laws uphold the validity of these clauses and where the insolvency representative seeks to continue the contract, it will only be able to do so if the counterparty does not elect, or can be persuaded not to elect, to terminate or accelerate the contract. Where a counterparty can terminate a contract, an insolvency law may provide a mechanism that can be used to persuade the counterparty to continue the contract, such as establishing a priority for payment for services provided after commencement of the proceedings (in some insolvency laws this may exist as a general provision that typically treats costs incurred after the commencement of proceedings as a first priority from unencumbered assets).

97. The approach of upholding termination clauses may be supported by a number of factors including the desirability of respecting commercial bargains; the need to prevent the debtor from selectively performing contracts that are profitable and cancelling others (an advantage that is not available to the innocent counterparty); the effect of such an override provision on netting; the belief that since an insolvent business will generally be unable to pay, delaying the termination of contracts potentially only increases existing levels of debt; the need for creators of intellectual property to be able to control the use of that property; the effect on the counterparty's business of termination of a contract with respect to a general intangible; and the undesirability of compelling a transfer of a contract to a transferee who may not be known to the counterparty or with whom the counterparty may not wish to do business.

98. A second approach provides that the insolvency representative can continue the contract over the objection of the counterparty, that is, any event of default that is triggered by commencement of insolvency proceedings and that would give rise to a right to terminate or accelerate the contract is overridden by operation of the law. Permitting these termination and acceleration clauses to be overridden in reorganization proceedings may be crucial to the success of the proceedings where, for example, the contract is a critical lease or involves the use of intellectual property embedded in a product. It may also enhance the earnings potential of the business; reduce the bargaining power of an essential supplier; and capture the value of the debtor's contracts for the benefit of creditors. Where an insolvency law provides that termination clauses can be overridden, creditors may be tempted to take pre-emptive action to avoid that outcome by terminating the contract before the application for insolvency proceedings is made (assuming default of the debtor other than one triggered by commencement of the proceedings). Such a result may be mitigated by providing that the insolvency representative has the power to reinstate those contracts, provided that both pre- and post-commencement obligations are fulfilled.

99. Although some jurisdictions have implemented provisions allowing termination clauses to be overridden, it has not yet become a general feature of insolvency laws. There is an inherent tension between promoting the debtor's survival, which requires the preservation of contracts, and injecting unpredictability and extra cost into commercial dealings by creating a variety of exceptions to the general rules. While this issue is one that may require a careful weighing of the advantages and disadvantages, there are, nevertheless, circumstances where the ability of the insolvency representative to continue contracts will be crucial to the conduct and successful implementation of reorganization and also, but perhaps to a lesser extent, liquidation where the business is to be sold as a going concern. Any negative impact of a policy of overriding termination clauses can be balanced by providing compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the continuation of the contract.

(ii) *Liquidation*

100. In liquidation, the desirability of continuing contracts is likely to be less important than in reorganization, except where the contract may add value to the business or to a particular asset or promote the sale of the business as a going concern. A lease agreement, for example, where the rental is below market value and the remaining term is substantial, may prove central to any proposed sale of the business or may be sold to produce value for creditors.

101. The arguments in favour of overriding termination clauses in liquidation would include the need to keep the business together to maximize its sale value or to enhance its earnings potential; to capture the value of the contract for creditors rather than forfeiting it to the counterparty; and the desirability of locking all parties into the final disposition of the business. [*other justifications?*]

(iii) Exceptions

102. Exceptions to the power of the insolvency representative to continue contracts generally fall into two categories. In respect of the first, where the insolvency representative has the power to override termination provisions, specific exceptions may be made for contracts such as short-term financial contracts (for example, swap and futures agreements). The second category relates to those contracts where, irrespective of how the insolvency law treats termination provisions, the contract cannot be continued because it provides for performance by the debtor of irreplaceable personal services (for example, an opera singer).

*(b) Termination**(i) Liquidation*

103. For the general reasons discussed in the introduction above, it is desirable that an insolvency representative has the power to terminate a contract in which both parties have not fully performed their obligations.

104. Different mechanisms may be adopted to terminate a contract. Under one approach the insolvency representative is required to take action to terminate the contract, such as by providing notice to the counterparty that the contract is to be terminated. This approach may not achieve the key objectives of certainty, predictability and efficient progress of the proceedings if the insolvency representative does not take timely action to terminate and allows the matter to continue unresolved for some time. It may also lead to the accrual of unnecessary expense (for example, rent for real or personal property that is leased by the debtor can be a significant administrative cost if a lease is not promptly terminated).

105. Under a second approach the contract may be regarded as automatically terminated if the insolvency representative does not elect to continue it within a specified time period, which may be longer in reorganization than in liquidation. This approach is aimed at ensuring certainty for both parties. It requires the insolvency representative to take timely action with respect to contracts outstanding at the time of commencement and offers the counterparty some certainty as to the continued existence of the contract within a reasonable period after commencement. [*other justifications?*]

106. Where a contract is terminated, the counterparty is excused from performing the rest of the contract and the only serious issue to be determined is calculation of the unsecured damages that result from the termination. The counterparty becomes an unsecured creditor with a claim equal to that amount of damages. Where a contract has been performed for a period of time during the insolvency proceedings before being terminated, the counterparty may have claims both for the period before termination (which may rank as an administrative claim) and for the damages resulting from the termination.

(ii) Reorganization

107. In reorganization, the prospects of success may be enhanced by allowing the insolvency representative to reject burdensome contracts. These may include contracts where the cost of performance is higher than the benefits to be received or, in the case, for example, of an unexpired lease, the contract rate exceeds the market rate.

108. However, while in liquidation it may be reasonable to assume that the failure of the insolvency representative to take a decision with respect to a contract would most likely imply a decision to terminate, the same assumption may not always be appropriate in reorganization. In reorganization, it may be appropriate to allow the insolvency representative to make a decision as to termination up to the time of approval of the reorganization plan, provided that any benefit received under the contract is paid for and that the counterparty has the ability to compel an earlier decision where it is required or desired. It is desirable that treatment of specific contracts be addressed clearly in the plan, with perhaps a provision that contracts not so addressed should be treated as automatically rejected on approval of the plan.

(iii) Exceptions

109. Irrespective of the extent of the termination powers given to an insolvency representative, exceptions may be needed for certain contracts. One important exception to the power to terminate is employment contracts (see paras. 113 and 114 below). A similar limitation may appropriately be applied to the case of agreements where the debtor is a lessor, a franchiser or a licensor of intellectual property and termination of the agreement would end or seriously affect the business of the counterparty, particularly where the advantage to the debtor may be relatively minor. Where the debtor is a lessee, it may be desirable to set a ceiling on damages (which may be a monetary amount or a specified period of time in respect of which damages may be payable) so that the claim under a long-term lease does not overwhelm the claims of other creditors. Lessors ordinarily can mitigate losses by re-letting the property.

(c) Assignment

110. The ability of the insolvency representative to elect to continue and assign contracts, notwithstanding insolvency-triggered termination provisions or restrictions on transfer contained in the contract, can have significant benefits to the estate and therefore to the beneficiaries of the proceeds of distribution following liquidation. There may be circumstances, such as where the contract lease price is lower than the market value, where termination of the contract may result in a windfall for the counterparty. If the contract can be continued and assigned, the insolvency estate rather than the counterparty will benefit from the difference between the contract and market prices.

111. However, this ability may undermine the contractual rights of the counterparty to the contract and raise issues of prejudice, especially where the counterparty has little or no say in the selection of the assignee. Different approaches are taken to this issue. Some insolvency laws specify that

non-assignment clauses are made null and void by the commencement of insolvency proceeding. Other insolvency laws require agreement of the counterparty or of all parties to the original contract in order for the contract to be assigned or provide that if the counterparty does not consent to assignment, the insolvency representative may assign with permission from the court if it can be shown that the counterparty is withholding consent unreasonably. A further approach provides that a contract can be assigned if the insolvency representative demonstrates to the counterparty that the assignee can adequately perform the contract. The insolvency representative is then free to assign the contract for the benefit of the estate. This approach is consistent with the approach taken in the United Nations [draft] Convention on the Assignment of Receivables in International Trade (art. 9). While this latter option is considered of critical importance to the liquidation proceedings of some countries, in other countries it is entirely foreign and is precluded.

112. Irrespective of the powers of the insolvency representative to assign contracts, some contracts cannot be assigned because they require the performance of irreplaceable personal services or because assignment is prevented by the operation of the law. Some countries, for example, prevent the assignment of government procurement contracts.

(d) General exceptions to the power to continue, terminate and assign contracts

Employment contracts

113. One important exception is that of employment contracts. Although particularly relevant to reorganization, such contracts are also relevant in liquidation where the insolvency representative is attempting to sell the entity as a going concern. A higher price may be obtained if the insolvency representative is able to terminate onerous employment contracts or to achieve necessary downsizing of the labour force of the debtor. However, the relationship between employee and employer raises some of the most difficult questions in insolvency law. It is not simply the contract itself, which in essence is a pending contract like any other, but the usually mandatory provisions of non-insolvency law that protect the position of employees. These may relate to, for example, unfair dismissal; minimum rates of pay; paid leave; maximum work periods; maternity leave; equal treatment; and non-discrimination. The difficult question is generally the extent to which these provisions will have an impact on the insolvency, raising issues that are much broader than termination of the contract and priority of monetary claims. For these reasons, a number of countries have adopted special regimes to deal with the protection of employees' claims in insolvency (see sect. IV.E, Claims of creditors and their treatment, below) and, in order to avoid insolvency proceedings being used as a means of eliminating employee protection, specifically limit the insolvency representative's ability to terminate employment contracts. This may include limiting the use of the powers to certain specified circumstances such as where the remuneration is excessive in comparison to what the average employee would receive for the same work. In some countries the law provides for employees to follow

the business in case of sale as a going concern in both liquidation and reorganization, in others only in reorganization.

114. To enhance the transparency of the insolvency regime, it is desirable that the limitations on the powers of the insolvency representative to deal with these types of contracts are stated clearly in the insolvency law.

(e) Disclaimer of onerous assets

115. In addition to the power to terminate contracts, some insolvency laws provide that the insolvency representative can disclaim other assets included in the estate whenever the asset is burdened in such a way that retention would require excessive expenditure or it is unsaleable or not readily saleable or it would give rise to an onerous obligation. As in the case of termination of a contract, the right to disclaim may be accompanied by provision for claims for damage suffered as a consequence of the disclaimer and by provisions allowing the ownership of the asset to be vested in some person other than the debtor.

(f) Set-off, netting and financial contracts¹

(i) Set-off

116. An important issue that arises in the design of an insolvency law is the treatment of a creditor who, at the time of the application for liquidation proceedings, also happens to be a debtor of the estate. If the fundamental principle of equality of treatment of similarly situated creditors is applied, the outcome would be relatively straightforward: the insolvency representative will be able to receive the full amount owed by the creditor and the creditor's claim will be satisfied upon the liquidation of the estate. However, an alternative approach permits the creditor, in these circumstances, to exercise set-off rights against the estate after the application for liquidation is made, with the effect that, depending on the size of the estate's claim on the creditor, the creditor's claim is satisfied in full.

117. There are several reasons why it may be appropriate to include the right of set-off in an insolvency law. The first is that of fairness: notwithstanding the importance of equality of treatment among creditors, it is considered unfair for a debtor to refuse to make a payment to a creditor but, at the same time, to insist upon payment from that creditor. In addition, since many counterparties are banks, the right of set-off is particularly beneficial to the banking system and, because of the important credit creation role of banks, it is therefore considered to be of general benefit to the economy. By virtue of their core functions (lending and deposit taking) banks that have lent to an insolvent debtor often find that they have financial obligations to the debtor in the form of deposits. A post-commencement right of set-off will allow the banks to offset their unpaid claims with the debtor's deposits even though these reciprocal claims

¹The material in this section is largely taken from *Orderly and effective insolvency procedures: key issues*, Legal Department, International Monetary Fund, 1999, pp. 42-44 and from "Principles and guidelines for effective insolvency and creditor rights systems", the World Bank, April 2001, paras. 121-125.

are not yet due and payable. Set-off allows the creditor to escape the difficulties created by the insolvency of the debtor and thus helps to avoid the cascade effect of bankruptcy, as well as reducing exposures and transaction costs and thus the cost of credit.

118. Although there are a number of advantages to allowing set-off, these may need to be balanced against some of the arguments against a right of set-off. Insolvency set-off is a violation of the *pari passu* principle because a creditor with a set-off gets paid in full. Set-off can deplete a debtor's assets and inhibit reorganization, in particular where the debtor loses access to its bank accounts or cash in its bank accounts and [others?].

119. The international position with regard to set-off is complex. A small number of countries do not permit set-off, except for certain transactions and for current account set-offs. A few countries have widened their transaction set-offs and introduced netting legislation, which applies only to specified contracts. Among those States that traditionally permit set-off, a small number impose a stay in reorganization proceedings, although permitting an exemption for financial contracts. Other insolvency laws do not address the question of set-off.

120. The right of set-off interacts with other provisions of insolvency in a number of important respects. For example, the right of a creditor to claim the benefit of a set-off will be subject to the avoidance provisions if the time of the provision or receipt of credit to or from the debtor falls within the relevant suspect period and the debtor was insolvent at that time or rendered insolvent by the set-off. It may also be subject to avoidance where it occurs after the making of the application for commencement of proceedings. Where an insolvency law generally allows termination clauses to be overridden thus allowing the insolvency representative to continue unperformed contracts, a creditor will only be able to exercise set-off rights regarding mutual monetary claims where the right to override the termination clause expressly allows a creditor to terminate the contract and set-off these claims. This is particularly important in the context of short-term financial transactions.

(ii) *Financial contracts and netting*

121. Depending on how an insolvency regime addresses issues relating to the treatment of contracts and set-off rights, it may or may not need to include provisions regarding certain types of short-term financial contracts, including derivative agreements (for example, currency or interest rate swaps). The terms of the increasingly standardized master agreements that govern these individual transactions normally contain provisions that enable one party, upon the commencement of the insolvency of the other party, to net (see glossary) the total of all its gains and losses and all unpaid amounts on separate transactions. Such "close-out netting" provisions (see glossary), which aggregate all independent payment obligations, are normally effective only upon the insolvency of one of the parties if the insolvency law contains two features. First, it must allow for the termination (or "close-out") of all outstanding transactions under the agreement on the insolvency of a party, and second, it must allow the

non-insolvent party to set off its claims against the obligations of the insolvent party.

122. The insolvency laws of a number of countries do not contain both of these features. With respect to termination, some countries allow an insolvency representative to elect to continue the contract in contravention of the termination provisions of the contract. With respect to set-off, a number of countries do not allow for the set-off of independent financial claims that are not mature at the time of commencement.

123. Many countries that do not possess these general rules that provide for both termination and set-off, have carved out exceptions to the applicable insolvency rules for the specific purposes of allowing "close-out netting" for financial contracts. The rationale for these exceptions is the increasing importance of these transactions in the global financial market and the fact that access to such transactions would be restricted if there was no certainty regarding netting upon the insolvency of one. Notwithstanding these important advantages, it should be recognized that such "carve-outs" complicate the law and result in preferential treatment for certain types of creditors.

2. *Summary and recommendations: treatment of contracts*

(1) The purpose of these provisions is to:

- (a) Enable the insolvency representative to interfere in contracts that have not been performed or not fully performed by both the debtor and its counterparty with the objective of maximizing the value and reducing the liabilities of the estate;
- (b) Define the scope of the powers of the insolvency representative to interfere in contracts and the situations in which they may be exercised;
- (c) Identify the contracts that should be excluded from those powers;
- (d) [. . .].

(2) An insolvency representative may terminate contracts that are not performed or not fully performed by both the debtor and the counterparty.

(3) Two approaches may be taken as to when termination may be effective:

- (a) When the insolvency representative gives notice of termination [advantages and disadvantages from para. 104 to be included here]; or
- (b) Automatically in the absence of a decision by the insolvency representative (or the court) to continue the contract within a specified period of time, where the time specified may be extended or reduced by the court [advantages and disadvantages from para. 105 to be included here].

(4) Termination gives rise to an unsecured claim for the damages arising from the termination.

(5) In insolvency proceedings the right to terminate certain classes of contracts, including employment

contracts, financial contracts and [...] should be limited. The powers of the insolvency representative with respect to those contracts should be stated clearly in the insolvency law.

(6) The insolvency representative may elect to continue contracts that will be beneficial to the business and add value to the insolvency estate, with the exception of financial contracts, contracts that cannot be continued because they require the debtor to perform irreplaceable personal services and [...]. Provisions on continuation and assignment should be accompanied by compensation of the counterparty for damages caused by the default, if any.

(7) Where a provision of the contract has the effect of terminating the contract upon the commencement of insolvency proceedings:

(a) The provision may be treated by the insolvency representative or the court as null and void; or

(b) The insolvency law can provide that it is null and void; or

(c) The automatic termination clause cannot be invoked as a defence against the insolvency representative's claim for performance of the contract.

(8) Contracts continued by the insolvency representative become obligations of the estate from the commencement of the proceedings.

(9) With the exception of contracts that cannot be assigned because they require performance of irreplaceable personal services or because assignment is prohibited by operation of law, the insolvency representative may treat a non-assignment clause as void and assign a continued contract subject to the agreement of all parties to the original contract.

(10) Where the parties do not agree to the assignment, the court may nevertheless approve the assignment of the contract if it will be beneficial to the business and add value to the insolvency estate and the court finds that the assignee can perform the contractual obligations.

(11) With the exception of those classes of special contracts in respect of which the insolvency representative has limited powers, the powers of the insolvency representative with respect to termination, continuation and assignment of contracts should be exercisable without the need for approval by the court or by creditors, but would be subject to review by the court on application by an interested party.

D. Avoidance actions

1. General remarks

124. Insolvency proceedings (both liquidation and reorganization) may commence at lengthy periods after a debtor first becomes aware that such an outcome cannot be

avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations to relatives and friends or pay certain creditors to the exclusion of others. The result of such activities, in terms of the eventual insolvency proceedings, is to disadvantage general unsecured creditors, who were not party to such actions and do not have the protection of security, and to undermine the key objective of equitable treatment of creditors.

125. Many insolvency laws include provisions that apply retrospectively and are designed to upset and overturn those past transactions to which the insolvent debtor was a party and that have had the effect of either reducing the net worth of the debtor (for example, by gifting of its assets or transferring or selling assets for less than its fair commercial value) or of upsetting the principle of equal sharing between creditors of the same class (for example, by payment of a debt to an unsecured creditor or granting a security to a creditor who is otherwise unsecured when other unsecured creditors remain unpaid). A principal goal of avoidance powers is to ensure that creditors receive a fair allocation of an insolvent debtor's assets consistent with established priorities for payment. Notwithstanding this goal, it is important to bear in mind that many of the transactions that may be subject to avoidance powers are perfectly normal and acceptable when they occur outside an insolvency context, but become suspect only because they occurred in proximity to the commencement of insolvency proceedings.

126. Avoidance rules are much discussed, principally as to their effectiveness in practice and the somewhat arbitrary rules that are necessary to define, for example, relevant time periods and the nature of the transactions to be included. Nevertheless, avoidance provisions can be important to the insolvency law not only because the policy upon which they are based is sound, but also because they may result in recovery for the benefit of creditors generally and because provisions of this nature help to create a code of fair commercial conduct and are part of appropriate standards for the governance of commercial entities.

127. As is the case with a number of the core provisions of an insolvency law, it is desirable to reach a balance, in designing provisions for avoidance powers, between competing social benefits. These would include the value of strong powers to maximize the value of the estate for the benefit of all creditors and the possible undermining of contractual predictability and certainty. When the balance suggests that a particular transaction is harmful, it may become legally "voidable", that is, subject to being treated as legally void, so that the asset the debtor has disposed of, or its value, may be recovered by an insolvency representative for the benefit of creditors generally.

128. Different approaches are taken to defining which transactions are subject to avoidance provisions. One approach emphasizes the reliance on generalized, objective criteria for determining whether transactions are avoidable. The question would be, for example, whether the transaction took place within a specified period prior to commencement of the insolvency proceedings (often referred to as the "suspect period") or whether the transaction contains

any of the general characteristics set forth in the law (for example, requirements for provision of appropriate value). While generalized criteria may be simple to apply, they can also have arbitrary results if relied upon exclusively. So, for example, legitimate and useful transactions that fall within the specified period are voided, while fraudulent or preferential transactions that fall outside the period are protected.

129. Another approach emphasizes case-specific, subjective criteria such as whether there is evidence of intention to hide assets from creditors, whether the debtor was insolvent when the transaction was made and whether the counterparty knew of the insolvency. This individualized approach may require consideration in some detail of the intent of the parties to the transaction and what constitutes the normal course of business between them. In some countries this type of approach has led to considerable litigation and extensive cost to the insolvency estate. In order to avoid these costs, some laws have adopted an approach of a short time limit for the suspect period, such as 3-4 months, combined with an arbitrary rule that all transactions occurring within that period would be suspect unless there was a roughly contemporaneous exchange of value between the parties to the transaction.

130. Irrespective of whether the insolvency law adopts either of these approaches or an intermediate approach that seeks to achieve a balance between the two, it is generally accepted that stricter rules should apply to transactions made to related parties (that is, persons who have a close business or family relationship to the debtor or its creditors, sometimes referred to as an insider). A stricter regime may be justified on the basis that those parties are more likely to be favoured and tend to have the earliest knowledge of when the debtor is, in fact, insolvent.

(a) *Types of transactions to be avoidable*

131. The use of the word “transaction” is intended to refer generally to the wide range of means by which assets may be disposed of including by way of a transfer, a payment, a security, a guarantee, an obligation, a loan, a release or a discharge.

132. Three common types of avoidable transactions are found in most legal systems. They are transactions intended to defraud creditors, transactions at an undervalue and transactions with certain creditors that could be regarded as preferential. Some transactions may have the characteristics of more than one of these different classes, depending on the individual circumstances of each contract. For example, transactions that appear to be preferential may be more in the character of fraudulent transactions when they occur while the debtor is nearly insolvent or where they leave the debtor with insufficient assets to conduct its business. Similarly, transactions at an undervalue may be preferential when they involve creditors, but not when they involve third parties. In considering categories of transactions to be avoided, an insolvency law may focus on the consequences of the transaction and the relationship between the parties involved. The relevance of such an approach may be seen, for example, in a situation where directors of the debtor entity sought to pay off, in the period before

commencement, all the liabilities that they had personally guaranteed. While the payments may appear acceptable, the effect of those payments may need to be considered.

133. These three types of transactions are made avoidable for several reasons, including to prevent fraud (for example, transactions designed to hide assets for the later benefit of the debtor or to benefit the officers, owners or directors of the debtor); to prevent favouritism, where the debtor wishes to advantage certain creditors at the expense of the rest; to prevent a sudden loss of value from the business entity just before the supervision of the insolvency proceedings is imposed; and to create a framework for out-of-court settlement—creditors will know that last-minute transactions or seizures of assets can be set aside and therefore will be more likely to work with debtors to arrive at workable settlements without court intervention.

(i) *Fraudulent transactions*

134. Fraudulent transactions are those made by the debtor’s management with the intent to defeat, hinder or delay the efforts of creditors to collect claims, by transferring assets beyond the reach of creditors to any third party where the third party knew of such an intent. Unlike the other transactions discussed in this section, fraudulent transactions cannot be automatically avoided by reference to an objective test of a fixed suspect period because of the need to prove the intent of the debtor. As a practical matter, in order to prove intent, if the debtor cannot explain the commercial purpose of a particular transaction which extracted value from the estate it may be relatively straightforward to show that the transaction is fraudulent. In designing an insolvency law, as noted above, it may desirable to bear in mind that transactions that are potentially fraudulent under insolvency law are often perfectly valid under non-insolvency law.

(ii) *Undervalued transactions*

135. Transactions may be avoidable where the value received by the debtor as the result of the disposal of an asset to a third party was either nominal or much lower than the true value of the asset disposed of and where the transaction occurred within a specified period of time before commencement of the insolvency proceedings. Some laws also require a finding that the debtor was insolvent at the time the transaction occurred, or was made insolvent as a result of the transaction. These transactions include transactions with both creditors and third parties.

(iii) *Preferential transactions*

136. Preferential transactions may be subject to avoidance where the transaction took place within a defined but usually rather short period before the commencement of the insolvency proceedings with a creditor on account of a debt and, as a result of the transaction, the creditor received more than its lawful, pro rata share of the debtor’s assets. Many countries also require evidence of insolvency or near insolvency when the transaction took place. The rationale for including these types of transactions within the scope of avoidance provisions is that when they occur very close to the commencement of proceedings, a state of insolvency is

likely to exist and they breach the key objective of equitable treatment of creditors.

137. Examples of preferential transactions may include transactions made after the application for insolvency proceedings but before commencement, unless the transaction was authorized by the terms of the insolvency law. It may be desirable for the insolvency law to provide that where these transactions are unauthorized they should be void, not voidable, in order to avoid disputes. Although in some cases gifts may be entirely innocent and permitted by law, they may also be unfair to creditors and avoidable as fraudulent, undervalued or preferential transactions. A set-off, while not avoidable as such, may be considered prejudicial when it occurs within a short period of time before the application for commencement of the insolvency proceeding and has the effect of altering the balance of the debt between the parties in such a way as to create a preference or where it involves transfer or assignment of claims between creditors to build up set-offs. It may also be subject to avoidance where the set-off occurs in irregular circumstances such as where there is no contract between the parties to the set-off.

138. A defence to an allegation of a preferential transaction may be to show that although appearing to be irregular the transaction was in fact consistent with normal commercial practice and, in particular, with the normal course of business between the parties to the transaction. For example, a payment made on receipt of goods that are regularly delivered and paid for may not be avoided even if made within proximity of the commencement of insolvency proceedings, whereas payment of a long overdue debt could be avoided. This approach encourages suppliers of goods and services to continue to do business with a debtor that may be having temporary financial problems, but that is still viable.

139. Security interests valid under the laws permitting the grant of security to creditors may be avoidable in insolvency proceedings under the categories of fraudulent, preferential or undervalued transactions. For example, the grant of a security interest shortly before insolvency, although otherwise valid, may be found to have favoured unfairly a certain creditor at the expense of the rest. Where a security interest can be granted on the basis of past consideration or of an existing debt (permitted in some legal systems, but not in others) it may also be invalid as favouring that particular creditor unfairly.

(b) Establishing the suspect period

140. Some insolvency laws explicitly specify the suspect period (for example, so many days or months before commencement of insolvency) during which each of these types of transactions would be subject to avoidance. In other laws, the suspect period is defined retrospectively by the court after proceedings have commenced. In those laws, the court's decision is often based on a finding as to when the debtor ceased paying its debts in the normal way ("cessation of payments"). A related issue is whether suspect periods stipulated in the insolvency law can be extended by the court in appropriate situations, such as where transactions that occurred outside the suspect periods

in questionable circumstances had the effect of diminishing the estate. While a discretionary approach may allow a certain degree of flexibility with respect to the transactions to be caught by the avoidance provisions, it may also lead to delay in the proceedings and does not give a certain or transparent indication to creditors as to the types of transactions that are likely to be avoided. If transactions can be unwound where they took place at some unspecified time prior to the commencement of insolvency proceedings and subject to the discretion of the court, there is likely to be less safety in commercial and financial transactions.

141. Some systems may have one suspect period for all types of avoidable transactions, while others have different periods depending upon factors such as whether the injury to creditors was intentional (that is, fraudulent) and whether the transferee was an insider (that is, a person who has a close corporate or family relation to the debtor or its creditors). Because fraudulent transactions involve intentionally wrongful conduct, many insolvency laws do not limit the time period within which these transactions must have occurred in order for them to be avoided. Other insolvency laws establish a very long limit (examples range from one to six years) where the suspect period is calculated from the date of commencement of proceedings.

142. Where preferential and undervalued transactions involve creditors who are not insiders, the suspect period may be relatively brief, perhaps no more than several months. However, where insiders of the debtor are involved, many countries apply stricter rules. These may include longer suspect periods, shifted burdens of proof and dispensing with requirements for the debtor to be either insolvent at the time of the transaction or rendered insolvent as a result of the transaction.

(c) Liability of counterparties to voided transactions

143. With regard to each of these types of transactions, the question arises as to whether the counterparty may be exempted from liability and whether annulment of the transaction is desirable. Such a decision may be subject to different considerations for each type of transaction and will involve balancing requirements of fairness in respect to innocent parties against the difficulties of proving motive and knowledge and the harm occasioned to creditors, independent of the counterparty's state of mind.

144. In the case of fraudulent transactions, for example, the extent to which the counterparty paid adequate value and had knowledge of the debtor's actual intent to defraud creditors will be relevant. In the case of undervalued transactions, the question of whether or not the counterparty was an insider and had knowledge of the debtor's actual or imminent insolvency or that the debtor was likely to become insolvent as a result of the transaction will be relevant. Some insolvency laws permit defences such as that the counterparty to the transaction gave value and had no knowledge of the crucial facts, while others require a return of the asset regardless, although with some protection for any value actually given by the counterparty.

145. In the case of preferential transactions, different approaches may be taken. Under one approach, where the

creditor acted in good faith and had no knowledge that the debtor was insolvent at the time of the transaction or was rendered insolvent as a result of the transaction, the creditor is not subject to liability and the transaction is not annulled. Another approach provides the same result where the transaction was substantially contemporaneous with the creation of the creditor's claim, was subsequently followed by provision of value, or occurred in the ordinary course of business.

146. Where these transactions involve insiders, stricter rules may be adopted and their ability to make claims in the proceedings can be restricted or their claims may be subordinated to all other creditors.

(d) Void and voidable transactions

147. Where a transaction falls into any of these categories, insolvency laws either render it automatically void or make it voidable, depending upon the test that is adopted in respect of each category of transaction. For example, where the law refers only to transactions occurring within a certain fixed period of time and includes no subjective criteria, it can specify that those transactions will be void. Even where the transaction is void, however, the insolvency representative may have to take action to recover from the counterparty.

148. In those laws where the transaction is voidable, the insolvency representative is required to decide whether the avoidance of the transaction will be beneficial to the estate, taking into account the elements of each category of avoidable transaction as well as the delays in recovering either the assets involved or the value of the assets and the possible costs of litigation. That discretion would generally be subject to the insolvency representative's obligation to maximize the value of the estate and it may be responsible for its failure to do so.

149. Where the insolvency representative does not take action to avoid certain transactions, insolvency laws adopt different approaches to the conduct of avoidance actions and to the manner in which they may be funded where there are insufficient assets in the insolvency estate to do so. As to the conduct of those actions, some laws permit a creditor or the creditor committee to take action to require the insolvency representative to initiate an avoidance action where it appears to be beneficial to the estate to do so or also permit a creditor itself or the creditor committee to commence an action to avoid these transactions, where other creditors agree. Where this latter action is permitted, some laws provide that assets or value recovered by the creditor are to be treated as part of the estate; in other cases whatever is recovered can be applied in the first instance to satisfy the claim of the creditor that takes the action.

150. As to the manner in which they may be funded, some countries make public funds available to the insolvency representative to commence avoidance actions. In other countries, those actions are to be funded from the insolvency estate. This latter approach may operate to prevent the recovery of assets that have been removed from the estate with the specific intention of leaving the estate with few assets from which to fund their recovery through

an avoidance action. Some insolvency laws allow the insolvency representative to assign the action for value to a third party or to approach a lender to advance funds with which to commence the avoidance action. In support of the use of the latter mechanisms, there are clearly significant differences between countries in the availability of public resources for such funding and where there is no ability to fund avoidance actions from the insolvency estate, these alternative approaches may offer, in appropriate situations, an effective means of restoring value to the estate.

(e) Evidentiary issues

151. Insolvency laws adopt different approaches to establishing the elements of an avoidance action. In some laws, the debtor is required to prove that the transaction did not fall into any category of avoidable transactions. In other laws, the insolvency representative or other person permitted to challenge the transaction, such as a creditor, is required to prove the existence of each element of an avoidance action. Some laws allow the burden of proof to be shifted where, for example, it is difficult for the insolvency representative to establish the debtor's actual intent to defraud creditors except through external indications, objective manifestations or other circumstantial evidence of such intent. The burden of establishing the debtor's innocent motive is shifted in those laws to the counterparty to the transaction.

2. Summary and recommendations: avoidance actions

(1) The purpose of avoidance provisions is to:

(a) Set out the circumstances in which certain transactions which occurred prior to insolvency proceedings involving the debtor may be considered injurious to creditors because they were fraudulent or violated the principle of equal treatment of creditors;

(b) Enable the insolvency representative to take proceedings to avoid those transactions;

(c) Enable money or assets to be recovered from other persons involved in transactions that have been avoided; and

(d) Enable obligations of the debtor arising from transactions that have been avoided to be declared unenforceable.

Variant 1

(2) The insolvency representative may take proceedings in court to set aside as a void transaction:

(a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims [irrespective of the time at which those transactions occurred] [where the transaction occurred within a period of [. . .] years immediately preceding or after commencement of proceedings];

(b) Transactions at an undervalue that occurred within a period of [. . .] [months] [years] immediately preceding commencement of proceedings [at a time when the debtor was insolvent or if the debtor became insolvent as a result of the transaction];

(c) Preferential transactions involving creditors that took place within a period of [...] months immediately preceding commencement of proceedings [at a time when the debtor was insolvent or became insolvent as a result of the transaction]

(d) Undervalued transactions involving related persons or preferential transactions involving insider creditors that took place within a period of [...] [months] [years] immediately preceding commencement of proceedings [at a time when the debtor was insolvent or became insolvent as a result of the transaction].

Variant 2

(2) An alternative approach would be to provide that both undervalued and preferential transactions could be automatically avoided by reference only to a fixed suspect period.

(3) The periods of time referred to in paragraph (2), variant 1, may be extended by the court.

(4) An insolvency law should specify the elements to be proven in order to establish a case for avoidance and also possible defences to that action.

(5) With respect to fraudulent transactions, two approaches may be taken:

(a) The insolvency representative is able to establish the actual intent of the debtor through external indications, objective manifestations or other circumstantial evidence; or

(b) The counterparty is required to establish the debtor's innocent motive.

(6) An insolvency law may provide alternative approaches to cover situations where the insolvency representative does not pursue avoidance actions. These may include permitting individual creditors or the creditor committee to pursue the actions or [*other measures to be included*].

(7) Transactions occurring after the commencement of proceedings should be void unless authorized by the insolvency representative or the court and the assets transferred should be subject to recovery.

IV. Administration of proceedings

A. Debtor's rights and obligations

1. General remarks

(a) Control of debtor's management

(i) Liquidation

152. Once liquidation proceedings have commenced, the conservation of the estate requires comprehensive measures to protect the estate not only from the actions of creditors (see paras. 54-82 above), but also from the debtor or its

managers or owners.² For this reason, many insolvency laws divest the debtor of all rights to manage and operate the business and appoint an insolvency representative to assume all responsibilities divested. These responsibilities may include the right to initiate and defend legal actions on behalf of the estate and the right to receive all payments directed to the debtor. Upon commencement of the liquidation proceedings, any actions taken by the debtor that are detrimental to the estate would normally be void.

153. Where it is determined that the most effective means of liquidating the estate is to sell the business as a going concern, some laws provide that the insolvency representative should supervise and have overall control of the business while permitting the debtor to enhance the value of the estate and facilitate the sale of the assets by continuing to serve and advise. This approach may be supported by the debtor's detailed knowledge of its business and the relevant market or industry, as well as its ongoing relationship with creditors. Under that approach, any transfer of the debtor's assets that occurs after commencement of proceedings and that is not authorized by the insolvency representative or the court will be void and the assets transferred will be subject to recovery (see sect. III.D, Avoidance actions, above). The insolvency representative may be made liable for the wrongful acts of the debtor during the period of its control.

(ii) Reorganization

154. In reorganization proceedings, there is no agreed approach either on the extent to which displacement of the debtor is the most appropriate course of action or on the ongoing role that the debtor may perform. In many circumstances, the debtor will have immediate and intimate knowledge of its business and the industry within which it operates. This knowledge is particularly important in the case of individual businesses and small partnerships and may provide a basis for management to provide continuity in the business and have a role in making short-term management decisions. It may also assist the insolvency representative to perform its functions with a more immediate and complete understanding of the operation of the debtor's business. For similar reasons, the debtor is often well-positioned to propose a reorganization plan for approval by creditors and the court. In such circumstances, total displacement of the debtor, notwithstanding its role in the financial difficulties of the business, may not only eliminate the incentive for entrepreneurial activity and risk taking, as well as for debtors to commence reorganization procedures at an early stage, but also undermine the chances of success of the reorganization.

155. The desirability of the debtor having an ongoing role may need to be balanced against a number of possible disadvantages. Creditors may have a lack of confidence in the debtor on account of its financial difficulties (and the role

²Because the insolvency law will cover businesses that are operated by different types of entities, whether individuals, partnerships or some form of company, the question of the continuing role of the debtor properly raises questions of the role of the debtor's management or owners, depending on the circumstances. For ease of reference, the Guide refers only to "the debtor", but it is intended that management and owners should be covered by the use of that term where appropriate.

that management may have played in that situation) and confidence will need to be rebuilt if the reorganization is to be successful. Permitting the debtor to continue to operate the business with insufficient control over its powers may not only exacerbate the breakdown of confidence but may antagonize creditors further. A system that is perceived to be excessively pro-debtor may result in creditors being apathetic about the process and unwilling to participate, which may in turn lead to problems of monitoring the conduct of the debtor where the insolvency law requires that role to be played by creditors. It may also encourage an adversarial approach to the insolvency process, adding to costs and delay. A debtor may have its own agenda that clashes with the objectives of the insolvency regime and in particular with the maximization of returns for creditors. The success of reorganization may depend on instituting change that existing management may not be willing to do and on existing management having the knowledge and experience to utilize the insolvency law to work through its financial difficulties. A related factor to be considered is whether the insolvency proceedings were commenced voluntarily or involuntarily (in which case the debtor may be hostile to creditors).

156. Insolvency laws adopt different approaches to balance these competing considerations. One option is to adopt the same approach as in liquidation, removing all control of the business from the debtor and replacing it with the insolvency representative. Displacing the debtor completely, however, may cause disruption to the business and repercussions detrimental to the operation of the business at a critical point in its survival.

157. Another approach is to establish a sharing arrangement between the debtor and approves the insolvency representative, where the latter supervises the activities of the debtor and approves significant transactions and the debtor continues to operate the business on a day-to-day basis. This approach may need to be supported by relatively precise rules to ensure that there is clarity as to the division of responsibility between the insolvency representative and the debtor and certainty as to how the reorganization will proceed. It may also be supported by providing that creditors can take appropriate action to ensure the sharing arrangement is effective and efficient. Where such powers are given to creditors or the creditor committee there may be a need for measures that would prevent possible abuse by creditors seeking to frustrate the reorganization proceedings or gain improper leverage. The required degree of protection could be achieved by requiring, for example, the vote of an appropriate majority of creditors before allowing creditors to take action to seek relief from the sharing arrangement.

158. Where this approach is adopted and there is evidence of gross mismanagement or misappropriation of assets by the debtor or the goal of reorganization is no longer realistic, it may be desirable to provide for the debtor to be displaced by the court, on its own motion or on that of the insolvency representative or perhaps on that of the creditors or creditor committee.

159. A third approach is to enable the debtor to retain full control over the operation of the business, with the

consequence that the court does not appoint an independent representative once the proceedings begin (known as “debtor in possession”). That approach may have the advantage of enhancing the chances of a successful reorganization if the debtor can be relied upon to carry on the business in an honest manner and obtain the trust, confidence and cooperation of creditors. There may be, however, disadvantages, which include the process being used in situations where the outcome is clearly not likely to be successful, that is to delay the inevitable with the result that assets continue to be dissipated, and the possibility that management may act irresponsibly and even fraudulently during the period of control, undermining the reorganization as well as the confidence of creditors. These difficulties may be mitigated by adopting certain protections such as appointment of an insolvency representative to supervise the debtor or a mechanism that allows the court (either on its own motion or at the request of creditors) to replace the debtor with an insolvency representative or to convert the proceedings to liquidation, as well as giving the creditors a significant role in supervising or overseeing the debtor. Nevertheless, this approach is a complex one that requires detailed consideration not only because it depends on strong governance rules and institutional capacity, but also because it affects a number of other aspects of the design of an insolvency regime.

160. To assist the debtor in carrying out its duties in relation to the proceedings generally, some laws permit the debtor to employ professionals such as accountants, attorneys, appraisers and other professionals as may be necessary, subject to authorization. In some laws, that authorization is provided by the insolvency representative, in other laws by the court or the creditors.

161. Issues to be addressed:

[A/CN.9/504, para. 94: After discussion, the Working Group agreed that it would be advisable to draw a distinction between the period between initiation of the insolvency proceedings and the approval of the reorganization plan, on the one hand, and the period following that approval, on the other hand. It was felt that, while in the first time span it would be appropriate for legislation to set out specific rules and provide for an independent representative to be involved, a more flexible approach, giving a wider scope to party autonomy, might be advisable during the period following the approval of the plan and throughout its implementation, with a view to enhancing the chances for successful reorganization.]

(b) Provision of information

162. To facilitate a thorough, independent assessment of the business activities of the debtor, including its immediate liquidity needs and the advisability of post-commencement financing, the prospects for the long-term survival of the business and whether management is qualified to continue to lead the business, information concerning the debtor, its assets and liabilities, financial position and affairs generally will be required. To enable that assessment to be undertaken, in both types of insolvency proceedings but in particular in reorganization proceedings, it is desirable for the

debtor to have a continuing obligation to disclose detailed information regarding its business and financial affairs over a substantial period, not simply the period in proximity to commencement of proceedings. That detailed information may include projections of profit and loss; details of cash flow; marketing information; industry trends; as well as information concerning the causes or reasons for the financial situation of the debtor and disclosure of past transactions that may be capable of avoidance under the avoidance provisions of the insolvency law. Although it may not be necessary for an insolvency law to detail exhaustively the information that is to be provided, such an approach may be useful to provide guidance as to the type of information that is expected to be provided. In that regard, some laws have developed standardized information schedules that set out the specific information required. These are to be completed by the debtor (with appropriate sanctions for false or misleading information) or by an independent person or administrator.

163. To ensure that the information provided can be used for these purposes, it needs to be up to date, complete, accurate and reliable and it is desirable that the obligation should require the information to be provided as soon as possible after the commencement of the proceedings. Where the debtor can meet this obligation it may serve to enhance the confidence of creditors in the ability of the debtor to continue managing the business.

164. Where the debtor is not a natural person, the information could be supplied to the insolvency representative by officers and other relevant third parties of the debtor. An alternative approach is to require the debtor itself (where it is a natural person) or one or more of the directors of the debtor to be represented at and required to attend a main meeting of creditors to answer questions, except where this is not physically possible when directors are not located in the place in which creditors meetings may be held.

165. Often the information in question will be commercially sensitive (such as trade secrets) and it is desirable that an insolvency law include provisions to protect confidential information to prevent abuse of that information by creditors or other parties in a position to take advantage of it.

166. Where information is withheld, there may be a need for some mechanism to compel the provision of relevant information such as a “public examination” of the debtor by the court or the insolvency representative. In more serious cases of withholding of information a number of countries impose criminal sanctions.

167. In addition to the specific obligation to provide information, an insolvency law may impose on the debtor a general obligation to cooperate with and assist the insolvency representative to perform its duties.

(c) Right to be heard

168. To preserve what are regarded in some countries as fundamental rights of the debtor and to ensure its fair and impartial treatment, as well as to encourage debtor confidence in the insolvency process, it is desirable for the

debtor to have the right to be heard in the insolvency proceedings or to participate generally in the decision-making that is a necessary part of the proceedings. Such a right is consistent with international and regional agreements such as article 14 of the International Covenant on Civil and Political Rights of 1976 and article 6 of the European Council Convention for the Protection of Human Rights and Fundamental Freedoms.

169. Where the exercise of the right may lead to formalities and costs that may impede the course of the proceedings without being of any direct benefit to the debtor, it may be desirable to limit the right to situations where the debtor has an interest in respect of both its financial situation and its personal rights. It may be the case, for example, that where the debtor is no longer available in the jurisdiction in which the proceedings are being conducted and refuses or fails to respond to all reasonable attempts by the insolvency representative or the court to establish contact, an absolute requirement to be heard could seriously impede progress of the proceedings, if not make them impossible to undertake. While it may be desirable to provide that all reasonable efforts to allow the debtor to be heard should be made, the insolvency law may need to avoid the exercise of the right resulting in abuse that would adversely affect the proceedings.

(d) Debtor's liability

170. When the business entity is solvent, management generally owes its principal obligation to the owners of the business and its relations with its creditors will be governed by their contractual agreements. When the business becomes insolvent, however, the focus changes and the creditors become the real financial stakeholders in the business, bearing the risk of any loss suffered as the debtor continues to trade. The conduct and behaviour of owners and management of a business entity is primarily a matter of law and policy outside the insolvency regime. It is not desirable for an insolvency law to be used to remedy defects in that area of legal regulation or to police governance policies, although some insolvency laws may include an obligation to commence insolvency proceedings at an early stage of financial difficulty (see sect. II.B, Application and commencement criteria, above). If the consequence of the past conduct and behaviour of persons connected with an insolvent business entity is damage or loss to the creditors of the entity (for example, by fraud or irresponsible behaviour), it may be appropriate for an insolvency law to provide for possible recovery of the damage or loss. This may extend to the powers of inquiry and examination.

2. Summary and recommendations: debtor's rights and obligations

(1) The purpose of these provisions is to [. . .].

(2) In both liquidation and reorganization proceedings, the debtor should have a right to [be heard on any issue concerning the proceedings] [participate in decision-making] provided that the exercise of that right does not result in abuse of the process that would adversely affect the expeditious conduct of the proceedings.

(3) In liquidation and reorganization proceedings, the debtor's obligations should be clearly specified in the law. These could include:

(a) An obligation generally to cooperate with and assist the insolvency representative to perform its duties;

(b) An obligation to provide the court, insolvency representative and, where appropriate, the creditor committee, with current, accurate and reliable information relating to its financial position and affairs generally.

(4) Information to be provided by the debtor would include [*a statement of assets and liabilities as well as information concerning the causes or reasons for the financial situation of the debtor and disclosure of past transactions that may be capable of avoidance under the avoidance provisions of the insolvency law and [. . .]*]. Additional information of particular relevance to reorganization may include [*projections of profit and loss; details of cash flow; marketing information; industry trends*]. The information should be provided as soon as possible after commencement of the proceedings.

(5) Where the debtor fails to provide the relevant information, the insolvency law should include alternative measures for obtaining the necessary information. These may include imposing on the debtor an obligation to submit to an examination by the insolvency representative or the court in respect of its assets and affairs.

(6) Where information provided by the debtor is commercially sensitive, the insolvency law should adopt confidentiality provisions to protect it.

(7) In liquidation proceedings, management of the [insolvency estate] [debtor] should be conducted by the insolvency representative. Where it is determined that the most effective means of liquidating the estate is to sell the business as a going concern, the insolvency representative should supervise and have overall control of the business and may engage the debtor's management to assist in the operation of the business if such engagement would be beneficial to the proceedings.

(8) In reorganization proceedings, management of the [insolvency estate] [business] may be conducted under a sharing arrangement between the debtor and the insolvency representative, where the insolvency representative supervises and has overall control of the [estate] [business] and approves significant transactions, while the debtor continues to operate the business on a day-to-day basis, but cannot dispose of assets of the insolvency estate and cannot enter into obligations that bind the estate. An insolvency law should include precise rules as to how the responsibilities of the parties to such a sharing arrangement are to be divided.

(9) Where there is a sharing arrangement between the insolvency representative and the debtor and there is evidence of gross mismanagement or misappropriation of assets by the debtor or the goal of reorganization is no longer realistic, the debtor could be displaced completely by the court on its own motion, on that of the insolvency representative or on that of the creditors or

creditor committee or the proceedings converted to liquidation proceedings.

B. Insolvency representative's rights and obligations

1. General remarks

171. Insolvency laws refer to the person responsible for administering the insolvency proceedings by a number of different titles, including administrator, trustee, liquidator, supervisor, receiver, curator, official or judicial manager or commissioner. The term "insolvency representative" is used in the present Guide to refer to that administrator in a broad sense without distinguishing between the different functions that may be performed. The insolvency representative may be an individual or, in some jurisdictions, a corporation or other separate legal entity. Whether appointed by creditors, the court, a government department or agency, a public or statutory authority or the debtor, the insolvency representative plays a central role in the effective implementation of the insolvency law, with certain powers over debtors and their assets and a duty to protect them and their value and ensure that the law is applied effectively and impartially.

172. Since it normally has the most information regarding the situation of the debtor, the insolvency representative is in the best position to make informed decisions about the conduct of the insolvency proceedings. That does not mean that the insolvency representative is a substitute for the court, as the court would generally be required to adjudicate disputes arising in the conduct of the proceedings and approval of the court is often required at a number of stages of the proceedings. Even in countries where the role of the court in insolvency is restricted, there is a limit to the amount of authority that would normally be conferred upon an insolvency representative.

(a) Functions to be performed by the insolvency representative

173. Insolvency laws often specify the powers and duties that the insolvency representative will be given over debtors and their assets. Although some of these duties may be more relevant to liquidation than to reorganization, they may generally include:

(a) Acting as representative of the insolvency estate;³

(b) Having the exclusive capacity to sue and be sued on behalf of the insolvency estate;

(c) Taking all steps necessary for preserving and keeping in reasonable condition any asset in the insolvency estate;

(d) Registering rights of the estate (where registration is necessary to perfect the rights of the estate against bona fide purchasers);

³For a definition of the use of the word "estate" in the present Guide, see the glossary and sect. III.A, The insolvency estate.

(e) Retaining accountants, attorneys, appraisers and other professionals as may be necessary to assist the insolvency representative in carrying out its duties;

(f) Examining the debtor and any person having had dealings with the debtor in order to investigate the financial affairs of the debtor and to establish the existence, whereabouts, extent and condition of any assets that the insolvency representative believes should be included in the insolvency estate;

(g) Applying to the court for an order requiring the delivery from any person of any asset included in the insolvency estate or restraining any person from disposing of any asset included in the insolvency estate;

(h) Examining and admitting claims and preparing a statement as to admitted and disputed claims;

(i) Responding to reasonable requests for information concerning the insolvency estate or its administration, except as restricted by the court;

(j) Submitting to the court periodic reports detailing the conduct of the proceedings. The report should contain, for example, details of the assets sold during the period in question, including the prices realized, the expenses of sale and such information as the court may require or the creditor committee may reasonably require; receipts and disbursements; and assets remaining to be administered;

(k) Attending meetings of creditors and the creditor committee and reporting to creditors on the insolvency estate's operation. The insolvency law may specify the details to be included in such reports;

(l) Selling the assets comprised in the insolvency estate at the best price reasonably obtainable in the market;

(m) Closing the estate promptly, efficiently and in accordance with the best interests of the various constituencies in the case; and

(n) Submitting a final report and accounting of the insolvency estate's administration to the court.

(b) Selection and appointment of the insolvency representative

174. In some jurisdictions, the court selects, appoints and supervises the insolvency representative. In other jurisdictions, a separate office or institute selects the insolvency representative after the court directs it to do so and it is charged with the general regulation of all insolvency representatives. This approach is increasingly being adopted in insolvency laws and allows the independent appointing authority to draw upon professionals that will have the expertise and knowledge to deal with the circumstances of a particular case, be it the nature of the debtor's business or other activities; the type of assets; the market in which the debtor operates or has operated; the special knowledge required to understand the debtor's affairs; or some other special reason. A third approach allows creditors to play a role in recommending and selecting the insolvency representative to be appointed, provided that that person meets the qualifications for serving in the specific case. The approaches that rely on the independent appointing authority and the creditor committee may serve to avoid perceptions of bias and assist in reducing the supervisory

burden placed upon the courts. The choice of an independent appointing authority will depend upon the existence of an appropriate body that has both the resources and infrastructure necessary to perform the required functions.

Assetless estates

175. In cases where there are no assets in the insolvency estate to fund the administration of the insolvency, some mechanism may need to be devised to resolve what should happen to the proceedings. Some insolvency laws provide for immediate termination of the procedure upon assessment of absence of assets by the court, some provide that no action should be taken, while others provide a mechanism for appointment of an insolvency representative.

176. In those countries which provide a mechanism for appointment of an insolvency representative, the insolvency representative may be a public officer or an insolvency professional appointed on the basis of a roster, which is designed to ensure a fair and ordered distribution of all insolvency cases, whether assetless or otherwise. In these cases, the administration of the assetless estate is paid for by the State. One possible disadvantage of the roster system, at least in those cases where the estate does have sufficient assets to pay for administration, is that it may not ensure the appointment of the person most qualified to conduct the particular case. That may depend, of course, on the manner in which the roster list is compiled and the qualifications required of insolvency professionals in order to be included on that list. That disadvantage may not be perceived to be as important an issue where the estate has no assets.

(c) Qualifications

177. The insolvency representative can be selected from a number of different backgrounds such as from the ranks of the business community, from the employees of a specialized governmental agency or from a private panel of qualified persons. A related issue is whether the insolvency representative must be a natural person, or whether a legal person may also be eligible for appointment. However appointed, the complexity of many insolvency proceedings makes it desirable that the insolvency representative has knowledge of the law, is impartial and has adequate experience in commercial and financial matters. If further or more specialized knowledge is required, hired experts can always provide it. In addition to having the requisite knowledge, it may be desirable for the insolvency representative to have certain personal qualities, such as that he or she is a fit and proper person to undertake the different fiduciary duties required.

178. Different approaches are taken to the issue of qualification of the insolvency representative. Requirements that have been adopted in different countries include professional qualifications and examinations; licensing where the licensing system is administered by a government authority or professional body; specialized training courses and certification examinations; and certain levels of experience (generally specified in numbers of years) in relevant areas, for example, finance and commerce [others?].

179. In designing the procedures and requirements for appointment, it is desirable that a balance be achieved between stringent requirements that lead to the appointment of a highly qualified person but that may significantly restrict the pool of professionals considered to be appropriately qualified and add to the costs of the proceedings and requirements that are too low to guarantee the quality of the service required.

180. Conflicts of interest arising from a pre-existing relationship with the debtor, a creditor, a member of the court or even with a competitor of the debtor may be sufficient in some countries to preclude the appointment of a person as an insolvency representative. In order to enhance the transparency, predictability and integrity of the insolvency system, a prospective insolvency representative should be required to disclose circumstances that may lead to such a conflict or lack of independence.

(d) *Duty of care*

181. The standard of care to be employed by the insolvency representative and its personal liability are important to the conduct of insolvency proceedings. The insolvency representative serves as a fiduciary in the performance of its duties, whether as a court official where it is appointed by the court or otherwise. As such, the insolvency representative may be liable for a breach of those duties. Establishing a measure for the care, diligence and skill which is owed requires a standard that will take into account the difficult circumstances in which the insolvency representative finds itself when fulfilling its duties.

182. Different approaches may be taken to setting that measure, although the measure adopted will depend on how the insolvency representative is appointed and the nature of the appointment (for example, a government employee—to be further addressed). One approach may be to require the insolvency representative to observe a standard no more stringent than would be expected to apply to the debtor in undertaking its normal business activities in a state of solvency, that of a prudent person in that position. Some countries, however, may require a higher standard of prudence in such a case because the insolvency representative is dealing with the assets of someone else, not its own assets. Another approach would be one based on an expectation that the insolvency representative will act in good faith for proper purposes. [*Note to the Working Group: Is there really a difference here, or is it semantic?*] A further approach may be based upon the standard of care required in negligence. In determining the applicable standard, a balance is desirable between a standard that will ensure competent performance of the duties of the insolvency representative and one that is so stringent that it invites law suits against the insolvency representative and raises the costs of its services.

183. One means of addressing the issue of costs may be to require the insolvency representative to post a bond or provide insurance coverage against a breach of its duties. This solution, however, may not be available in all countries. In designing a solution to this issue, a balance may be desirable between controlling the costs of the service and distributing the risks of the insolvency process among the

participants, rather than placing it entirely on the insolvency representative on the basis of availability of personal indemnity insurance.

184. Where losses are sustained by the estate as a result of the actions of agents and employees of the insolvency representative, the insolvency law may need to address the liability of the insolvency representative for those actions. Some insolvency laws provide that the insolvency representative is not personally liable except where it fails to exercise the proper degree of supervision in the performance of its duties.

185. Some insolvency laws require court authorization for the insolvency representative to retain accountants, attorneys, appraisers and other professionals that may be necessary to assist the insolvency representative in carrying out its duties. Other laws do not require court authorization. It is desirable that an insolvency law establish some criteria relating to the employment of such professionals in terms of their experience, knowledge and reputation, as well as the need for their services to be of benefit to the estate. In terms of remuneration of those professionals, some laws require an application to and approval by the court, while another approach may be to require approval of the creditor body. Professionals may be paid periodically during the proceedings or may be required to wait until the proceedings are completed.

(e) *Replacement or removal*

186. In the event of the death, resignation or removal of the insolvency representative, disruption of the proceedings and the delay that may be occasioned by failure to provide for succession may be avoided by providing for the appointment of a successor insolvency representative. Some insolvency laws permit the insolvency representative to be removed in certain circumstances, which may include that the insolvency representative had violated or failed to comply with its legal duties under the insolvency law or had demonstrated gross incompetence or gross negligence. Different approaches provide that removal may occur on the basis of a decision of the court, acting on its own motion or at the request of an interested party, or a decision taken by an appropriate majority of unsecured creditors. Where an insolvency law provides for removal of the insolvency representative, it may also need to address issues relating to substitution and succession to either title or control (as appropriate) of the assets of the estate (see sect. III.A, The insolvency estate).

2. *Summary and recommendations: insolvency representative's rights and obligations*

(1) The purpose of these provisions is to:

(a) Define the functions of the person that will play a central role in the implementation of the insolvency law;

(b) Establish a mechanism for the appointment of insolvency representatives, including indicating the relevant qualifications required;

(c) Provide for the liability, removal and replacement of insolvency professionals;

(d) [. . .].

(2) Insolvency representative may be appointed:

(a) By the court, as a provisional measure, for the period between application and commencement;

(b) [By the court] [by an independent appointing authority] [on the basis of a recommendation by the creditor committee] on commencement of the proceedings.

(3) An insolvency representative should have certain qualifications and personal qualities. These could include that they be a fit and proper person to fulfil the fiduciary obligations required of an insolvency representative, are independent and impartial, have the requisite knowledge of relevant commercial law and have experience in commercial and business matters.

(4) A prospective insolvency representative should be required to disclose circumstances that may lead to a conflict of interest or lack of independence.

(5) The insolvency representative's duties [functions] [rights and obligations] with regard to liquidation and reorganization proceedings should be clearly specified in the law.

(6) An insolvency law should address the issue of the liability of the insolvency representative for failure to perform its [duties][functions].

(7) An insolvency law should address replacement and removal of the insolvency representative. The insolvency representative may be removed by the court on an application by the creditors or the creditor committee or by the court on its own motion for reasons such as incompetence or negligence or failure to exercise the proper degree of care in the performance of its duties.

(8) In the event of the death, resignation or removal of the insolvency representative, an insolvency law should provide for appointment of a successor insolvency representative. If the insolvency representative is vested with the title to the estate, the law should provide for succession to the [title] [control] of the assets of the estate.

C. Post-commencement financing

1. General remarks

187. The continued operation of the insolvent entity is critical for reorganization and, to a lesser extent where the business is to be sold as a going concern, in liquidation. To maintain its business activities, the debtor must have access to cash flow to enable it to pay for crucial supplies of goods and services. Where the debtor has no available funds to meet its immediate cash flow needs, an insolvency law can recognize the need for such post-commencement lending, provide authorization for it and create priority for

repayment of the lender. The central issue is the scope of the power, in particular the inducements that the insolvency representative can offer a potential creditor as a means of obtaining credit. To the extent that the solution adopted has an impact on the rights of existing secured creditors or those holding an interest in assets that is prior in time, it is desirable that provisions addressing post-commencement financing are balanced against the general need to uphold commercial bargains, protect the rights and priorities of creditors and minimize the negative impact on the availability of credit, in particular secured credit.

188. Post-commencement lending is likely to come from a limited number of sources. The first is pre-insolvency lenders who have an ongoing relationship with the debtor and its business and may advance new funds in order to enhance the likelihood of recovery of their existing claims and perhaps gain additional value through the higher rates charged for the new lending. A second type of lender has no pre-insolvency connection with the business of the debtor and is likely to be motivated only by the possibility of high returns. The inducement for both types of lender is the certainty that special treatment will be accorded to post-commencement lending. For existing lenders there are the additional inducements of the ongoing relationship with the debtor and its business and the assurance that the terms of their pre-commencement lending will not be altered.

189. A number of different approaches can be taken to attracting post-commencement credit and providing security for repayment. Security can be provided on unencumbered property or a second-priority security interest provided on encumbered property. Where those approaches are either insufficient or not available, some insolvency laws provide for repayment of the loan to be given a priority over other creditors. These priorities include an administrative priority (see sect. V.A, Distribution priorities, below), which ranks ahead of the general unsecured creditors, but not ahead of a secured creditor with respect to its security, or a "super" administrative priority, which ranks ahead of administrative creditors. A further approach is to provide lenders advancing post-commencement credit with a priority that ranks ahead of all creditors, including secured creditors (sometime referred to as a "priming lien"). In countries where that type of priority is recognized, it is rarely given without the consent of the secured creditors that will be displaced. The decision to obtain credit on that basis is not therefore one that could be made solely by the court, the insolvency representative or the unsecured creditors. In some legal systems, all of these options are available.

190. Incurring unsecured trade credit is essential in any case that permits continuation of the business operations. Many insolvency laws provide that the insolvency representative can obtain such unsecured credit without approval by the court or by creditors, while other laws require approval by the court or creditors in certain circumstances. With respect to the granting of different types of priorities, such as an administrative priority, some laws provide the insolvency representative with the power of approval, while in other laws approval by the court or creditors is required in respect of some forms of priorities.

191. Issues to be addressed:

[A/CN.9/504, para. 126: [. . .] *It was noted that a distinction needed to be drawn, in terms of the provision of finance, between the different stages of the reorganization process, such as the post-application, pre-plan and post-plan periods, with only the latter period being addressed by the plan. A question was raised as to whether the issue of post-commencement finance might not also be relevant in the case of the sale of a business in liquidation.*]

2. Summary and recommendations: post-commencement financing

(1) The purpose of these provisions is to: [. . .].

(2) An insolvency law should recognize the need for post-commencement lending and provide authorization for it in both liquidation proceedings where the business is to be sold as a going concern and in reorganization proceedings.

(3) If the insolvency representative determines that further credit is necessary for the continued operation of the debtor or its business, the [insolvency representative] [debtor] may obtain the necessary credit and provide security over its property.

(4) To facilitate the provision of credit, the insolvency law may permit the insolvency representative to give a post-commencement creditor a priority for payment that ranks ahead of either payment of unsecured creditors (an administrative priority) or payment of administrative expenses (a super administrative priority).

(5) A security created over the assets of the debtor for post-commencement financing does not have priority ahead of any existing security over the same assets unless the insolvency representative obtains a written agreement to that effect from the holder of the existing security.

D. Creditor committee

1. General remarks

192. Creditors have a significant interest in the business once an insolvency proceeding is commenced. As a general proposition, these creditor interests are safeguarded by the appointment of an insolvency representative; however many insolvency laws provide for creditors to be directly involved in the proceedings in different ways and for a number of reasons. As the party with the primary economic stake in the outcome of the proceedings, they may lose confidence in a process where key decisions are made without consulting them and by individuals that may be perceived as having limited experience, expertise or independence. In addition, creditors are often in a good position to provide advice and assistance with respect to the debtor's business and to monitor the actions of the insolvency representative, thus discouraging fraud, abuse and excessive administrative costs.

193. In cases where there is a large number of creditors, the formation of a creditor committee can provide a mechanism to facilitate creditor participation in the administration of the case, whether it is liquidation or reorganization proceedings.

(a) Involvement of creditors in the decision-making process

194. There are varying possible degrees of involvement of creditors in decision-making in insolvency proceedings. In some insolvency laws, the insolvency representative makes all key decisions on uncontested general matters of administration and liquidation, with the creditors playing a marginal role and having little influence. Such an approach may be efficient where it is handled by an experienced insolvency representative because it avoids potential delays and costs involved in managing the participation of creditors. That approach may be supported by an insolvency system that provides a high level of regulation of the process and its participants.

195. Other approaches afford creditors greater participation in the proceedings. Under some insolvency laws, in liquidation proceedings creditors may be able to select and replace the insolvency representative, approve the temporary continuation of the business by the insolvency representative, approve private sales of assets and approve the conversion of liquidation proceedings to reorganization. In reorganization proceedings, they may perform tasks such as monitoring the activities of the business (such as where the system allows the debtor some degree of control after commencement) and of the insolvency representative, as well as proposal and approval of the reorganization plan. They may also have a role in requesting or recommending action from the court, for example, a recommendation that the reorganization be converted to liquidation or that an avoidance action be commenced by creditors. In terms of costs, the creditors may also be given a role in monitoring the remuneration of the insolvency representative.

196. In liquidation, although generally it may not be important for creditors to intervene in the process or participate in decision-making, it is desirable that there should be the opportunity for them to be involved, as they can provide a valuable source of expert advice and information on the debtor's business, in particular where it is to be sold as a going concern. It may also be desirable for creditors to receive reports on the conduct of the liquidation to ensure their confidence in the process, as well as its transparency. In reorganization, the input of creditors is both useful and necessary, as they will generally determine whether the reorganization will be successful.

197. In order to take account of the nature and size of a particular case, it may be desirable for an insolvency law to adopt a flexible approach to the functions the committee should perform, rather than stipulating the performance of specified functions in each case. As a general proposition, the committee may perform an advisory function in insolvency proceedings. In addition, it may have defined functions with respect to development of the reorganization plan and, in liquidation, the sale of significant assets, as

well as participating as and when requested by the insolvency representative or the court.

198. An important issue that may need to be considered where an insolvency law allows creditors to participate actively in the process is how to overcome creditor apathy and encourage participation in the proceedings. This concern may be addressed by the overall balance that an insolvency law strikes between the different interests of the parties involved in the proceedings (see for example, considerations under sect. IV.A, Debtor's rights and obligations, paras. 152-160) and by specific measures relating, for example, to selection of the creditor committee (see paras. 199-206 below).

(b) Composition of the creditor committee

199. Different approaches are taken as to the composition of creditor committees. Although creditor committees generally represent only unsecured creditors, some laws recognize that there may be cases where a separate committee of secured creditors is justified. Those systems base this approach on the fact that the interests of the different types of creditors do not always converge and the ability of secured creditors to participate in and potentially affect the outcome of decisions by the committee may not always be appropriate or in the best interests of other creditors.

200. Other insolvency laws provide for both types of creditors to be represented on the same committee. The rationale of this approach is that since the creditor committee is responsible for participating in the decision-making process and for making important decisions, secured creditors should participate, otherwise they are excluded from the making of important decisions that may affect their interests. A further approach may be for an insolvency law not to specify which creditors should be represented in a given case, but to allow creditors to choose their own representatives on the basis of willingness to serve (to address the problem of creditor apathy which is not uncommon) and to provide for enlargement or reduction of the size of the committee as required. Where the types of creditors requiring representation are too diverse to accommodate their interests within a single committee, such as may be the case for special interest groups such as tort claimants and shareholders, an insolvency law could provide for different committees to represent different interests. It is desirable, however, that this mechanism only be used in special cases, in order to avoid costs and the possibility of the creditor representation mechanism becoming unwieldy.

201. The participation of shareholders or owners of the debtor and creditors related to the debtor is controversial, especially where the creditor committee has the power to affect the rights of secured creditors or where the shareholders or owners are involved with the management of the debtor. There will be cases, however, where the shareholders have no direct knowledge of or involvement with the management of the debtor, such as where the shareholders are investors with no direct association with or access to management. In such cases, there may be compelling reasons for allowing the shareholders to participate through their own committee.

202. A similar question of participation may arise in respect of parties who purchase the claims of creditors. Such purchasers may be related to the debtor or may be third parties who have no particular interest in the business of the debtor. Third-party purchases may give rise to concerns about access to sensitive, confidential information that may be of value in the secondary debt market, while insider purchases raise the question of whether the purchaser is entitled to claim the original face value of the claim or only the amount actually paid for it.

203. To address any potential problem, an insolvency law could adopt the approach of stipulating which parties are not entitled to participate in a creditor committee or vote on approval of a reorganization plan.

(c) Formation of the creditor committee

204. Where the law provides for the formation of creditor committees, details of the manner in which the committee is to be formed, the scope and extent of its duties, its governance and operation, including voting eligibility and powers, quorum and conduct of meetings, as well as replacement and substitution of members are often also addressed. It may be desirable to include such provisions in an insolvency law not only to avoid disputes and ensure confidentiality, but also to provide transparent and predictable procedures.

205. To facilitate administration and oversight of the committee, some insolvency laws specify the size of the committee, generally an odd number in order to ensure the achievement of a majority vote. Where the committee represents only unsecured creditors, membership of the committee is sometimes limited to the largest unsecured creditors. These creditors can be identified by a number of means, including requesting the debtor's managers to prepare a listing of the debtor's largest creditors. To ensure equality of treatment of creditors, it may be desirable for creditors such as those whose claims have not yet been approved and foreign creditors to be eligible for appointment to the committee.

206. A number of different approaches are taken to choosing the members of the committee. One approach is for the appointment to be made by the insolvency representative or the court or some other authorized body. This approach may be subject to perceptions of bias and a lack of equity and transparency. Creditors may not have confidence in a system that does not encourage or allow them to play a role in selecting their own representatives and may not serve to overcome the widespread problems of creditor apathy. A further approach, which may encourage both creditor confidence and participation in the insolvency process, is to allow creditors to select the members of the committee.

207. To ensure that it fulfils its duty to represent creditors fairly, oversight of the committee may be desirable and could be undertaken by the insolvency representative.

(d) Duties of the creditor committee

208. The creditor committee can be appointed to undertake a number of tasks, including monitoring the progress

of the case, consulting with other principals in the proceedings, especially the insolvency representative and the existing management of the debtor, and advising the insolvency representative on the wishes of the creditor body on issues such as the sale of significant assets and formulation of the reorganization plan. To perform its functions, the committee may require administrative and expert assistance. This can be addressed by providing that the committee can seek permission from the insolvency representative to hire a secretary and, if circumstances warrant, consultants and professionals at the expense of the insolvency estate.

209. The committee's duty would be to the general body of creditors, but it would not have any liability or fiduciary duty to the owners of the insolvent business. It may be desirable to require the committee to act in good faith and to provide that members of the committee would be immune from liability in respect of actions and decisions taken by them as members of the committee unless they were found to have acted improperly or to have breached a fiduciary duty to the creditors they represent. In considering the question of the liability of the committee, a balance may need to be struck between setting too high a level of responsibility, which will promote creditor apathy and effectively discourage creditors from participating, and too low a level, which may lead to abuse and prevent the committee from functioning efficiently as a representative body.

(e) *Voting of creditors*

210. Where actions to be taken in the course of the proceedings will have a significant impact on the creditor body, it is desirable that all creditors (as opposed to just the creditor committee) are entitled to receive notice of, and to vote on, those actions. These actions may include voting to select the insolvency representative where an insolvency law provides creditors with this role; on approval of the reorganization plan; and on other significant events such as sale of substantial assets. A number of different approaches can be taken with respect to achieving that vote, depending on the nature of the matter to be voted upon. Some laws provide that voting should occur in person at a meeting of creditors, while other laws provide that where a large number of creditors are involved or where creditors are not local residents, voting may take place by mail or by proxy. It may also be desirable to recognize that voting may take place using electronic means.

211. Different approaches are taken to the type of vote that is required to bind creditors to different decisions. As to the types of voting systems, some insolvency laws require the vote of a supermajority of the value of the claims that actually vote in order to bind all creditors [*to which types of decisions?*], where the proportion required for a supermajority may be three fourths or two thirds. Another approach is to require a majority of the number of voting creditors together with a supermajority of the value.

212. In other examples, the insolvency law distinguishes between different types of decisions. Some laws require a majority in value for most decisions and for decisions such as election or removal of the insolvency representative and hiring of particular professionals by the insolvency

representative, a majority in value and number is required. Other laws provide that a simple majority is sufficient on issues such as election or removal of the insolvency representative. Some laws also distinguish between matters requiring the support of both secured and unsecured creditors: secured creditors will only participate in the vote on specified matters such as selection of the insolvency representative and matters affecting their security.

2. *Summary and recommendations: creditor committee*

(1) The purpose of these provisions is to: [. . .].

(2) Where the debtor has a large number of creditors, a creditor committee may be appointed to facilitate the conduct of the insolvency proceedings. The committee would generally represent [unsecured] [and secured] creditors. Where the interests of creditors cannot properly be represented in a single committee, different committees may be appointed.

(3) In both liquidation and reorganization proceedings the creditor committee should perform a general advisory function, providing expert advice and assistance to the insolvency representative. In addition to its general advisory function, the committee should play a central role in certain defined areas, including development of the reorganization plan, in the sale of significant assets and in other matters as directed by the insolvency representative or the court.

(4) To assist the committee to perform the specific functions noted in paragraph (2), the creditor committee, subject to approval by the insolvency representative, may employ specialist advisers who would be paid out of the assets of the insolvency estate.

(5) As a representative committee, members of the creditor committee should be selected by creditors on the basis of their willingness to serve. The insolvency law may stipulate that the creditor committee should consist of no more than a specified number, preferably an odd number, of unsecured [and secured] creditors [with flexibility to enlarge or reduce the size of the committee as required to suit the needs of the particular proceedings]. [A mechanism for selection of the members of the committee would be that representatives may be selected on the basis of the majority vote of those creditors attending a meeting of creditors, with the vote based on criteria such as value of claims and number of creditors.]

(6) Members of the committee should have a duty to act in good faith. They should be exempt from liability for actions taken by them in their capacity as members of the committee unless they are found, for example, to have acted fraudulently or to have breached their fiduciary duty to creditors. The creditor committee should have no fiduciary duty to shareholders or owners of the debtor.

(7) Where the creditor committee is required to decide on any matter, each member of the committee should

have one vote and decisions of the committee should be taken on a majority basis.

(8) A vote of the general creditor body is required in respect of [...].

E. Claims of creditors and their treatment

1. General remarks

213. There are many diverse and competing interests in insolvency proceedings. For the most part, creditors are creditors by virtue of having entered into a legal and contractual relationship with the debtor prior to the insolvency. There are creditors, however, who have not entered into such an arrangement with the debtor, such as taxing authorities (who will often be involved in insolvency proceedings) and tort claimants (whose participation will generally be less common).

214. The rights of these creditors will be governed by a number of different laws. While many creditors may be similarly situated with respect to the kinds of claims they hold based on similar legal or contractual rights, others may have superior claims or hold superior rights. Even within the same class of creditor, there will be competing rights such as secured creditors that have better security than others. For these reasons, insolvency laws generally rank creditors by reference to their claims, an approach not inconsistent with the objective of equitable treatment. In developing these categories, it is desirable that a balance be reached between the legal and commercial rights of creditors based on fairness and the commercial reasonableness of their relative positions, at the same time observing the objective of equality of treatment, preserving legitimate commercial expectations and fostering predictability in commercial relationships. There is, however, a limit to the extent to which these goals can be achieved, given the balance that is desirable in an insolvency law between these competing objectives and other public policy considerations. To the extent that these broader public interests compete with private interests, they may lead to a distortion of normal commercial incentives. Where these public interests are given priority and equality of treatment based on the classification of claims is not observed, the policy reasons for establishing that priority should desirably be clearly addressed in the insolvency law. In the absence of equality of treatment, this approach will at least provide an element of transparency and predictability in the area of claims and distribution.

215. Claims by creditors operate at two levels in insolvency proceedings: for purposes of determining which creditors may vote and how they may vote (according to the class of creditor into which they fall) and for purposes of distribution. Laws differ in the types of claims that may be made. Some laws provide that certain claims are not admitted on public policy grounds, for example, foreign tax claims, judgements obtained by fraud, fines and penalties and gambling debts (see paras. 246-249 below, on excluded claims). For the purposes of determining the priority of distribution of the proceeds of the estate in liquidation, reference is generally made to the categories

into which creditors have been divided. In addition to relying on these categories based on commercial and legal relationships between the debtor and its creditors, distribution policies also very often reflect choices that recognize important public interests.

(a) Creditors

216. Creditors of an insolvent debtor generally fall into categories of secured creditors, or preferred or priority creditors, and unsecured or ordinary creditors. In some insolvency laws, account is taken of employees as a separate interest group.

(i) Secured creditors

217. Most insolvency laws draw a distinction between secured and unsecured claims, depending on how security interests are treated in the proceedings, in particular in terms of application of the stay. Where the insolvency law provides for a secured creditor to separate its security, it will no longer have a claim unless it has surrendered its security or is undersecured (that is, the value of its claim exceeds the value of its security) and wishes to claim for the unsecured portion. Where the security is retained for sale of the business as a going concern or in reorganization, the secured creditor will have a claim. Claims by secured creditors may be admitted on a provisional basis where there are difficulties in making a precise assessment of the value of the security at the commencement of the proceedings (see para. 240 below, on provisional claims).

218. Many insolvency laws recognize the rights of secured creditors to have a first priority for payment of their debts from their security or its proceeds. The method of distribution to secured creditors depends on the method used to protect the secured creditor during the proceedings. If the security interest was protected by preserving the value of the security, the secured creditor generally will have a priority claim on the proceeds of its security to the extent of the value of the secured claim. Alternatively, if the security interests of the secured creditor were protected by fixing the value of the secured portion of the claim at the time of the commencement of the proceedings, the creditor generally will have a priority claim to the general proceeds with respect to that value.

219. Other insolvency laws provide that secured creditors may fall behind other interests, such as unpaid wage claims, tax claims, environmental claims and personal injury claims [*others?*]. It is desirable, however, that these types of exceptions to the first priority rule be limited to provide certainty with respect to the recovery of secured credit, thus encouraging the provision of secured credit and lowering the associated costs. A different type of exception to the priority of secured creditors may arise from the costs associated with the insolvency proceedings. Since the secured claim will be satisfied directly from the net realization of proceeds from the asset concerned, the secured creditor, unlike unsecured creditors, will not contribute to the general costs of the insolvency proceeding. It may, however, contribute to other costs directly related to it, such as the administrative expenses related to the maintenance of the security. If the insolvency representative has

expended resources in maintaining the value of the security, it may be reasonable to deduct those expenses as administrative expenses. These exceptions may also relate to priorities provided in respect of post-commencement finance, where the effect on the interests of secured creditors of any priority that is granted should be clear at the time the finance is obtained, in particular since it may have been approved by the secured creditors [*other reasons?*].

(ii) *Administrative claims*

220. Insolvency proceedings often require the assistance of professionals, such as the insolvency representative and advisers to the debtor or insolvency representative. Costs may be incurred by creditor committees and also for the purposes of operating the business and carrying out the proceedings, including many or all post-commencement debts, such as claims of employees, lease costs and similar claims. These expenses of the insolvency proceedings often have a priority, as administrative claims, over unsecured claims and are treated differently from other claims to ensure proper payment for the parties dealing with the insolvency proceedings.

221. Notwithstanding the importance of providing appropriate remuneration to those involved in the conduct of the insolvency proceedings, administrative expenses have the potential for a significant impact on the value of the insolvency estate. While to some extent that impact will depend on the design of an insolvency law and its supporting infrastructure, consideration of how that impact can be minimized may be desirable. An insolvency law can provide, for example, precise but flexible criteria relating to the allowance of those expenses. These criteria may include providing that allowance of the expenses is conditional upon the utility of the expense to increasing the value of the estate for the general benefit of all constituents or that the expenses should be not only reasonable and necessary, but also consistent with the key objectives of the process. Reasonableness of the expense may be assessed by reference to the amount of resources available to the proceedings and to the possible effect of the expense on the proceedings. [*Note to the Working Group: Are there examples of laws which include such criteria?*]

222. Different approaches may be taken to conducting that assessment. One approach may be to require authorization by the court prior to the cost being incurred or authorization by the court of all costs falling outside the scope of the ordinary course of business. A second approach may be to provide that the assessment should be made by creditors to facilitate the transparency of the proceedings, subject to recourse to the court in the event that the assessment of the creditors is disputed.

(iii) *Priority or preferential creditors*

223. Insolvency laws often attribute priority rights to certain (mainly unsecured) claims, which will in consequence be paid in priority to other, unsecured and non-preferential (or less preferential) claims. These priority rights militate against the principle of *pari passu* distribution and generally operate to the detriment of ordinary, unsecured debts by reducing the assets available for distribution. They also

have the potential to foster unproductive debate on the assessment of privileges attaching to the various types of priority claims.

224. Many different approaches are taken to the types of claims that will have priority and what that priority will be. The types of priorities provided by countries vary, but two categories are particularly prevalent. The first type provides priority for employee salaries and benefits (social security and pension claims), an approach generally consistent with the special protection that is afforded to employees in other areas of insolvency law (see paras. 228-230 below). The second type relates to government tax claims. Affording a priority to tax claims can compromise the uniform enforcement of tax laws and may constitute a form of state subsidy, which can undermine the discipline that an effective insolvency regime is designed to support. [*Other examples?*]

225. In some recent insolvency laws there has been a significant reduction in the number of these types of priority rights, reflecting a change in the public acceptability of such preferential treatment. In other countries, however, there is a tendency to increase the categories of debt that enjoy priority. Maintaining a number of different priority positions for many types of claims has the potential to complicate the basic goals of the insolvency process and to make the achievement of an efficient and effective process difficult. It may create inequities and, in reorganization, complicates preparation of the plan. In addition, it should be remembered that adjusting the distribution priorities to create these priorities will not increase the total amount of funds available for creditors. It will only result in a benefit to one group of creditors at the expense of another group. The larger the number of preferred categories of priority creditors, the greater the scope for other groups to claim that they also deserve preferential treatment. The greater the number of creditors receiving preferential treatment, the less beneficial it becomes.

226. Some priorities raise issues that may be better addressed by non-insolvency law rather than designing an insolvency law to achieve social objectives, which are only indirectly related to questions of debt and insolvency. Where priorities are to be included in an insolvency law or priorities exist in other laws that will affect the operation of the insolvency law, it is desirable that those priorities be clearly stated or referred to in the insolvency law. This will ensure that the insolvency regime is at least certain, transparent and predictable as to its impact on creditors and will enable lenders to assess more accurately the risks associated with lending.

(iv) *Ordinary unsecured creditors*

227. Once all secured and priority creditors have had their claims satisfied, the balance generally would be distributed pro rata to ordinary unsecured creditors. There may be subdivisions within the class, with some claims being treated as subordinate. Some countries subordinate claims such as gratuities, fines and penalties, shareholder loans and post-petition interest to general unsecured claims, while in others some of these claims are treated as excluded claims.

(v) *Employees*

228. As an essential part of a business, the rights of employees often compete with those of other creditors. As a class, employees tend to fall between the extremes of owners and managers and lenders or creditors, with their relationship to the debtor based on an implicit commitment that their work will be paid for and, where they work effectively, their employment will be continued. This commitment is necessarily qualified in cases of insolvency, but many insolvency laws recognize the importance of the commitment and afford priority for outstanding wages over some other classes of creditors (see also sect. III.C, Treatment of contracts, above).

229. At a broader level, the employment relationship raises other issues that typically are difficult to resolve and brings employee interests into competition with the interests of other creditors, with a potential impact on the availability and cost of credit, especially for labour-intensive businesses. Some of these issues may arise in situations where workers have little job mobility, where unemployment is endemic, where pension and security benefits depend on the continuation of the business or are vested in the stock of the debtor, where there is a weak social safety net for workers and [. . .].

230. Where employees wages are protected by special (employee) funds, the course of the insolvency is unlikely to be altered unless the claims of the fund guaranteeing those claims is excluded from making a claim in the insolvency or if those claims do not have the same priority as the employees would have had. Usual practice would be for the fund to enjoy the same rights as the employee, at least in respect of a certain specified amount which may be denoted in terms of amount of wages or weeks of pay.

231. Issues to be addressed:

[A/CN.9/504, para. 153: In respect of the privilege granted to employee salaries and benefits, it was observed that providing for a system of social guarantee would result in a benefit for the insolvency estate, since that would allow those claims to be excluded from the distribution of the assets. It was however clarified that that would require that the social institution guaranteeing those claims would not be allowed to have the same priority vis-à-vis the insolvency estate as the employees. Another view was that the draft guide should draw attention to solutions available in different legal systems.]

(vi) *Owners*

232. Many insolvency laws adopt the general rule that the owners of the business are not entitled to a distribution of the proceeds of assets until the creditors, who are senior in priority, have been fully repaid. This may or may not require the payment of interest. Where a distribution is made, it would be in accordance with the ranking of shares specified in the company law and corporate charter.

(vii) *Related party creditors*

233. A further category of creditors that may require special consideration is persons related to the debtor,

whether in a familial or business capacity. Special treatment may be justified on the basis that these parties are more likely to have been favoured and tend to have had early knowledge of the financial difficulties of the debtor and [other?]. While they do not properly fall within classes of excluded claims, it may be appropriate to consider whether they should be treated in the same way as other creditors or subject to special treatment, such as subordinating their claims to those of other creditors and preventing the related creditor from voting with other creditors on approval of the plan and other key issues.

(b) *Creditor claims*(i) *Making of claims*

234. As a general principle, claims can only be made in respect of debt incurred prior to commencement. How debt incurred after commencement is treated will depend on the nature of the proceedings and what is provided in the insolvency law: many laws provide that they are payable in full as costs of the proceedings.

235. Different mechanisms may be used for making claims. Many insolvency laws place the burden on creditors to produce evidence of their claims to the insolvency representative (which under some reorganization laws may be the debtor) for its review. Some laws provide that, as an initial step, a list of creditors and claims is prepared, either by the court or by the debtor. Preparation of such a list by the debtor takes advantage of the knowledge the debtor will have about its creditors and their claims and gives the insolvency representative an early indication of the state of the business. An alternative approach would be for the insolvency representative to prepare that list, an approach that may serve to reduce the formalities associated with the process of verification of claims, but may add to expense and delay. Once the list is prepared, creditors would be invited to make their claims to the insolvency representative for purposes of verification. A mechanism that requires creditors to make their claims to the insolvency representative and the insolvency representative to verify them may assist in ensuring proper distribution.

236. To ensure that claims are made in a timely fashion and that the insolvency proceedings are not unnecessarily prolonged, deadlines for submitting claims with the insolvency representative can be included in an insolvency law. Such deadlines, however, may operate to disadvantage foreign creditors who in many cases may not be able to meet the same deadlines as domestic creditors. To ensure the equal treatment of domestic and foreign creditors and to take account of the international trend of abolishing discrimination based on the nationality of the creditor, it may be possible to adopt an approach that either allows claims to be made at any time prior to distribution or sets a time limit, which can be extended or waived where a creditor has good reason for not complying with the deadline or the deadline operates as a serious impediment to a creditor. Where the claim is submitted late and causes costs to be incurred, the costs should be borne by the creditor.

237. To enable claims to be made in a timely fashion, it is desirable that the insolvency law require provision of

adequate notice to creditors, both domestic and foreign, of the commencement of proceedings. With regard to foreign creditors, the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency notes, in respect of article 14, that a number of the formalities required for serving notice on these creditors are cumbersome and time-consuming and their use would typically not provide foreign creditors with timely notice concerning insolvency proceedings. The Guide to Enactment recommends that these procedures should not be required, except where they may relate to an international treaty obligation (paras. 106-111 of the Guide to Enactment).

238. A further issue of particular importance to foreign creditors is whether the claim must be submitted in the language of the jurisdiction in which the insolvency proceedings have commenced and whether the claim is subject to certain formalities, such as notarization and translation. To facilitate the access of foreign creditors, consideration may be given to whether these requirements are essential or may be relaxed as in the case of other procedural formalities discussed in respect of article 14 of the Model Law.

239. Most laws provide that all identified and identifiable creditors are entitled to receive notice of claims that have been made. That notification may be given personally or by publishing notices in appropriate commercial publications. An insolvency representative may additionally be required to prepare a list of claims, both admitted and disputed, and file it with the court or other administrative body to facilitate the provision of notice to unknown creditors and provide updated information on progress with regard to admission or rejection of disputed claims.

(ii) Provisional claims

240. Creditors claims may be of two types: those that involve a determined amount and those where the amount owed by the debtor has not been or cannot presently be determined. Such claims may be either contractual or non-contractual in nature and may arise in respect of both secured and unsecured claims. Where the amount of the claim cannot be or has not been ascertained at the time the claim is to be made to the insolvency representative, many laws provide for a claim to be made provisionally or to be given a provisional value. Admission of provisional claims raises a number of issues. These concern valuation of the claim and the party to undertake that valuation (the insolvency representative, the court or some other appointed person); voting of provisional creditors on important issues such as determining whether the case is one of liquidation or reorganization or approval of the reorganization plan (see sect. IV.D, Creditor committee, below); and whether, as minority creditors, they can be bound by a plan to which they have not agreed (see sect. VI, Reorganization plan, below).

(iii) Verification of claims

241. Verification involves not only an assessment of the underlying legitimacy and amount of the claim, but also a determination of the category within which a claim fits for purposes of voting and distribution (for example, secured as opposed to unsecured claims; pre-commencement as opposed to post-commencement claims).

242. Many insolvency laws provide for the insolvency representative to verify the claims of the creditors, with disputes to be resolved by the court. It may be suggested, however, that an approach that relies heavily on the discretion of the insolvency representative may lead to delay or even collusion with the debtor, thus undermining the predictability of the system. If that approach is adopted, however, it is desirable that the insolvency representative be required to give reasons for rejecting a claim, preferably in writing. Such a procedure is likely to enhance the transparency of the procedure and potentially its predictability. A second approach would be to provide that the court would verify all claims and resolve disputes. That approach also has the potential to lead to significant delay at a time when it may be crucial to ensure that proceedings are conducted quickly and efficiently and will require the use of significant resources of the court.

243. An alternative approach may be to provide that claims outstanding at the time of commencement do not require verification and can be admitted on an automatic basis unless the claim is challenged. If that approach is adopted, it may be desirable to combine it with a mechanism aimed at ensuring that adequate information as to the claims admitted on that basis is available to all interested parties. Automatic admission of claims may avoid many of the difficulties associated with the insolvency representative having to make a precise assessment of the situation at the outset of the proceedings to enable creditors to participate in and vote at meetings held at an early stage of the proceedings. Automatic admission of claims may be assisted by requiring claims to be made in the form of a declaration, such as an affidavit, to which sanctions would attach in the event of fraud. It could also be assisted by admitting claims that are supported by properly maintained accounting records.

244. Admission of a claim of a creditor will establish the right of the creditor to attend and the amount for which the creditor is entitled to vote at a meeting of creditors or for the purposes of voting on the election of an insolvency representative or approval of a reorganization plan and the amount that the insolvency representative must take into account in making payment to the creditor in a distribution to creditors.

245. Where the insolvency law allows a claim to be challenged, it may also indicate which parties are entitled to initiate a challenge. Some laws allow claims to be disputed only by the insolvency representative, while other laws permit other interested parties, including creditors, to challenge a claim. To avoid a situation where there may be a significant number of claims challenged by creditors, it may be desirable to provide for final review of the list of creditors' claims at a creditors' meeting, following preparation of the list. Where disputes as to claims arise, whether between a creditor and the insolvency representative or the debtor and the insolvency representative, and including disputes as to security or security rights, a mechanism for quick resolution is essential to ensure efficient and orderly progress of the proceedings. If disputed claims cannot be quickly and efficiently resolved, the ability to dispute a claim may be used to frustrate the proceedings and create unnecessary delay.

(iv) *Excluded claims*

246. For a variety of public policy reasons, an insolvency law may seek to exclude certain types of claims. Such claims may include foreign tax claims, fines and penalties and gambling debts.

247. Foreign tax claims are currently excluded by many countries and it is generally recognized that such an exclusion does not violate the objective of equal treatment of foreign and domestic creditors. Despite this general view, however, there are no compelling reasons why such claims cannot be admitted if a country wishes to do so. Where foreign tax claims are admitted, they can be treated in the same manner as domestic tax claims or as general unsecured claims. Article 13 of the UNCITRAL Model Law on Cross-Border Insolvency recognizes these different approaches, providing that the requirement of equal treatment of foreign and domestic creditors is not affected by the exclusion of foreign tax and social security claims or by their ranking with general non-preference claims or lower if equivalent local claims have a lower ranking.

248. Where gambling debts are treated as excluded claims it is generally on the basis that they arise from an activity that is itself illegal. Rather than focusing on the specific types of claims that may be excluded as illegal, an insolvency law may exclude, as a general category, those claims that arise from illegal activity and are thus unenforceable.

249. With respect to fines and penalties, an insolvency law may distinguish between those which are of a strictly administrative or punitive nature (such as a fine imposed as the result of an administrative or criminal violation) and those of a compensatory nature. It may be argued that the first category should be excluded on the basis that they arise from some wrongdoing on the part of the debtor and unsecured creditors should not be made to bear the burden of that wrongdoing by seeing a reduction in the assets available for distribution. In comparison, there would seem to be no compelling reason for excluding the second category, particularly where it relates to recompense for damage suffered by another party, except to the extent that exclusion may also be justified as a means of increasing the assets available to unsecured creditors. An alternative approach would be to admit claims based on fines and penalties because otherwise they will remain uncollected [*other reasons?*].

(v) *Conversion of foreign currency claims*

250. The valuation of claims is of particular relevance to foreign creditors who will generally make their claims in currencies other than that of the country of the insolvency proceedings. For verification and distribution purposes, these claims are normally converted into the domestic currency. If the date of conversion is set at the date of commencement of the insolvency proceedings, and the currency depreciates or appreciates in the period before distribution (which could occur at a significantly later time), the amount of the claim will also fluctuate. An alternative approach is to make a provisional conversion at the time of commencement for the purposes of voting, but if

the exchange rate fluctuates more than a given percentage in the period before distribution, then the conversion can be made at the time of distribution.

(vi) *Assignment of claims*

251. [...]

252. Issues to be addressed:

[A/CN.9/504, para. 117: *With respect to the treatment of loans granted by shareholders, a view was that those loans deserved a regime that took into account the specific reasons usually underlying their issuance, which would not necessarily be the same as in the case of loans by other entities. As a general remark, it was pointed out that the draft guide should make national legislators mindful of the possible implications of legislative choices at a corporate governance level.*

118. *The suggestion that the draft guide should address the issue of the treatment of joint obligations under insolvency law received significant support. In particular, it was suggested that it should address whether and to what extent the commencement of the insolvency proceedings would affect the right of a creditor to enforce the claim against one or more joint debtors other than the one subject to the proceedings. In that respect, a further view was that treatment of guarantors should be included in the draft guide and that the situation where the guarantor was also insolvent should be addressed.*

119. *A further view was that the draft guide should recommend that the issue of treatment of unsecured claims acquired after commencement of the insolvency proceedings should be specifically addressed by outlining the different approaches available under various legal systems.]*

2. *Summary and recommendations: claims of creditors and their treatment*

(1) The purpose of provisions on creditor claims is to:

(a) Provide for persons who claim a debt or liability against an insolvent debtor to submit their claims for consideration by the insolvency representative;

(b) Require the insolvency representative to consider claims and to admit or reject them, in full or in part, and to provide for appeals from that process;

(c) Provide for the treatment of particular claims, including those of secured creditors, foreign creditors, creditors whose claims are in a foreign currency, claims for interest and claims in respect of non-matured liabilities;

(d) Provide for an order of priority in the payment of claims of creditors;

(e) Provide for the application of the same rules in respect of the above objectives both in a case of liquidation and a case of reorganization.

(2) All creditors, both domestic and foreign, should be notified of the commencement of proceedings and the time allowed for the making of claims. Notice should be given in a manner consistent with the requirements of article 14 of the UNCITRAL Model Law on Cross-Border Insolvency.

(3) Claims may be made within a specified time after the commencement of proceedings [notice of commencement of proceedings] or at any time prior to distribution.

(4) To facilitate the processing of claims, the insolvency representative should prepare a list of creditors and a statement of claims.

(5) Each [unsecured] [and secured] creditor is entitled to make a claim against the insolvency estate [within [. . . days] after commencement of insolvency proceedings] [at any time before distribution]. Where an insolvency law adopts a time limit for the making of claims, that time limit should be capable of extension or waiver by the court. A claim by a foreign creditor should be treated in the same way as any other claim. Claims by secured creditors should only be made where the creditor has surrendered its security or is under-secured (that is, the value of its claim exceeds the value of its security) and wishes to claim for the unsecured portion.

(6) Certain claims may be excluded. These may include claims arising from activities that are illegal (such as gambling debts) and [foreign revenue claims], [fines and penalties], [others?].

(7) A creditor may make a claim by producing evidence of its claim to the insolvency representative in the form of a [declaration][affidavit].

(8) The insolvency representative will admit or reject any claim in full or in part or claims can be admitted automatically [on the basis of accounting records] unless contested by [a creditor] [the insolvency representative]. Where the insolvency representative rejects a claim it should be required to give reasons for the rejection. Creditors whose claims have been rejected or disputed should have a right of appeal to the court.

(9) Claims of undetermined value, secured claims and disputed claims should be provisionally admitted pending valuation of the claim or security and resolution of the dispute by the court. Valuation of a claim may be undertaken by the insolvency representative or by the court. Creditors should be able to appeal against a valuation to the court.

(10) Admission of a claim of a creditor establishes:

(a) The right of the creditor to attend and the amount for which the creditor is entitled to vote at a meeting of creditors of an insolvency debtor or for the purposes of voting on the election of an insolvency representative or approval of a reorganization plan; and

(b) The amount that the insolvency representative must take into account in making payment to the creditor in a distribution to creditors.

(11) Right to set-off.

(12) Claims by insiders and shareholders.

V. Liquidation and distribution

A. Distribution priorities

1. General remarks

253. Distribution of the proceeds of the estate will generally be made according to the ranking of creditors by category and the different priorities accorded to those categories.

254. Where there are a number of different categories with different priorities, each level of priority will be paid in full before the next level is paid. Once a priority is reached where there are insufficient funds to pay all the creditors in full, the creditors of that priority share pro rata. In some laws that do not have different levels of priority, all the creditors share pro rata if there are insufficient funds to pay them in full.

255. It may be desirable to provide in reorganization proceedings that priority claims must be paid in full as a predicate to confirmation of a plan unless the affected priority creditors agree otherwise. A plan of reorganization may propose distribution priorities that are different to those provided by the insolvency law, provided that creditors voting on the plan approve such a modification.

2. Summary and recommendations: distribution priorities

(1) The purpose of these provisions is to: [. . .].

(2) The amount available for distribution to creditors would be paid in the following order:

(a) [Secured claims];

(b) Expenses and remuneration in connection with the appointment, duties and functions of the insolvency representative;

(c) Administrative expenses;

(d) [other approved claims].

(3) The claims in each of these classes are ranked equally between themselves. All the claims in a particular class will be paid in full before the next class is paid. If there are insufficient funds to pay them in full, they will be paid in proportion.

B. Discharge

1. General remarks

256. Following distribution it is likely that a number of creditors will not have been paid in full. An insolvency law will need to consider whether these creditors will still have an outstanding claim against the debtor or, alternatively,

the debtor will be released or “discharged” from those residual claims.

257. When the insolvency entity is a limited liability company, the question of discharge following liquidation does not arise; either the law provides for the disappearance of the juridical entity or, alternatively, the entity merely continues to exist as a shell with no assets. The shareholders will not be liable for the residual claims and the issue of their discharge does not arise. It does arise, however, in the context of reorganization and should be addressed. If the business entity takes a different form, such as an individual (sole proprietorship), a group of individuals (a partnership) or an entity whose owners have unlimited liability, the question arises as to whether these individuals will still be personally liable for the unsatisfied claims following liquidation.

258. Insolvency laws adopt different approaches to the question of discharge. In some, the debtor is still liable for unsatisfied claims, subject to any law as to limitations. This type of rule emphasizes the value of a debtor-creditor relationship: the continued responsibility of the debtor following liquidation serves to both moderate a debtor’s financial behaviour and encourage a creditor to provide financing. Other insolvency laws provide for a complete discharge of an honest, non-fraudulent debtor immediately following liquidation. This approach emphasizes the benefit of the “fresh start” that discharge brings and is often designed to encourage the development of an entrepreneurial class. It is also a recognition that over indebtedness is a current economic reality. A third approach attempts to strike a compromise: discharge is granted after a period following distribution, during which the debtor is expected to make a good faith effort to satisfy its obligations.

259. In some circumstances, it may be appropriate to limit the availability of discharge. These may include where the debtor has acted fraudulently, engaged in criminal activity, violated employment or environmental laws and [others?]. In some of the countries where a discharge is given, certain debts may be excluded, such as those arising from maintenance agreements, fraud, court fines and taxes. Conditions may also be imposed upon the debtor, both during the proceedings or as a condition for a discharge, either by way of recommendation by the insolvency representative or by the court. These conditions may include restrictions on the ability to obtain new credit, to leave the country or to carry on business for a certain period or time. Other limitations relate to the number of times a debtor can be discharged. In some jurisdictions, a discharge is a once in a lifetime opportunity; in others there is a minimum waiting period, for example 10 years, before a debtor will qualify for a new discharge or even be able to enter insolvency proceedings that may lead to a new discharge.

260. One issue that may need to be taken into account in considering discharge of individuals engaged in a business undertaking is the intersection of business indebtedness with consumer indebtedness. Recognizing that different approaches are taken to the insolvency of natural persons (in some countries a natural person cannot be declared bankrupt at all, in others there is a requirement for the

individual to have acted in the capacity of a “merchant”) and that many countries do not have a developed consumer insolvency system, a number of countries do have insolvency laws that seek to distinguish between those who are simply consumer debtors and those whose liabilities arise from small businesses. In many cases, for example, consumer credit is used to finance small business either as start-up capital or for operating funds and it may be difficult to separate the debts into clear categories. For that reason, where a legal system recognizes individual consumer and business debt, it is not feasible to have rules on the business debts of individuals that differ from the rules applicable to consumer debts.

2. *Summary and recommendations: discharge*

- (1) Where an insolvency law allows the insolvency of individuals engaged in business activity, provision should be made for the debtor to be discharged following liquidation. That discharge should be [complete and immediate where the debtor is honest and non-fraudulent] [subject to a particular time limit] [other?].

VI. *Reorganization plan*

1. *General remarks*

261. Insolvency laws address a number of issues in the context of formulation of a reorganization plan, such as the nature or form of the plan; when the plan is to be prepared; who is able to prepare the plan; what is to be included in the plan; how the plan is to be approved and the effect of the plan.

262. Reorganization plans perform different functions in different types of proceedings. In some the plan may be the tailpiece of the reorganization proceedings, dealing with the pay-out of a dividend in full and final settlement of all claims (also referred to as a composition or a scheme of arrangement) or it may be proposed at the commencement of the proceedings and set out the way the debtor and the business should be dealt with during the reorganization period, much like a business plan, as well as setting out expected dividends and dates of payment. There may also be circumstances where a plan like a plan of reorganization is prepared in a liquidation where the business is to be sold as a going concern. That plan would be much like a business plan and would not address any matters relating to distribution as that would be handled according to the insolvency law.

(a) *Nature or form of a plan*

263. The purpose of reorganization is to maximize the possible eventual return to creditors and provide a better result than if the debtor were to be liquidated. With different constituents involved in the reorganization process, each may have different views of how that objective can be reached, for example through continued business with a major customer or supplier as opposed to rapid repayment, and varying levels of risk tolerance. Some creditors may prefer an equity stake in the business, while others will not.

Typically, therefore, there is a range of options from which to select in a given case and if an insolvency law adopts a prescriptive approach to the range of options available or to the choice to be made in a particular case, it is likely to circumvent achievement of the goal of maximizing value. It is desirable that the law should not, for example, permit only a plan that is designed to rehabilitate the debtor fully; nor provide that debt cannot be written off; nor provide that a minimum amount must eventually be paid to creditors. The determination of what is the most appropriate commercial solution may best be left to the marketplace.

264. An insolvency law may wish to establish some limits, such as that the priorities afforded to creditors in liquidation should be maintained in reorganization and that the effect of the plan should not be such that it could result in the debtor remaining insolvent and being returned to the marketplace in that condition. A non-intrusive approach would result in flexibility sufficient to allow the most suitable (in terms of the particular entity) of a range of possibilities to be chosen. Some insolvency laws adopt an approach of listing some of the possibilities that may be adopted, but it is not intended that the list would be exclusive of other approaches. These possibilities could include a choice of a simple composition (an agreement to pay creditors a percentage of their claims); the continued trading of the business and its eventual sale as a going concern (and for the debtor to then be liquidated); transfer of all or part of the assets of the estate to one or more existing entities or entities that will be established; a merger or consolidation of the debtor with one or more other entities; a sophisticated form of restructuring of debt and equity; or some other solution.

(b) Preparation of a plan

265. Two important issues to be considered in relation to preparation of a reorganization plan are the stage of the proceedings at which it should be prepared and the party that should be responsible for its preparation. A number of different approaches can be taken to each of those issues.

266. As to the first issue, the approach depends on the purpose or objective of the particular reorganization. Some laws adopt the approach that the plan for reorganization forms a part of the application for reorganization proceedings (where the application may be called a “proposal” for reorganization), while other laws provide for it to be prepared after commencement of reorganization proceedings. One potential difficulty with preparation of the plan before commencement of the proceedings is that, if it has been prepared without consultation with creditors and other interested parties, it may not be a plan that could feasibly be implemented and could thus operate to pre-empt the proceedings and cause delay.

267. With regard to the second issue, different participants in the reorganization proceedings may have primary responsibility for preparation of the reorganization plan, depending on the manner in which the insolvency law is designed and in particular the respective roles assigned to the insolvency representative, the debtor and creditors. In some insolvency laws, these parties have a positive obligation to cooperate in preparing the plan. In determining

which party should have primary responsibility for preparing the plan, a balance may be desirable between the freedom accorded to the different parties to prepare the plan and the restraints necessarily attached to the process in terms of approval (voting) requirements, time limits for preparation, amendment of the plan and other procedural considerations. A flexible approach, as opposed to a regulatory approach, is likely to ensure that this balance is achieved, although in the interests of efficiency, certainty and predictability, it is desirable that an insolvency law take some steps to address these issues.

268. Some insolvency laws require the debtor to prepare the reorganization plan. This approach may have the advantages of encouraging debtors to commence reorganization proceedings at an early stage and making the best use of the debtor’s familiarity with its business and knowledge of the steps necessary to make the insolvent entity viable (although the freedom accorded to the debtor may need to be balanced against the need to ensure creditor confidence in the debtor and its proposal). The opportunity provided to the debtor could be made exclusive or exclusive for a specified period, with the court having the power to extend the period if it will be of advantage to the reorganization proceedings. Where the plan is to be prepared before commencement, it could only be prepared by the debtor, as creditors would lack both the information and the organizational structure to do so and no insolvency representative would have been appointed.

269. Since the plan will only be successful if it is approved by a requisite majority of creditors, there is always a risk that reorganization will fail if the plan presented by the debtor is not acceptable. For example, creditors may only wish to approve a plan that deprives the debtor’s shareholders of a controlling equity interest in the insolvent entity and may also deprive the incumbent management of any management responsibilities. If the debtor is given the exclusive opportunity to prepare the plan and refuses to consider such an arrangement, there is a danger that the reorganization will fail, to the detriment of the creditors, the employees and the insolvent entity. To address that concern, some insolvency laws provide that, if the debtor fails to provide an acceptable plan before the end of an exclusive period, the creditors are given the opportunity to propose a plan (which could be achieved through a creditor committee (see sect. IV.D, Creditor committee, above)). This option may provide the leverage necessary to reach a compromise between the participating parties.

270. A third approach would be to give the insolvency representative an opportunity to prepare the plan, whether as an alternative to preparation by the debtor or the creditors or as a supplementary measure. Given that the insolvency representative will have had the opportunity to become knowledgeable about the debtor’s business, it will be well placed to determine what measures are necessary for the business to be viable. The importance of providing for participation by the insolvency representative or the creditors depends upon the design of the law. In circumstances where approval by the requisite majority of creditors is a necessary condition for effectiveness of the plan, a plan that takes account of proposals that will be acceptable to creditors has a greater likelihood of being

approved than one which does not. This consideration will not apply where creditor approval is not necessary or can be overruled by the court. While a number of parties may be given the opportunity to prepare a plan, it is generally not desirable that a number of plans be prepared simultaneously. Although this may complicate the process and lead to inefficiency, in some cases it may also promote the preparation of a mutually acceptable plan.

271. Some laws provide for the court to consider the opinions of third parties on the plan, such as governmental agencies and labour unions. Although in particular cases this may assist in the preparation of an acceptable plan, it also has the potential to lengthen the duration of the process and may be desirable only if it is likely to be beneficial in a particular case and the process is carefully monitored and time limits are specified.

(c) Content

272. Most countries have laws requiring that the reorganization plan should adequately and clearly disclose to all parties information regarding both the financial condition of the insolvent entity and the transformation of legal rights that is being proposed in the plan. Information as to the financial situation of the debtor may include asset and liability and cash flow statements; details of the precise proposals included in the plan; details of what creditors would receive (and how that would be more than they would otherwise receive in liquidation); and the basis on which the business would be able to keep trading and could be successfully reorganized. Information relating to the proposals to be included in the plan may include details of distribution of funds; the continuation or termination of contracts that are not fully executed and non-expired leases; the settlement of claims; the sale of security; minimum dividend pay-out to creditors; the disclosure and acceptance procedure; the rights of claimants with disputed claims to take part in the voting process and provisions for disputed claims to be resolved; and voting rights and powers of “insiders”. Provision of this information supports the key objective of transparency and can assist in ensuring creditor confidence in the process. It may need to be balanced, however, against confidentiality concerns arising from creditor access to potentially sensitive financial and commercial information relating to the debtor, even where that information may ultimately enter the public domain through approval of the plan by a court.

273. The question of what is to be included in the plan is closely related to the question of approval and effect of the plan. The outcome of the plan rests on what is feasible, in other words whether, on the basis of known facts and circumstances and reasonable assumptions, the plan and the debtor are more likely than not to succeed. When voting on a plan, creditors need to be able to assure themselves that the plan is feasible and not based, for example, on faulty assumptions or leaves the debtor overburdened with debt. To facilitate that evaluation, the plan can be accompanied by a report of a qualified professional who can be expected to provide a credible and unbiased view of the measures proposed by the plan. Where creditors do not agree with the professional evaluation, those views could be taken into account either in voting on the plan, by a mechanism

allowing for amendment of the plan or by the court when it confirms the plan (where that is a required element of the process).

274. The content of the plan also raises issues related to other laws. For example, to the extent that national company law precludes debt-for-equity conversions, a plan that provides for such a conversion could not be approved. Since debt-for-equity conversion can be an important feature of reorganization, it would be necessary to eliminate the prohibition if such provisions were to be included in a plan and approved. Similarly, if a plan is limited to debt forgiveness or the extension of maturity dates, it may not receive adequate support from creditors for it to be successful. Some insolvency cases raise similarly straightforward and uncontroversial issues of the relationship between the insolvency law and other laws. Other cases may raise more complicated questions. These may include limits on foreign investment and foreign exchange controls (especially in cases where many of the creditors are non-residents) or the treatment of employees under relevant employment laws where, for example, the reorganization may raise questions of modification of collective bargaining agreements or questions related to taxation law. Some insolvency laws allow certain limitations contained in other laws to be overruled in specified circumstances and it is desirable, in order to ensure transparency and predictability, that an insolvency law specifically address the question of its relationship with other laws.

(d) Approval and effect of the plan

275. Designing the law with regard to the approval and effect of the plan requires balancing of a number of competing considerations. On the one hand, it may be desirable to provide a way of imposing an agreed plan upon a minority of dissenting creditors in order to increase the chances of success of the reorganization. To the extent that a plan can be approved and enforced upon dissenting creditors, there may be a need to ensure that the content of the plan provides appropriate protection for dissenting creditors and, in particular, that their rights cannot be unfairly affected. On the other hand, to the extent that the approval procedure results in a significant impairment of creditors' claims without their consent (particularly secured creditors), there is a risk that the willingness of creditors to provide credit in the future may be undermined.

(i) Secured and priority claims

276. In many cases, secured claims will represent a significant portion of the value of the debt owed by the debtor and different approaches may be taken to the approval of the plan by secured and priority creditors. Under one approach, where the law ensures that an approved plan will not preclude secured creditors from exercising their rights, there is generally no need to give these creditors the right to vote since their interests will not be impaired by the plan. Priority creditors are in a similar position under this approach—the plan cannot impair the value of their claims and they are entitled to receive full payment. The limitation of this approach, however, is that it may reduce the chances for a successful reorganization, especially where the assets securing the claim are vital to the success of the plan—if a

secured creditor is not bound by the plan or the plan does not provide for full satisfaction of the secured creditor's claims, the election by the secured creditor to exercise its rights may make the plan impossible to implement. Similarly, in certain circumstances, the only way in which the plan may succeed is to provide that priority creditors receive less than the full value of their claims upon approval of the plan.

277. To resolve some of these difficulties, some countries adopt the approach of allowing secured and priority creditors to vote as separate classes on a plan that would otherwise impair the value of their claims or to otherwise consent to be bound by the plan. The creation of these classes recognizes that the respective rights and interests of these creditors differ from those of unsecured creditors. To the extent that majority support is obtained from both secured and priority classes of creditors, they will be bound by the terms of the plan. In these circumstances, laws generally require that dissenting creditors are entitled to receive at least as much as they would have received under liquidation. Some insolvency laws also provide that secured creditors may be bound by the plan where the court has the power to order that they are bound, provided it is satisfied as to certain conditions. These may include that enforcement of the security by the secured creditor will have a material adverse effect on achieving the purposes of the plan and that the security and interests of the secured creditor will be sufficiently protected under the plan.

(ii) *General unsecured creditors*

278. Even if voting by secured or priority creditors is not permitted, it is desirable that the general unsecured creditors have an effective means for voting on a plan. Different mechanisms may be used, but whichever is chosen it should be clearly set out in an insolvency law to ensure predictability and transparency.

279. *Majorities.* Some laws identify the minimum threshold of support required of general unsecured creditors in order make the plan binding on those creditors, as well as the voting procedures that are to be used to determine that support. One issue of importance is the manner in which votes are calculated, whether on the basis only of the percentage of value of the debt that supports the plan or also of the number of creditors that are supportive. Some laws require, for example, for the plan to be supported by two thirds of the value of the debt and one half of the number of creditors. Other combinations are also used. Although increasing the difficulty of achieving approval, such a procedure may be justified on the basis that it protects the collective nature of the proceedings. For example, if a single creditor holds a majority of the value, such a rule prevents that creditor from imposing the plan on all other creditors against their will. Similarly, a large number of very small creditors cannot impose their decision on a few creditors who hold very large claims. That procedure may also be justified on the basis that it helps to ensure that the support for the plan is sufficient to enable it to be successfully implemented.

280. With regard to voting procedures, many countries adopt the approach of calculating the percentage of support

on the basis of those actually participating in the voting. Absentees are considered to have little interest in the proceedings. Such an approach requires adequate notice provisions and their effective implementation, especially where creditors are non-residents (see para. 237, above).

281. *Classes of creditors.* Some countries that have established classes for secured and priority creditors also provide for the division of unsecured creditors into different classes. The creation of these classes is designed to enhance the prospects of reorganization in at least three respects, by providing a useful means of identifying the varying economic interests of unsecured creditors; a framework for structuring the terms of the plan; and a means for the court to utilize the requisite majority support of one class to make the plan binding on other classes that do not support the plan. Since the creation of different classes has the potential to complicate the voting procedure, it may be desirable only where there are compelling reasons for special treatment of some unsecured creditors. Criteria that may be relevant in determining commonality of interest may include the nature of the debts giving rise to the claims; the remedies available to the creditors in the absence of the reorganization plan and the extent to which the creditors could recover their claims by exercising those remedies; the treatment of the claims under the reorganization plan; and the extent to which the claims would be paid under the plan.

282. *"Cram-down" authority.* A few countries that provide for voting by secured and priority creditors and for the creation of different classes of unsecured creditors also include a mechanism that will enable the support of one class to make the plan binding on other classes (including classes of secured and priority creditors) without their consent. This is often referred to as a "cram-down" provision. The creation of classes and the application of such rules complicate both the insolvency law and its application by the insolvency representative and the court and may require for example, the exercise of considerable discretion on economic matters, such as categorization by the court of unsecured creditors on the basis of their economic interests. This discretion, where it is not exercised in an informed, independent and predictable manner, has the potential to undermine creditor confidence.

283. *Shareholders.* Some laws provide for the approval of plans by shareholders of the debtor, at least where the corporate form, the capital structure or the membership of the debtor will be affected by the plan. In addition, where the debtor's management proposes a plan, the terms of the plan may already have been approved by the shareholders (depending upon the entity in question, this may be required under its constitutive instrument). This is often the case where the plan directly affects shareholders such as by providing for debt-for-equity conversions, either through the transfer of existing shares or the issuance of new shares.

284. In circumstances where the law permits creditors or an insolvency representative to propose a plan and the plan contemplates debt-for-equity conversion, some countries allow the plan to be approved over the objection of shareholders, irrespective of the terms of the constitutive

instrument of the entity. Such plans may result in existing shareholders being entirely displaced without their consent.

(iii) *Related party creditors*

285. [Voting on approval of the plan].

(iv) *Effect of the plan*

286. Where the plan is approved, different approaches are taken as to who is bound by it. Some insolvency laws appear to bind only those creditors who voted on the plan, while other laws appear to bind all unsecured creditors, directors and shareholders.

(e) *Court confirmation of the plan*

287. Not all countries require the court to confirm the plan approved by creditors; approval by a majority of creditors is all that is required. The court, however, may have a role to play with regard to reviewing the plan where the plan itself or the means by which it was procured is challenged by minority creditors (see para. 290 below).

288. Where the court (or in some countries an administrative authority) is required to confirm a plan, it would normally be expected to confirm a plan that has been approved by the requisite majority of creditors. Many countries enable the courts to play an active role in “binding in” creditors by making the plan enforceable upon a class of creditors that has not approved the plan. This may involve the court in undertaking a role that is in the nature of a legal formality; it does not require the court to examine the commercial basis on which the plan was approved but to ensure that the decision of the creditors was properly obtained and that the necessary pre-conditions were satisfied. The court may reject the plan on the grounds that the interests of dissenting creditors have not been adequately protected (because, for example, they have not received as much as they would have received in liquidation) or there is evidence of fraud in the approval process.

289. Some insolvency laws also give the court the authority to reject a plan on the grounds that it is not feasible. This may be justified, for example, where secured creditors are not bound by the plan but the plan does not provide for full satisfaction of the secured claims of these creditors. The court may reject the plan in such a case if it considers that secured creditors will exercise their rights against the security, thus rendering the plan impossible to perform. The risk of this occurring can be addressed in provisions relating to preparation and approval of the plan. Whatever role the court is required to play in terms of the reorganization plan, it is desirable that it not be asked to review the economic and commercial basis of the decision of creditors unless it has the competence and experience to do so.

(f) *Challenges to the plan*

290. Since all creditors are likely to be prejudiced by reorganization proceedings, a level of prejudice or harm that exceeds the prejudice or harm suffered by other creditors or classes of creditors would generally be required to support a challenge to the plan. Some laws also provide

that the plan should be subject to challenge, with provision for it to be reconsidered or set aside, by reference to established criteria against which the dissent of those creditors can be judged. Criteria may include that approval of the plan was obtained by fraud (such as that false or misleading information was given or material information was withheld with respect to the reorganization plan) or there was some irregularity in the voting procedure (such as that related-person creditors participated or that the resolution approving the plan was not consistent with the interests of creditors generally) or in the conduct of the meeting at which the vote was taken.

(g) *Amendment of the plan*

291. Where a vote on a reorganization plan fails to achieve the level required for the plan to be approved, an insolvency law may adopt a mechanism that could lead to amendment and reconsideration of the plan by creditors. One approach, for example, may be to allow a majority of creditors to vote to adjourn the decision meeting to enable further disclosure, if it appears that some further negotiation on a plan may produce a favourable result, or to address unresolved disputes and issues. As with all areas of the process, however, it is desirable that that adjournment be available in limited circumstances or at least a limited number of times, with perhaps time limits being included to facilitate speedy resolution of the renegotiations and avoid abuse.

292. An insolvency law may also include provision for a plan to be amended after it has been approved if its implementation breaks down or it is found to be incapable of performance. Many jurisdictions provide for the plan to be amended if that is in the interests of creditors. Where the court has confirmed the original plan, it may also be required to confirm the amended plan.

(h) *Implementation of the plan*

293. Most plans can be executed without the need for further intervention. But sometimes it may be necessary for the implementation to be supervised or controlled by an independent person. Several countries provide that the court has an ongoing role in supervision of the debtor after approval and confirmation of the plan, pending completion of its implementation. This may be important where issues of interpretation of the performance or obligations of the debtor or others arise. Some countries permit the court to authorize continued supervision of the affairs of the debtor, to varying degrees, by a supervisor or insolvency representative after the confirmation of the plan.

(i) *Where the plan is not approved or implementation fails*

294. In cases where a plan is not approved or implementation breaks down and in both of those cases amendment of the plan will not resolve these difficulties, an insolvency law may adopt different approaches as to what should occur. Some insolvency laws provide that the failure by creditors to approve the plan should be taken as an indication that they favour liquidation. This approach may operate to encourage debtors to propose an acceptable plan,

but it is desirable that it be subject to safeguards preventing abuse in cases where the support for liquidation is not in the interests of all creditors.

295. Where the implementation of the plan has broken down irretrievably, an insolvency law may provide for conversion to liquidation. Although that approach will provide some certainty as to an ultimate resolution of the proceedings, it may lead to further delay and diminution of value, with the result being of less value to creditors than a reorganization. A further approach may be to regard the insolvency proceedings as at an end and allow creditors to take individual actions. This approach does not resolve the financial difficulties of the debtor and could lead to a race for assets that the commencement of collective proceedings was intended to avoid. A compromise approach may be to allow the proposal of a different plan by creditors within a specified deadline and only in situations where no plan can be prepared would liquidation follow. It must be recognized that at some point the balance between achieving the best outcome for all creditors and achieving what is feasible tips in favour of pursuing what is feasible and it is desirable that an insolvency law be sufficiently flexible to allow this to occur.

(j) Conversion to liquidation

296. A number of circumstances may arise in the course of reorganization proceedings where it may be desirable for an insolvency law to provide a mechanism to convert the proceedings to liquidation. These circumstances may include where it is determined that there is no reasonable likelihood of the business being successfully rehabilitated or where it is apparent that the debtor is abusing the reorganization process either by not cooperating with the insolvency representative (for example, withholding information) or otherwise acting in bad faith (for example, fraudulent transfers). Because it is the party that, after the debtor or its management, has the greatest knowledge of the debtor's business, and so often learns at an early stage whether or not the debtor's business is viable, the insolvency representative can play a key role in the conversion process. In addition, it may be reasonable to allow creditors or the creditor committee, where one has been appointed, to request the court to convert the proceedings on similar grounds. The court could also be given the power to convert on its own motion.

297. Several approaches may be adopted to provide safeguards against abuse of the conversion procedure. One option may be to provide time limits for the completion of the reorganization procedure (for example, 120 days from commencement) and that the court will not have the authority to extend that period. This approach may have the advantage of establishing a deadline that acts as a catalyst for the preparation and approval of the plan, although it could also run the risk of imposing arbitrary constraints that may prove to be unnecessary or unwarranted in certain cases (such as very large insolvencies where preparation of the plan may take more than 12 months) and may lead to the failure of an otherwise successful reorganization because of the inflexibility of the deadline. A variation of that approach that would give greater leverage to creditors may be to establish an initial

time period (perhaps 60-90 days) that could be extended only by a vote of the creditors (perhaps on the basis of a report by the insolvency representative or an independent expert regarding the feasibility of reorganization) but which, in any event, could not exceed an outside limit (for example, 120 days).

(k) Discharge of debts and claims

298. To ensure that the reorganized entity has the best chance of succeeding, an insolvency law can provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan. This approach supports the goal of commercial certainty by giving binding effect to the forgiveness, cancellation or alteration of debts in accordance with the approved plan. The principle is particularly important to ensure that the plan provisions will be complied with by creditors that rejected the plan and by creditors that did not participate in the process. It also gives certainty to other lenders and investors that they will not be involved in unanticipated liquidation or have to compete with hidden or undisclosed claims. Thus the discharge establishes unequivocally that the plan fully addresses the legal rights of creditors.

(l) Termination of the plan

299. A reorganization plan would normally be treated as terminated where it had been fully implemented or where the court orders it be terminated because of a failure of implementation. In the latter case, in order to avoid the debtor being left in an insolvent state with its financial situation unresolved, the court may also make an order for the proceedings to be converted to liquidation.

2. Summary and recommendations: reorganization plan

(1) The purpose of provisions relating to the reorganization plan is to:

(a) Facilitate negotiations between the debtor, its creditors and other interested parties for the purpose of dealing with the financial difficulties of the debtor under a plan of reorganization;

(b) Bind all creditors and the debtor to the plan of reorganization;

(c) Provide for the implementation of the plan of reorganization;

(d) Address the consequences of a failure to propose an acceptable plan, inability to have the plan approved by creditors or failure of implementation of the plan;

(e) Convert the proceedings to liquidation in certain circumstances;

(f) Discharge debts and claims.

(2) A reorganization plan may be proposed upon filing of an application for insolvency proceedings or after commencement of the insolvency proceedings. Where the reorganization plan is required on filing of the application it would be prepared by the debtor.

(3) Where the reorganization plan is to be formulated after commencement of proceedings, an insolvency law should adopt a flexible approach to formulation of the plan that potentially involves all parties central to the insolvency proceedings: the debtor, the creditors and the insolvency representative. For example, it could provide that the debtor be given an exclusive period to propose a plan, but should consult with creditors and the insolvency representative in so doing. After the expiration of that exclusive period, if the debtor has not been able to propose an acceptable plan, one or more creditors or the creditor committee, in consultation with the insolvency representative, or the insolvency representative itself could be given the opportunity to propose a plan.

(4) The insolvency law may specify the minimum contents of a reorganization plan, taking into account the provisions of other relevant laws. This could include [*statements as to the financial situation of the debtor including asset and liability and cash flow statements; details of the precise proposals included in the plan; details of what creditors would receive (and how that would be more than they would otherwise receive in liquidation); and the basis on which the business would be able to keep trading and could be successfully reorganized*].

(5) For the purposes of a reorganization plan, creditors may be divided into classes according to the nature and content of their respective rights.

(6) A reorganization plan can be approved if it is supported by:

- (a) The majority of classes of priority and secured creditors (where their rights are affected by the proposed plan);
- (b) The majority of classes of unsecured creditors; and
- (c) The majority of the shareholders of the debtor (when their rights are affected by the proposed plan).

(7) For the purposes of approval, a majority shall be one half of the number of creditors that actually vote and two thirds of the debt respectively held by them.

(8) The insolvency law may provide that approval of the reorganization plan by a majority of creditors will make the plan binding on dissenting creditors ("cram-down provision").

(9) An insolvency law may provide for confirmation of the reorganization plan by a court or relevant administrative body in order to make it enforceable against creditors. The court may have the power to confirm the plan provided that:

- (a) The interests of dissenting creditors are adequately protected;
- (b) The plan is feasible;
- (c) [other].

(10) Dissenting creditors can object to the plan on the basis that approval of the plan was obtained by fraud (such as that false or misleading information was given or material information was withheld with respect to the reorganization plan) or there was some irregularity in the voting procedure (such as that related-person creditors participated or that the resolution approving the plan was not consistent with the interests of creditors generally).

(11) The court should have the power to supervise the implementation of the plan or to authorize supervision by a supervisor or insolvency representative, where this is necessary.

(12) Provision should be made for the plan to be amended when it fails to achieve the level of support required for approval, or after approval, on the basis that implementation of the plan breaks down or the plan is found to be incapable of implementation.

(13) The insolvency law should address the issue of discharge of the debts and claims on the basis of the manner in which they are treated in the reorganization plan.

(14) The insolvency law should provide for termination of the plan when implementation has been completed or, where implementation fails and the plan cannot be amended, for the proceedings to be converted to liquidation.

**G. Working paper on alternative informal insolvency processes:
comments by the Commercial Finance Association, submitted to the
Working Group on Insolvency Law
at its twenty-fifth session (A/CN.9/WG.V/WP.59) [Original: English]**

On 19 October 2001, the Secretariat received comments by the Commercial Finance Association on informal insolvency processes. The text of those comments is reproduced in the annex to the present note.

ANNEX. INFORMAL INSOLVENCY PROCEDURES

I. Introduction

1. The Commercial Finance Association (CFA) is pleased to submit this memorandum to the United Nations Commission on International Trade Law (UNCITRAL) Working Group on Insolvency Law in connection with its consideration of the desirability and feasibility of legislation concerning informal insolvency procedures. This memorandum is in response to the report of the Secretary-General on alternative approaches to out-of-court insolvency processes (A/CN.9/WG.V.WP.55).

2. By way of background, CFA is a trade association for financial institutions that provide asset-based commercial financing and factoring to business borrowers. Although most of the members of CFA have their headquarters in North America, many are located, or have affiliates or branches, outside North America, or are owned by entities with headquarters outside North America. Among the nearly 300 members of CFA are substantially all of the major money centre and important regional banks and other large and small commercial lenders in North America. CFA members provide financing to businesses on an international, national, regional and local scale. Most of the borrowers served by CFA members depend on secured financing to operate and grow. Although much of this financing is used by businesses for working capital purposes, a substantial amount of it is used to finance the acquisition of other companies. Financing provided by CFA members is generally secured by various forms of personal and real property collateral owned by borrowers or guarantors, including accounts receivable, inventory, equipment, real estate, intellectual property and investment securities. Last year, secured financing provided by CFA members totalled in excess of \$340 billion.

3. In recent years, CFA members have become increasingly active in making cross-border loans, including loans predicated on the value of collateral located in other jurisdictions and denominated in local currencies. This increased activity in cross-border lending flows naturally from the increased globalization of borrowers, fueled by reductions in trade barriers and explosive developments in technology.

II. Discussion

4. As a general matter, CFA believes that the development of insolvency procedures may be desirable as a means of promoting the availability of lower-cost credit in States that adopt such procedures. In CFA's view, the central theme of any set of procedures should be to provide a mechanism for implementing, in an efficient and cost-effective manner, an agreement on restructuring the debts of a debtor company (a borrower) that is endorsed by all or substantially all of the borrower's creditors (other than trade creditors), without the cost and delay inherent in typical formal insolvency proceedings.

5. If a primary purpose of the insolvency procedures is to promote the availability of secured credit, CFA submits that the procedures should not create circumstances in which a secured lender is worse off under the procedures than it would be under applicable formal insolvency laws. Thus, CFA suggests that the procedures should not, without the secured lender's consent, impair either the secured lender's rights and remedies in its collateral or the value of the collateral. Thus, for example, the procedures should preserve the secured lender's rights in (a) proceeds of its collateral and (b) after-acquired property and should not require the secured lender to release or exchange collateral without appropriate substitute collateral. Further, if any of the secured lender's collateral is used during the restructuring process, the procedures should provide for reasonable compensation to the secured lender for any diminution in the value of the collateral resulting from such use. Moreover, the procedures should not, without the secured lender's consent, frustrate the reasonable expectations of the secured lender under its loan documents with respect to choice of law or applicable forum.

6. In order to be effective, CFA believes that the insolvency procedures should empower the insolvency court to (a) temporarily stay actions by creditors against the borrower and its property, (b) bind dissenting creditors to the restructuring plan and (c) prevent the borrower from withdrawing from a restructuring plan to which it has previously agreed. This suggests that the procedures take the form of legislation, ideally as part of the formal insolvency laws rather than separate legislation, as opposed to a set of core principles.

7. Further, in order to promote the use of the insolvency procedures in a given jurisdiction, the insolvency court should be authorized to defer to pending restructuring negotiations being conducted in accordance with the procedures if the court determines that the negotiations have a realistic prospect of success and the proposed restructuring is in the best interests of the creditors generally. The procedures should also incorporate an expedited means of obtaining judicial review and approval of the proposed restructuring.

8. CFA also believes that the insolvency procedures should incorporate a mechanism for financing the operations of the borrower during the restructuring negotiations, with appropriate priority and other protections being afforded to the parties providing such financing. However, such financing should not prejudice the rights of existing secured lenders electing not to provide such financing (non-electing lenders). Thus, CFA suggests that (a) no lien superior to those of the non-electing lenders should be granted without the consent of the non-electing lenders, unless the non-electing lenders already have, or are provided with, collateral having a value substantially in excess of the indebtedness owing to them and (b) no lien junior to the liens held by the non-electing lenders should be granted without subordination and standstill provisions reasonably acceptable to the non-electing lenders.

9. A secured lender that elects to withdraw from the restructuring process should be permitted to do so on an expedited basis (thereby obtaining judicial relief from any stay) upon a showing that it is prejudiced by the proposed restructuring. Such expedited relief should be available even if such secured lender's collateral is essential to the restructuring. Such relief should be available in any forum that would have been available to the secured lender under its loan documents and otherwise applicable law.

III. Conclusion

10. CFA believes that the development of insolvency procedures consistent with the foregoing principles would encourage secured lenders to extend financing in jurisdictions adopting such procedures. On the other hand, CFA also believes that procedures that do not recognize such principles would have a deterrent effect on secured lending to the extent that they would frustrate the reasonable expectations of secured lenders concerning the enforcement of their rights and remedies under applicable formal insolvency laws and other creditors' rights laws.

H. Report of the Working Group on Insolvency Law on the work of its twenty-sixth session (New York, 13-17 May 2002) (A/CN.9/511) [Original: English]

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I. INTRODUCTION

1. The United Nations Commission on International Trade Law (UNCITRAL), at its thirty-second session, in 1999, had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission of the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a “front line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work at an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session.

4. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had made in its report on the exploratory session (A/CN.9/469, para. 140), held in Vienna from 6 to 17 December 1999 and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the UNCITRAL secretariat, in cooperation with INSOL International and IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4 to 6 December 2000.

6. At its thirty-fourth session, in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished thus far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required

guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

8. The Working Group on Insolvency Law commenced the preparation of a legislative guide on insolvency law at its twenty-fourth session (New York, 23 July-3 August 2001) and continued its work at its twenty-fifth session (Vienna, 3-14 December 2001). The reports of those meetings are contained in documents A/CN.9/504 and A/CN.9/507.

9. The Working Group on Insolvency Law, composed of all States members of the Commission, held its twenty-sixth session in New York from 13 to 17 May 2002. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Burkina Faso, Canada, China, Colombia, Fiji, France, Germany, India, Iran (Islamic Republic of), Italy, Mexico, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand and United States of America.

10. The session was attended by observers from the following States: Algeria, Australia, Denmark, Gabon, Iraq, Ireland, Jordan, Malta, New Zealand, Nigeria, Philippines, Portugal, Republic of Korea and Switzerland.

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

(a) Specialized agencies and other organizations of the United Nations system: International Labour Organization, International Monetary Fund and World Bank;

(b) Intergovernmental organizations: League of Arab States and European Bank for Reconstruction and Development;

(c) Non-governmental organizations invited by the Commission: American Bar Association, American Bar Foundation, Groupe de Reflexion sur l'Insolvabilité et sa Prévention, International Bar Association, International Federation of Insolvency Professionals (INSOL International), International Insolvency Institute, International Law Institute and International Working Group on European Insolvency Law.

12. The Working Group elected the following officers:

Chairman: Wisit WISITSORA-AT (Thailand)

Rapporteur: Jorge PINZON-SANCHEZ (Colombia)

13. The Working Group had before it a note by the Secretariat on the draft legislative guide on insolvency law (A/CN.9/WG.V/WP.61 and Add.1 and 2).

14. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on insolvency law.

4. Other business.

5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

15. The Working Group on Insolvency Law continued its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third (New York, 12 June-7 July 2000)¹ and thirty-fourth (Vienna, 25 June-13 July 2001)² sessions and by the Working Group on Insolvency Law at its twenty-fourth and twenty-fifth sessions. The decisions and deliberations of the Working Group with respect to the legislative guide are set forth below.

16. The Secretariat was requested to prepare a revised version of the guide, based on those deliberations and decisions, to be presented to the twenty-seventh session of the Working Group on Insolvency Law, to be held in Vienna from 9 to 13 December 2002, for review and further discussion.

III. PREPARATION OF A DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

A. General remarks

17. The Working Group suggested that the reorganization procedure needed to be discussed more clearly in the recommendations and that reorganization should be stressed before liquidation. It was also suggested that sections C and D of chapter V should be moved from the chapter on administration of the insolvency proceedings to a subsequent part dealing with resolution of the proceedings. A further suggestion was that the recommendations should be included in the draft guide both as a separate text or an annex, as well as throughout the document following each relevant section of the analytical commentary.

B. Part One. Key objectives

18. As a general remark, it was observed that the recommendations focused on the protection of creditors and did not mention the protection of the debtor, which was an equally important aspect of an insolvency regime.

19. As to the form of part one, support was expressed in favour of including the recommendations in the form of a preamble to state the purposes and objectives of the guide. That approach would establish the background for the recommendations that would follow the preamble and would also serve as a useful tool of interpretation.

¹See *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 400-409.

²*Ibid.*, *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, paras. 296-308.

20. A number of suggestions were made as to the content of recommendations 1-7. It was suggested that recommendation 1 should focus more clearly on the options of liquidation and reorganization and omit the remainder of the sentence following the words “nonviable businesses”. A proposal to include a reference to the need to give full consideration to the protection of employees in recommendation 1 was not supported.

21. The Working Group generally agreed that recommendation 3 should include the term “equally” rather than “equitably” with respect to similarly situated creditors, while the term “equitably” was more relevant in the context of recommendation 6 and the treatment of different classes of creditors and that that usage should be reflected throughout the draft guide.

22. General support was expressed in favour of including in recommendation 5 a reference to the periodic provision to creditors by those supervising the insolvency process of information with respect to the debtor’s financial situation and the progress of the proceedings.

23. In the context of recommendation 6, it was noted that the protection of employees was of particular importance in an insolvency law and that they should be specifically mentioned as a class of creditor requiring particular attention. While that proposal received some support, the Working Group was generally of the view that although protection of employees was an issue of some importance (in particular in terms of meeting international obligations) a reference to one particular class of creditors in recommendation 5 was not desirable and might reflect a policy bias that should not be included in the general objectives. It was observed that as drafted the reference to creditors would include employees with claims and that the issue of protection of employees could be addressed more specifically under the sections on treatment of contracts and distribution.

24. General support was expressed in favour of retaining recommendation 7 to encourage and promote adoption of the UNCITRAL Model Law on Cross-Border Insolvency.

25. Suggestions for additional recommendations were that all claims of creditors should be dealt with in a single insolvency proceedings, and that the insolvency law should encourage the search for an amicable agreement and solution to the debtor’s financial situation to avoid the need for insolvency proceedings.

C. Part Two. Core provisions

1. Introduction

A. Structure [organization] of the insolvency regime

26. It was suggested in respect of recommendation 8 that more explanation should be presented in the guide, including recommendations on the ways in which the different procedures could be arranged in the insolvency regime.

27. A drafting suggestion was that the reference to the ability of the debtor to convert proceedings in recommendation 9 should be amended to refer to the need to include in the insolvency law a facility for conversion of proceedings.

2. Application for and commencement of insolvency proceedings

A. Eligibility and jurisdiction

28. A general remark was that the draft guide should more clearly indicate whether each recommendation applied to either liquidation or reorganization or to both procedures.

29. It was observed that recommendation 13 was potentially in conflict with article 28 of the Model Law on Cross-Border Insolvency, which provided for commencement of insolvency proceedings on the basis of presence of assets. In response, it was suggested that a distinction should be drawn between the draft guide and the Model Law on the ground that the Model Law referred to commencement of ancillary proceedings based on presence of assets in a situation where main proceedings had been commenced elsewhere, whereas recommendation 13 was referring essentially to commencement of those main proceedings. It was noted however, that since some insolvency laws did provide for commencement on the basis of assets, a more flexible approach should perhaps be adopted in the draft guide. It was suggested that the recommendation should include a general statement of the principle along the lines of subparagraph (c) of the purpose clause, that the insolvency law should address the question of which debtors have sufficient connection to a State to be subject to its insolvency laws. An additional recommendation should then be added to the effect that while different approaches might be taken to identifying those connecting factors, at a minimum or as examples, they should include those set forth in recommendation 13, subparagraphs (a) and (b).

B. Application and commencement criteria

30. General support was expressed in favour of amending the reference in subparagraph (c) of the purpose clause from “inexpensive” to “cost-effective”.

31. Concern was expressed with the reference in recommendation 17(a) to the future inability of the debtor to pay its debts, on the basis of the difficulty of proof of that criterion and the need to establish some element of the imminence of that inability. It was suggested that if the inability to pay was not imminent, the debtor should seek to resolve its position by informal negotiations, not by commencing formal proceedings. It was observed in response that informal negotiations were not always possible with respect to certain types of financial instruments that required unanimity for amendment of repayment terms.

32. A contrary view was that the recommendation should be included as currently drafted in order to encourage voluntary applications by debtors at an early stage, which

the Working Group had agreed should be a key element of the insolvency law. It was suggested in support of that view that if such a provision led to abuse by debtors, that issue should be addressed in terms of the consequences of the application, rather than in terms of the commencement criteria.

33. Concern was also expressed with regard to recommendation 18 on the basis that failure to pay a single debt might lead to application of the presumption without consideration of whether the debt was disputed or whether there might a right of set-off in respect of that debt. To address those concerns it was suggested that the recommendation should include words to the effect that the debt was not subject to a legitimate dispute or an offset in an amount equal or greater than the amount of the debt. That proposal received some support. With respect to the number of creditors, some support was expressed in favour of requiring failure to pay more than one creditor. In response, it was suggested that what was important was not the number but rather the quantity of the debt held by a particular creditor and the relationship between assets and liabilities. It was noted, however, that different approaches with respect to those issues might need to be taken in different countries to reflect varying stages of economic development, prevalence of different types of financial instruments and other similar factors.

34. A further concern was that as presently drafted, recommendation 18 did not make it clear how the debtor could defend itself against such a presumption. In response it was suggested that recommendations 20(b) and 23 provided protection for the debtor, who would have the opportunity to rebut the presumption by showing that it was able to pay its debts, that the debt was subject to a legitimate dispute, that the debt was not mature and other relevant facts and the court would have to assess those facts in considering whether or not to commence insolvency proceedings. It was observed that the purpose of the recommendation was to provide an opportunity to compel the debtor to show that it should not be subject to the insolvency law.

35. After discussion, the Working Group agreed that in order to accommodate the different views expressed, the recommendation should indicate that the insolvency law “might” rather than “should” provide for the inclusion of a presumption, with reference to the different approaches that might be taken with respect to the circumstances that must be established for proceedings to be commenced, in particular the number of creditors or quantity of debt that might be required.

36. Support was expressed in favour of retaining in recommendation 21 the words in square brackets as examples of how notice might be provided and adding references to other means by which notice could be given, such as through relevant electronic registries. Another suggestion that received support was that recommendation 21 should be limited to provision of notice to the public and that recommendation 22 should address provision of notice to creditors, both known and generally. A further suggestion that received support was that the information to be included in the notice to creditors should be set forth in a

separate recommendation, which would apply to both the general notification of creditors and notification to known creditors and should be a requirement of the law.

37. With regard to the opening words of recommendation 23, it was suggested that a distinction should be drawn between denial of an application for commencement and dismissal of proceedings, especially where the commencement criteria functioned as automatic commencement, as referred to for example in recommendation 19(a). General support was expressed in favour of including two recommendations to deal with denial along the lines of recommendation 23 and a separate recommendation providing for dismissal on the grounds contained in recommendation 23(a) and (b). A proposal that a further ground should be added to reflect the discussion in the Working Group on denial of an application based on the debt being the subject of a legitimate or bona fide dispute was supported. The Working Group agreed that the text in the second set of square brackets in subparagraph (b) was preferable and should be retained and that a subheading could usefully be added to the recommendation.

3. *Treatment of assets on commencement of proceedings*

A. *Assets to be affected*

38. One suggestion of a general nature in respect of the recommendations on assets to be affected by the commencement of insolvency proceedings was that a distinction should be drawn between liquidation and reorganization, as the assets to be affected by the commencement of different types of proceedings might differ. In response, it was observed that that approach might establish an artificial distinction, which could potentially be abused by debtors. It was also noted that the difference between liquidation and reorganization was more important in terms of how the assets were affected, rather in the definition of the assets to be included in the estate.

39. With respect to recommendation 24(a), the Working Group discussed the question of the location of the assets to be subject to the proceedings and whether the recommendation should adopt the universal approach of referring to all assets “wherever situated”. Some concern was expressed in relation to both that approach and to the guide addressing the question of which law should govern the assets, particularly secured assets.

40. After discussion, the Working Group agreed that the concerns expressed could be accommodated by revising the recommendation along the lines “The insolvency law should define the assets to be included in the insolvency estate”, which might include assets of the kind referred to in subparagraphs (a) and (b) of recommendation 24, and clearly indicating whether the law adopted a universal or territorial approach to the assets to be included. Support was also expressed in favour of the proposal that the guide should clarify how assets possessed by the debtor pursuant to a contract should be treated and include a reference to assets recovered through avoidance actions and potential assets, such as prospective awards from an action for damages.

B. Protection and preservation of the insolvency estate

41. With respect to recommendation 26(a), some concern was expressed as to the meaning of the word “execution” and it was suggested that the paragraph should refer to “execution and other enforcement against the assets of the insolvency estate” to clarify the point. It was also suggested that that language could be used in recommendation 28(b). It was pointed out that recommendation 26(b) should refer to administration “or” realization of all or part of the debtor’s assets, although the need to address realization was questioned. With respect to the words following “. . . preserve the value of assets”, an alternative was suggested along the lines of “in accordance with the objective of the insolvency proceedings”, which would accommodate both liquidation and reorganization without specifying the types of actions included in recommendation 26(b).

42. A further concern raised was whether the recommendations as presently drafted would apply to secured creditors. To address that issue it was suggested that the words “including perfection or enforcement of security interests” could be added to recommendation 28(a). A further suggestion to clarify that point drew attention to the difference between the language of recommendation 28(c) and article 20 of the Model Law on Cross-Border Insolvency on which the recommendation was based. To clarify the concern, it was suggested that the language of 28(c) should be amended to read “the transfer, encumbrance or other disposal of any assets of the insolvency estate is suspended”. In the course of the discussion of recommendation 28(a) it was observed that in some countries the stay and suspension did not apply to commencement or continuation of actions, but rather to enforcement of the outcome of those actions. It was noted that that approach was reflected in article 20, paragraph 3, of the Model Law on Cross-Border Insolvency.

43. With regard to recommendation 32 it was suggested that both the open text and the text in square brackets in subparagraph (a) should be retained.

44. A suggestion was made that recommendation 33 should be redrafted to express the general principle of protection, with the types of protection mentioned in the recommendation to be included as examples of how that protection might be provided.

C. Use and disposition of assets

45. As a matter of drafting, support was expressed in favour of the proposal to omit from subparagraph (c) of the purpose clause the references to abandonment or surrender of assets and refer only to treatment of burdensome assets and, using the language of recommendation 38, assets determined to be of no value to the insolvency estate and assets that cannot be realized in a reasonable period of time.

46. A general concern related to the definition of “insolvency representative” and whether it would include a debtor in possession. It was noted that that issue could be considered at a later time when the Working Group considered the glossary to the draft guide.

47. Concern was expressed that the relationship of recommendation 35 to recommendation 24 was not clear and, in particular, whether assets owned by third parties would be considered part of the insolvency estate.

48. With respect to recommendation 36 it was proposed that both texts in square brackets should be retained so that the assets should be both of benefit to, and necessary for, the conduct of the insolvency proceedings. A concern was expressed as to the meaning of “assets subject to security interests” and whether the reference was limited in the context of recommendation 36 to rights in rem. It was observed that the draft recommendations included provisions addressing the protection of secured creditors (recommendations 32 and 33) and counterparties to contracts with the debtor (recommendation 44). To ensure the protection of third parties, it was proposed that parallel provisions be included after recommendation 36.

49. Some support was expressed in favour of a proposal that the second sentence of recommendation 39 should require private sales to be subject to supervision by the court or approval of the creditors. In regard to approval of creditors, it was suggested that reference should be made to the section on creditors and the creditor committee. In response to a suggestion that the recommendation should perhaps make a distinction between sales in liquidation and reorganization, it was noted that the purpose of the provision was to address the issue of sales outside the ordinary course of business, whether in liquidation or reorganization. In response to a question of whether or not a creditor could be a buyer, it was noted that it was not generally desirable to place restrictions on who could purchase assets of the debtor, and that what was required were protections of the kind included in recommendation 39. It was further proposed that those protections would also be relevant to recommendation 40.

D. Treatment of contracts

50. As a matter of drafting, concern was expressed as to the precise meaning of the phrase “that have not or not fully been performed by either the debtor and its counterparty” and thus to the scope of section D. It was clarified in response that the section was intended to address contracts that required performance by both parties and not simply the situation where one party had performed its obligations and was awaiting payment by the other party. The UNCITRAL secretariat was requested to reflect that idea more clearly in the draft recommendations.

51. Support was expressed in favour of using mandatory language in recommendation 42 and including as a further category (c) the fact of insolvency of the debtor or its weakened financial position. Recalling the discussion in the context of protection of the estate that many countries provided for the stay to apply to the counterparty to a contract with the debtor in order to prevent the contract being terminated, support was also expressed in favour of ensuring that that was clearly stated in the recommendations to ensure that the contract remained in place to allow the insolvency representative time to consider the possibility of continuation.

52. With respect to recommendations 43 and 45 it was noted that recommendation 43 contained a condition for continuation whereas recommendation 45 made the right of rejection unconditional. It was proposed that recommendation 45 should be limited to contracts that were burdensome to the insolvency estate.

53. Wide concern was expressed on the inclusion of recommendation 46(b) on the basis that it appeared to give an advantage to parties who did not perform their contractual obligations and had the potential to place an insolvent debtor in a stronger position than a party that continued to perform its obligations. In response, it was observed that subparagraph (b) might have some application in certain cases, particularly in the case of reorganization, where the contract in question might be crucial. After discussion, the Working Group agreed that the issue required further consideration and placed subparagraph (b) in square brackets.

54. In the context of recommendation 50, it was noted that although reference was made to the time period within which the insolvency representative should act to continue or reject a contract, no provision was included for the counterparty to request the insolvency representative to take prompt action. That proposal was supported.

55. Different views were expressed as to the need for provisions on assignment of contracts. One view expressed was that the question of assignment should be left to the general law of contracts and should not be addressed in the insolvency law. A contrary view was that special rules were required to address assignment in the insolvency context, particularly in those jurisdictions where assignment was not permitted against the disagreement of the counterparty. It was noted that a policy justification for such provisions was the retention of the value of a contract for the benefit of the insolvency estate (and subsequently creditors), provided that the counterparty's position was not disadvantaged or its position made worse as a result of the assignment. For those purposes, either variant A or B was acceptable. A further view was that variant A, recommendation 53, might be too difficult to satisfy and that all that was required were recommendations 51 and 52 of variant A. After discussion, the Working Group agreed that the recommendations should reflect both views, that assignment could be left to general contract law and that special provisions could be included in the insolvency law. The UNCITRAL secretariat was requested to prepare the necessary revisions.

56. As to recommendation 54, it was suggested that specific mention should be made of financial transactions (addressed in detail in section F), as well as contracts involving intellectual property where it was desirable that the contract be able to be continued.

E. Avoidance actions

57. With respect to the purpose clause, it was suggested that subparagraph (a) should not so much refer to preservation of the assets, as to reconstruction or reconstitution of the assets. The use of the phrase "fair treatment" was queried in light of the earlier discussion on the key

objectives and the use of equal and equitable treatment. Suggestions for additions to the purpose clause included a paragraph to the effect that a purpose of the provisions was to ensure legal certainty for third parties as to the actions that might be avoidable and a paragraph concerning the treatment of payments made prior to commencement that were in the ordinary course of business. Different views were expressed on the need to address post-commencement transactions in the section on avoidance, but the Working Group agreed generally that the issue should be addressed in the guide, such as in recommendations 35 and 57(d) or in the section on treatment of contracts.

58. A change to the title of the section to "Avoidance proceedings" was also proposed.

59. It was observed with respect to subparagraph (b) of the purpose clause that the phrase "involving the debtor" might be too narrow, as there might be transactions involving the debtor's property to which the debtor was not a party.

60. A drafting suggestion in respect of recommendation 56 was to replace "retrospectively" with "retroactively".

61. A number of views were expressed on recommendation 57. A preliminary remark was that the reference to "commence proceedings" in the chapeau might not be sufficient to cover other ways in which avoidance might arise, such as by way of defence to an action concerning particular assets brought by someone other than the insolvency representative. Additional suggestions were that subparagraph (a) should refer, in addition to the transfer of assets, to the incurring of liabilities and to transactions that left the debtor with few assets or in financial difficulties.

62. One concern with respect to subparagraph (a) was that the reference to fraud might not be sufficient to describe the types of transactions that should be covered in the recommendation and that what was required were examples of transactions and some objective indicators as to the types of transactions covered. A related concern was that the requirement of actual intent might prove difficult to satisfy and that a reference to situations where the third party had reason to suspect the fraudulent nature of the transaction might be of assistance. It was also suggested that the requirement of fraud might be too narrow and too specific and it was proposed that supplementary requirements such as transactions made in bad faith might be relevant. Another suggestion was that the word "fraud" should be deleted and the section should focus on the objective characteristics of the transactions sought to be avoided.

63. In respect of recommendation 61, it was proposed that it include the transactions referred to in recommendation 57(a).

64. With respect to determination of the suspect period in recommendation 58, it was suggested that reference should be made to recommendation 62 and the need to have longer periods for the transactions addressed in recommendation 57(a) generally, not just those involving related parties.

65. Support was expressed for the view that recommendation 65 was not required in the section on avoidance.

66. With respect to footnote 15, it was noted that the notion of control of the debtor and a reference to a legal entity, not just natural persons, should also be included.

67. It was suggested that a reference to the exercise of avoidance powers could usefully be added to recommendation 78.

68. It was observed that section E did not address the treatment in the insolvency proceedings of a transferee to a contract that was avoided where the transferee failed to disgorge or return the assets to the estate. It was noted that some insolvency laws provided that a claim by such a transferee would not be admitted.

F. Netting and set-off and financial contracts

69. The Working Group based its consideration of those topics on the following text, which had been revised by the UNCITRAL secretariat.

“F. Netting and set-off [reference document A/CN.9/WG.V/WP.58, paras. 116-123]

“(66) In general, netting and close-out arrangements should be legally protected and should, to the greatest extent possible, not be [unwound] [undone].

“(a) A right of set-off existing under general law and exercised before the commencement of insolvency proceedings should be excluded from the application of provisions on avoidance;

“(b) After commencement of insolvency proceedings, the insolvency law should permit creditors and the insolvency estate to exercise a right of set-off permitted under general law and should exclude the exercise of that right of set-off from the application of provisions on stay and suspension of actions against the debtor and treatment of contracts.

“G. Financial contracts*

“(67) Notwithstanding other provisions of general law or the insolvency law:

“(a) Upon application for commencement of insolvency proceedings against a debtor, any creditor of the debtor that is a party to a financial contract involving the debtor may terminate that contract;

“(b) Upon an application for commencement of insolvency proceedings against a debtor, any creditor of the debtor that is a party to a financial contract involving the debtor may [apply security][exercise their security] and exercise rights of set-off under that financial contract; and

“(c) Transactions under a financial contract and related security arrangements should not be subject to provisions on stay and suspension of action against the

debtor and should not be subject to avoidance provisions unless they constitute actual fraud.

“*The definition from the United Nations Convention on Assignment of Receivables in International Trade, 2001, art. 5(k) provides: ‘Financial contract’ means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets, *irrespective of whether or not they were effected on an exchange*, and any combination of the transactions mentioned above [*underlining indicates new text*].”

70. There was general agreement in the Working Group that those issues should be addressed in the guide and that the guide should stress the importance of the types of contracts to be covered and the complexity of the arrangements involved.

71. As to the scope of the financial contracts to be covered, it was suggested that the definition in footnote 16 was too broad and should be more narrowly focused to cover only those transactions which formed part of a broader framework contract.

72. Some concern was expressed as to whether the right of set-off described was limited in its application to financial contracts or was of more general application. After discussion, the Working Group agreed that set-off in the context of those recommendations would be limited to financial contracts and that the guide would address the issue of set-off more generally in another section. It was proposed that the recommendation should, in the context of financial contracts, generally protect a pre-commencement right of set-off and permit post-commencement set-off where the mutual claims arose under the same framework agreement.

73. With respect to recommendation 67 it was noted that there was a need for an exception for financial framework agreements only where two conditions were satisfied: (a) where post-commencement set-off was not permitted for mutual financial obligations; or (b) where the insolvency law gave the insolvency representative the ability to override contract termination provisions.

74. It was suggested that the provisions required careful consideration to ensure that they were clearly explained and that countries would not adopt provisions that would interfere with the operation of arrangements such as the Society for Worldwide Interbank Financial Telecommunications (SWIFT) and the International Air Transport Association (IATA) clearing house, taking into account rules on insolvency and unwinding of transactions under special systems.

4. Participants and institutions

A. The debtor

75. With respect to subparagraph (a) of the purpose clause, it was noted that the text in square brackets referred to the obligations of third parties. Considerable support was

expressed in favour of addressing the obligations of third parties in the draft guide. While those obligations might include an obligation to deliver books and records belonging to or relating to the debtor and to surrender property of the debtor in the possession of the third party, it was noted that the obligations of third parties might differ from the corresponding obligations of the debtor. For example, it was suggested that the provision of information might need to be more specifically defined by reference to its relevance to the proceedings.

76. It was observed that given the importance of participation of the debtor in reorganization proceedings, the word “may” should be replaced by “should” in recommendation 70. That proposal was supported. It was also proposed that some distinction might need to be made between liquidation and reorganization, as the latter procedure required a more active participation, and the provision of information was more important to the success of the procedure.

77. With respect to recommendation 71, support was expressed in favour of adding a number of additional obligations. Those included an obligation of the debtor not to leave its habitual residence; to provide information on any ongoing court or administrative proceedings, including enforcement proceedings; to surrender property and business records; and to provide information on transactions occurring during the suspect period. With respect to the surrender of property, it was suggested that that obligation would need to be cross-referenced to recommendation 24 and limited to property that comprised the insolvency estate, whether domestic or foreign. With respect to foreign property, the suggestion was made that a reference to the Model Law on Cross-Border Insolvency and the appointment of a foreign representative might be appropriate. Both of those proposals were supported. It was also suggested that some consideration should be given to the relationship between recommendations 71 and 73 and to indicating where the different obligations would be relevant to the types of procedures included in recommendation 73.

78. Wide support was expressed in favour of including an additional recommendation that made reference to recommendation 25 and the debtor’s right to retain personal property needed for daily survival.

79. The Working Group agreed that the duty of confidentiality in recommendation 72 should extend to information in the control of the debtor but belonging to a third party and to information relating to trade secrets irrespective of whether that information belonged to the debtor or a third party.

80. Some support was expressed in favour of deleting recommendation 73(c) on the basis that it described a particularly specialized type of procedure, which relied on a well-developed court structure. The view was expressed that it was not an option that should be recommended without considerable explanation and background information. In response, however, it was agreed that since recommendation 73 merely set forth different options, all three paragraphs should be retained. It was noted, however, that some reference might be made to different levels of supervision

that could be provided in such an approach and to the protections that operated in conjunction with that approach.

81. Support was expressed in favour of retaining recommendation 74 and for an addition to the effect that the insolvency law should also provide for actions taken in violation of the obligations to be invalid. It was also suggested that the recommendation should apply to both individual and corporate debtors.

B. The insolvency representative

82. Some support was expressed in favour of giving more prominence in recommendation 76 to appointment of the insolvency representative by creditors. In response to suggestions that that approach might lead to compromise of the insolvency representative’s independence, the attention of the Working Group was drawn to the protections already included in recommendations 77, 79 and 80(d). A contrary view was that the guide already adequately addressed the interests of creditors and the recommendation should be retained as drafted.

83. With regard to recommendation 77, some support was expressed for the view that a conflict of interest should disqualify an insolvency representative from acting. A contrary view was that although conflicts of interest should be disclosed, the issue of disqualification should ultimately be determined by the court. An additional suggestion was that the recommendation should include a requirement that the insolvency representative be independent of other interests. It was proposed that those requirements concerning conflict of interest and independence should extend to persons employed by the insolvency representative.

84. It was proposed that the obligations of the insolvency representative in recommendation 78 should be cross-referenced to the recommendations concerning the debtor and corresponding obligations for the insolvency representative to take action should be included, such as to take possession of books and records. Further proposals, which received some support, were that the chapeau should include a reference to the general obligations to maximize the value and protect the security of the estate; that the paragraphs should be reorganized to reflect a hierarchy of importance ((i) for example, should be included more prominently); that subparagraph (b) should provide for the insolvency representative to conduct an examination of the debtor (whether under oath or some equivalent procedure); that subparagraph (g) should clarify the parties to whom the information should be provided; that the insolvency representative should be required to provide regular reports to creditors on the progress of the proceedings; and that the insolvency representative could exercise rights for the benefit of the estate in respect of court proceedings under way but to which the stay and suspension applied; and that subparagraph (j) could provide for the creditor committee also to refer matters to the insolvency representative.

85. With respect to recommendation 79, some support was expressed in favour of including more detail in terms of liability arising from recommendations 77 and 78.

86. Some concern was expressed as to the meaning of “circumstances” in recommendation 80.

87. With respect to recommendation 84, it was suggested that the terms of the right of review described by reference to footnote 14 were too broad and required further consideration.

88. A general issue as to the treatment of assetless estates was discussed. The Working Group agreed that those estates should be addressed in the guide, in particular because an estate could be assetless as a result of transactions that would be subject to avoidance and the failure to administer such estates might encourage behaviour that the insolvency law otherwise sought to address. It was proposed that the guide should recommend the need to address such estates and indicate the need for a mechanism for administration to be established, whether through a public agency or some other approach. That mechanism would also address appointment and remuneration of the insolvency representative. A related suggestion was that that issue could also be addressed in respect of some cases under the section on commencement.

C. Creditors

89. With respect to section 1, in respect of which no recommendations were yet included in the guide, it was proposed that the different classes of claims should be addressed, in particular the need for the insolvency law to clearly identify classes and their treatment. It was noted in response that such a section would have to be closely linked to the section on distribution.

90. Some concern was expressed in relation to the structure of the recommendations, as recommendations 89 to 96 clearly related to the committee and should be included under that heading.

91. With regard to the functions of the creditor assembly, support was expressed in favour of including the substance of footnote 19 in the recommendation. A further function could relate to verification of claims. Concern was expressed that the recommendations did not clearly address issues such as the relationship between the assembly and the committee, including whether a committee was always required; the distribution of powers between the two bodies; whether the assembly or the committee should be required to exercise the powers and functions listed; sharing of the listed powers and functions with the insolvency representative; a mechanism for convening meetings of the assembly; and resolution of conflicts between the assembly and the committee. It was also observed that some countries used mechanisms for representation of creditors other than the assembly or the committee, which might be reflected in the commentary.

92. It was observed that recommendation 87, although establishing an acceptable principle, was less fundamental than the parallel right of the debtor in recommendation 69. It was suggested that the recommendation should indicate the matters in respect of which the creditors should have a right to be heard. It was also suggested that the recommendation should clarify the individual nature of the right.

93. With respect to recommendation 90, support was expressed for reversing the order of the two sentences and clarifying the language of the first sentence with respect to the limitation on the participation of secured creditors to the extent that they were secured. It was also observed that different approaches might be taken to the participation of secured creditors in liquidation and reorganization, particularly where the secured creditor’s claim was to be restructured and in that situation no limitation should be imposed on its participation.

D. Institutional framework

94. General support was expressed in favour of addressing in the draft guide issues related to the institutional framework required for implementation of the insolvency law. Some concerns were raised, however, as to the manner in which relevant issues would be treated and the level of detail to be included. It was suggested that while discussion should be included in the commentary, no recommendations should perhaps be included in the technical recommendations on the content of the insolvency law. In preparing the commentary, it was proposed that the Secretariat could have regard to the work of other international institutions, in particular the World Bank and IMF. Suggestions as to some of the issues that could be included in the commentary included distribution and balance of responsibility between the participants; case management; supervision of both the insolvency proceedings and the participants in those proceedings, including professionals; disciplinary issues; education and training; and issues of cost-effectiveness and economic functionality. It was proposed that the need for specific recommendations could be further considered when a specific text had been prepared for the Working Group.

5. Management of proceedings

95. As a general remark, it was suggested that chapter V should only include sections A-C, as D and E properly related to resolution of the insolvency proceedings.

A. Treatment of creditor claims

96. It was observed that since subparagraph (e) of the purpose clause included only some examples of different types of claims, but was not exhaustive, it should either be extended to refer to all other claims or all examples should be deleted, leaving only a reference to the treatment of particular claims.

97. With respect to recommendation 99, it was suggested that some reference should be made, as a general principle, to the need to establish a mechanism for admission and treatment of claims and for creditors to file claims (or to establish a procedure by which undisputed claims could be automatically admitted) in order for them to participate in insolvency proceedings, as well as to the treatment of claims in reorganization and post-commencement claims. With regard to the establishment of some alternative mechanism for the admission of undisputed claims, support was expressed in favour of the principle, particularly in

those circumstances where it would be appropriate to avoid the often complex and lengthy procedures associated with filing and verification of claims. However, in response to the suggestion that the accounting records of the debtor could form a sufficient basis for such admission, it was pointed out that the books and records of an insolvent debtor may not be a good source of uncontested information and some other criteria should be found. It was also suggested that footnote 20 was too categorical; in particular it was observed that the claims of tax authorities were often affected by insolvency law, with those claims being limited or subject to some other constraint. It was agreed that the footnote required revision.

98. As a general remark it was noted that the section on treatment of creditor claims did not address the treatment of under-secured claims or the question of whether interest would accrue on claims following commencement.

99. Support was expressed in favour of introducing into recommendation 100 the notion of the equal treatment of similarly situated creditors as contained in recommendation 3. A related suggestion was that the minimization of formalities and easing of restrictions as to the language in which claims might be made, issues that were addressed in the Model Law on Cross-Border Insolvency, should also be reflected in the draft guide.

100. With respect to recommendation 101(b), it was noted that where the claim was not filed until late in the proceedings, the creditor would be required to accept that it could not participate in distributions already made.

101. It was observed that the consequences referred to in recommendation 102 differed between countries and the inclusion in the Guide of some comparative information would therefore be useful.

102. With respect to recommendation 103, it was suggested that provision should be made for situations where parties to a contract had agreed to the time at which conversion of the claim would occur.

103. It was observed that the drafting of recommendations 105 and 107 departed from the general formulation of "The insolvency law should . . ." and should be revised accordingly. With respect to recommendation 105, it was also suggested that the types of review being proposed should be clarified, whether by the court or some other tribunal, and that the insolvency representative could be allowed to take a decision, in the process of verifying the claim, on the question of set-off.

104. Preference was expressed in favour of the second text in square brackets in recommendation 108(b).

105. Some concerns were expressed with respect to recommendation 109. It was suggested that the mere fact of a relationship between the claimant and the debtor would not be sufficient in all cases to justify special treatment of a claim. In some cases such claims would be absolutely transparent and in others they might be suspicious. It was noted that some mechanism might be required to address those related party claims that were suspicious or deserved particular attention and that the draft guide should make it clear

that such treatment was not to be accorded as a matter of course, but would be available in a limited range of situations. It was observed, however, that the treatment of claims described in recommendation 109 did not relate to the admission or rejection of a claim, but to the treatment it might be accorded either at the time of admission or at some later time when it became apparent that the related party had caused harm to the estate. It was suggested that the Working Group should take account of the interrelationship between various recommendations, especially where a number of different approaches were included, such as in recommendation 109. For example, where creditors were to play a role in selection of the insolvency representative, related party creditors should not be entitled to participate. A question was raised as to whether recommendation 109 was to apply to claims generally and whether any distinction should be made between liquidation and reorganization. After discussion, a suggestion was made to redraft recommendation 109 to include subparagraph (a) in the chapeau, as well as some reference to the types of situations in which the recommendation might be applicable, along the following lines: "The insolvency law should specify that claims of related parties should be subject to scrutiny and where justified by reference, for example, to undercapitalization of the debtor or self-dealing, then [insert paragraphs (b) and (d)]." That proposal received some support.

B. Post-commencement finance

106. The Working Group generally agreed that the revised provisions reflected the discussion at its twenty-fifth session. Support was expressed for retaining the reference to unreasonable harm in recommendation 114(a). As a point of clarification, the relevance of the words included in parentheses at the end of recommendation 115 was questioned and it was suggested that the application of the recommendation to a priority given to an unsecured provider of post-commencement finance should be made clear. A further suggestion related to the need to link the recommendations with new finance that might be provided under a reorganization plan.

6. Reorganization: additional issues

A. The reorganization plan

107. As a general observation, it was noted that the recommendations concerning the plan did not address the question of interest on claims and how it might be treated.

108. It was suggested that subparagraph (a) of the purpose clause was somewhat vague and that reference should be made to "the business that was subject to the insolvency law", rather than to "troubled businesses".

109. With respect to recommendation 125, it was suggested that the phrase "but no later than the end of a specified time period" should be replaced by "within a specified time period". The importance of time periods as a mechanism to end the stay on creditor actions if no plan was presented within the period was stressed. Support was expressed in favour of the time period for submission being fixed by the insolvency law rather than by the court.

110. The reference in recommendation 126 to the need to identify the party “responsible for preparation of the reorganization plan” was felt to be inappropriate and the phrase “identify the parties capable of preparing” was proposed. It was suggested that the recommendation might also address the issue of to whom the proposal for a plan could be made, since it was not always necessary for a plan addressing all creditors to be prepared.

111. It was observed that the word “acceptable” in recommendation 127(b) did not indicate how the question of acceptability was to be addressed and should therefore be deleted.

112. A number of suggestions were made with respect to recommendation 128. These included that subparagraph (a) should require some detail to be provided as to the classes of creditors and treatment of their claims, the terms and conditions of the plan, identification of those who would be responsible for the management of the entity into the future, guarantees to be provided by the debtor, whether the assets would be transferred back to the debtor for implementation of the plan and supervision of the implementation of the plan. It was observed that the reference in recommendation 128(b) to “employment” contracts was different to the terminology used elsewhere in the guide and should be aligned with that terminology.

113. With respect to recommendation 129, it was suggested that the party responsible for drafting the statement should be identified and information as to how and when it would be provided to creditors should be included. The need for clarification as to whether the statement was an explanatory or disclosure statement was noted. It was suggested in that regard that the information to be included was of the kind that might be required for investment purposes in some jurisdictions and it might therefore be more in the nature of a disclosure statement. Words along the lines of “and that the debtor will have cash flow to pay mature debts” were proposed for addition to the end of subparagraph (d).

114. Some clarifications with respect to recommendations 131 and 132 were proposed to reflect more clearly that recommendation 131 addressed approval by creditors of a particular class and recommendation 132 the issue of approval in the context of all classes of creditors. In recommendation 131 it was implicit that if the required majority of a particular class voted in favour of the plan, that class would be regarded as supporting the plan. In recommendation 132, where the required majority was not achieved, the class would be regarded as not approving the plan and would be addressed as dissenting creditors. It was observed that the second criterion concerning lower ranking claims had previously been discussed by the Working Group and some agreement reached to exclude that criterion. All that was required was the criterion included in recommendations 133(b) and 135(b). Further suggestions with respect to recommendation 131 were that the last sentence was not required, that the sentence concerning the combination of amount of claims and number of creditors was too restrictive, and that the reference to voting in person could be expanded to include voting by proxy. It was also noted that some clarification could be provided as to which creditors

should be required to vote on approval of the plan. In respect of recommendation 132, concern was expressed as to the meaning of the words in square brackets at the end and whether, for example, four classes of junior classes could bind two classes of more senior creditors.

115. As a general remark with regard to approval of the plan, it was noted that the recommendations as drafted made reference only to approval by the creditors, not by the debtor. If the debtor was not required to participate in the approval process, it was questioned whether the debtor might not be able, as an interested party, to challenge the plan. In that event, subparagraphs (a) and (c) of recommendation 135 might be relevant. Some support was expressed in favour of clarifying the meaning of “interested parties”.

116. With respect to the issue of confirmation, it was suggested that an additional recommendation might be included concerning the issue of confirmation more generally. That recommendation could then be followed by recommendation 133, redrafted as a positive statement as to when the court should confirm. To the extent that the criteria were not met, the plan could not be confirmed. With regard to subparagraph (b), it was observed that the requirement that the court should not confirm in cases where creditors did not receive as much under the plan as in liquidation was inappropriate as it did not take account of commercial realities. It was suggested that where the requirements of the recommendations concerning notice, preparation of the plan and explanatory statement and voting, as well as subparagraphs (a) and (c) of recommendation 133 had been satisfied, the court should not be able to refuse to confirm. Although the amount to be received might be a factor to be considered by the court, it was pointed out that there were many situations where creditors might agree to receive less under the plan because there were advantages, for example, in receiving an early payment or in the continuing operation of the business of the debtor. In response it was observed that subparagraph (b) was intended only as a protection for those creditors who did not vote to approve the plan. A suggestion to address those issues was to add words to the effect of “absent consent of the affected creditors and considering the costs and delays of liquidation” to subparagraph (b).

117. Some concern was expressed with regard to the relationship between recommendations 133 and 135. It was suggested that since recommendation 135 was capable of applying both to challenges to the approval of the plan and to appeal against the court’s decision to confirm a plan, the draft guide should clearly distinguish the two. It was also suggested that given the requirements for majorities in recommendation 131 and recommendation 132 and the binding nature of the plan under recommendation 134, it was difficult to understand firstly, how recommendation 135 would operate and secondly, the identity of interested parties. Several drafting suggestions to resolve some of those difficulties were made and the Secretariat was requested to prepare a revised text for consideration at a future meeting.

118. Support was expressed for the view that the reference to discharge in recommendation 134 created some uncertainty as to the time at which discharge might be effective,

and might more appropriately be included in recommendations 138 and 139 or amended to indicate that discharge would be effective only after the plan was performed. Some preference was expressed in favour of retaining the reference to commencement of proceedings in the square bracketed text. It was suggested that the recommendations on the effect of approval of the plan should also address proceedings that had been stayed on commencement of insolvency and recovery by the debtor or management of the entity and that the use of the terms shareholders, equity holders and owners should be clarified.

119. Some concern was expressed with regard to the mechanism for approval of an amendment to a plan under recommendation 136, although it was noted in response that it might not prove too difficult in practice to obtain the agreement of creditors. It was also noted that some insolvency laws imposed a materiality threshold for amendments that required approval of creditors and, if the amended plan were to be more favourable to creditors, no approval was required. It was agreed that more guidance might be required as to mechanisms for approval of amendments.

120. With respect to recommendation 137, it was observed that some insolvency laws did not provide for supervision of implementation of the plan by the court, but enabled creditors to appoint a supervisor, an option that might be reflected in the guide.

121. As a point of drafting, it was suggested that recommendation 138(a) should indicate whether termination related to the reorganization proceedings or implementation of the plan. Where reorganization proceedings were converted to liquidation, support was expressed in favour of protecting payments made pursuant to the plan from avoidance in the subsequent liquidation. A further suggestion with respect to recommendation 138(b) was that conversion to liquidation should be mandatory. It was observed that since there were a number of reasons for which the proceedings might be converted to liquidation, these should all be included in a single provision, such as recommendation 10.

B. Expedited reorganization proceedings

122. The Working Group discussed the topic of expedited reorganization proceedings on the basis of document A/CN.9/WG.V/WP.61/Add.1. Wide support was expressed in favour of including such proceedings in the draft guide and discussing their advantages and benefits. It was recalled that such proceedings had been discussed at the previous session of the Working Group and reference was made to the explanatory material set forth in A/CN.9/507, paragraphs 244-246.

123. Some concerns were expressed, however, as to the scope of the proposal contained in A/CN.9/WG.V/WP.61/Add.1, particularly with respect to the types of creditors that would be involved in such a procedure and its effects on those creditors of the debtor whose interests might not be affected by the plan being proposed; the relationship of such a procedure to both informal negotiations and formal insolvency proceedings; and the effects of commencement of such proceedings, in particular application of the stay.

124. To address those concerns, it was proposed, firstly, that the explanatory material included in document A/CN.9/507 should be redrafted to form a purpose clause to introduce the recommendations set forth in document A/CN.9/WG.V/WP.61/Add.1, and secondly, that the drafting of the recommendations should be revised to take account of the Working Group's concerns. That proposal was widely supported.

125. For lack of time, the Working Group was not able to consider chapter V, section C, on distribution following liquidation of assets, section D on discharge and section E on closing and reopening of proceedings.

IV. OTHER ISSUES

A. Intersection of the work of Working Group V (Insolvency law) and Working Group VI (Security interests)

126. The Working Group had before it a report of the Secretary-General (A/CN.9/WG.VI/WP.2/Add.10) on the treatment of security interests in insolvency proceedings prepared for consideration in the context of the legislative guide on secured transactions. The Working Group agreed on the need to ensure a consistent approach by both Working Groups with respect to the treatment of secured interests in insolvency proceedings. It was suggested in that regard that document A/CN.9/WG.VI/WP.2/Add.10 provided a useful summary of the areas in which secured interests intersected with insolvency law and might provide material that could be included in the insolvency guide to clarify the treatment of secured creditors at each step of insolvency proceedings.

127. Support was expressed for the suggestion that core principles that might govern the intersection of the work on insolvency and secured interests could include that the pre-insolvency priority of security rights should be maintained vis-à-vis other creditors; that secured creditors have the right to the economic value of the secured asset to the extent of their security; that enforcement of the secured right should be subject to the stay; that the secured asset could be used by the debtor; and that the debt secured should be able to be modified in reorganization proceedings.

B. Progress of the work on preparation of a legislative guide on insolvency law

128. The Working Group considered the progress of its work on the development of the legislative guide and the likely timing of completion of that work. General satisfaction was expressed with respect to the progress of the work to date.

129. There was some support for the view that the work might be capable of finalization by the meeting of the Commission in 2003 and that the Working Group would be in a better position to make a recommendation on that question at the completion of its twenty-seventh session, in December 2002.

**I. Note by the Secretariat on the draft legislative guide on insolvency law,
working paper submitted to the Working Group on Insolvency Law
at its twenty-sixth session (A/CN.9/WG.V/WP.61 and Add.1 and 2)
[Original: English]**

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BACKGROUND REMARKS

1. The United Nations Commission on International Trade Law (UNCITRAL), at its thirty-second session, in 1999, had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission of the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country had adopted had become a “front line” factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work at an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a

final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That session of the Working Group was held in Vienna from 6 to 17 December 1999.

4. At its thirty-third session, in 2000, the Commission noted the recommendation that the Working Group had made in its report (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Federation of Insolvency Professionals (INSOL International) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the

Secretariat, in cooperation with INSOL International and IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna from 4 to 6 December 2000.

6. At its thirty-fourth session, in 2001, the Commission had before it the report of the Colloquium (A/CN.9/495).

7. The Commission took note of the report with satisfaction and commended the work accomplished thus far, in particular the holding of the Global Insolvency Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

8. The twenty-fourth session of the Working Group on Insolvency Law, which was held in New York from 23 July to 3 August 2001, commenced consideration of that work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504. Work continued at the twenty-fifth session, in Vienna from 3-14 December 2001, the report of which is contained in document A/CN.9/507.

9. The present note sets forth the draft recommendations that will form a part of the legislative guide. Both the text and the order of the recommendations have been revised in light of the discussion of the Working Group at its twenty-fifth session. The order of the recommendations follows document A/CN.9/WG.V/WP.61/Add.2, which sets forth a revised structure for chapter and section headings according to which the commentary contained in documents A/CN.9/WG.V/WP.57 and A/CN.9/WG.V/WP.58 will be revised.

10. Recommendations in the present note have been numbered sequentially from 1 to 139 for ease of discussion. References to relevant paragraphs from the commentary contained in documents A/CN.9/WG.V/WP.57 and 58 are indicated in the chapter and section headings of the recommendations. New sections are also indicated in that manner.

11. The version of the glossary and commentary of the draft guide that will be available to the Working Group is that contained in documents A/CN.9/WG.V/WP.57 and 58. A revised version of the complete draft legislative guide on insolvency law (including glossary, commentary and recommendations) will be prepared for consideration by the Working Group at its twenty-seventh session, in Vienna in December 2002.

DRAFT LEGISLATIVE GUIDE ON INSOLVENCY LAW

EFFECTIVE AND EFFICIENT INSOLVENCY REGIMES

Part One. Key objectives

[A/CN.9/WG.V/WP.57, paras. 15-22]

Recommendations

- (1) The insolvency law¹ should provide both for reorganization of viable businesses and for efficient liquidation of nonviable businesses and those businesses where liquidation is likely to produce a greater return to creditors.
- (2) The insolvency law should be transparent and predictable and facilitate easy access to insolvency processes by reference to clear and objective criteria.
- (3) The insolvency regime should treat similarly situated creditors [equitably][equally].
- (4) The insolvency law should be orderly and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts.
- (5) The insolvency law should require that adequate information be made available in respect of the debtor's situation to enable those supervising the process to assess its financial situation and determine the most appropriate solution.
- (6) The insolvency law should recognize and respect existing creditor rights and establish clear and predictable rules for ranking the priorities of both existing and post-commencement creditor claims.
- (7) The insolvency law should provide rules on cross-border insolvency, including recognition of foreign proceedings, by adopting the UNCITRAL Model Law on Cross-Border Insolvency.

Part Two. Core provisions

I. Introduction

A. Types of insolvency procedures

B. Structure [organization] of the insolvency regime

Relationship between different types of proceedings

- (8) The insolvency regime should address the balance to be struck between liquidation and reorganization and the relationship between these different processes in the insolvency regime. Where that structure includes liquidation and reorganization as distinct procedures which may be separately [initiated] [commenced], the insolvency regime should provide for conversion between these proceedings.

¹The term "law" is intended to refer to a legislative regime for insolvency. All recommendations are directed towards provisions to be included in that insolvency legislation.

*Conversion of proceedings [New section:
see A/CN.9/WG.V/WP.57, paras. 50-57]*

Purpose

The purpose of provisions on conversion between reorganization and liquidation procedures is:

- (a) To provide easy access to the procedure most suited to resolution of the financial situation of the debtor;
- (b) To facilitate the avoidance of abuse of the insolvency process;
- (c) To ensure that the protections of the insolvency law continue to apply to the debtor until its financial difficulties are resolved.

Recommendations

(9) A debtor may convert liquidation proceedings to reorganization proceedings unless the proceedings were previously converted from reorganization proceedings.

(10) Provisions should be included to enable conversion between reorganization and liquidation and the law should establish the circumstances in which conversion may be appropriate, including:

- (a) Where reorganization proceedings are commenced by the debtor in order to avoid or delay liquidation [where the debtor is found to have no honest intention in commencing reorganization];
- (b) Where the debtor fails to cooperate with the insolvency representative in the conduct of reorganization proceedings or otherwise fails to observe its obligations under the insolvency law;²
- (c) Where there is a continuing loss of assets and value and no prospect of reorganization;
- (d) Where the reorganization plan has been rejected by the creditors or denied confirmation by the court; or
- (e) Where the debtor is unable to implement the plan.

II. Application for and commencement of insolvency proceedings

A. Eligibility and jurisdiction [A/CN.9/WG.V/WP.58, paras. 1-9]

Purpose

The purpose of provisions on eligibility and jurisdiction is to establish:

- (a) Which types of debtors can be subject to the [general] insolvency law;
- (b) Which types of debtors may be excluded from the [general] insolvency law;
- (c) Which debtors have sufficient connection to a State to be subject to its insolvency laws.

²This would include failure to prepare a plan within the specified time period where this is an obligation of the debtor under the insolvency law.

Recommendations

Eligibility

(11) The insolvency law should govern insolvency proceedings of all debtors, including State-owned enterprises, which engage in commercial activities.

(12) Exclusions from the application of the [general] insolvency law should be limited and clearly identified in the law.³

Jurisdiction

(13) The insolvency law should specify that a debtor can be subject to an insolvency proceeding if:

- (a) The debtor has its centre of main interests in the State; or
- (b) The debtor has [its] [an] establishment⁴ in the State.

(14) In interpreting the phrase “centre of main interests”, the insolvency law should provide a presumption that, in the absence of proof to the contrary, a legal person’s centre of main interests is in the State in which it has its registered office and a natural person’s centre of main interests is in the State in which it has its habitual residence.

(15) The insolvency law should clearly indicate which court has jurisdiction over insolvency proceedings and over matters arising in the conduct of insolvency proceedings.

B. Application and commencement criteria [A/CN.9/WG.V/WP.58, paras. 10-39]

Purpose

The purpose of provisions on application and commencement criteria is to:

- (a) Facilitate access for debtors and creditors to the remedies provided by the insolvency law;
- (b) Establish application and commencement criteria that are transparent and certain;
- (c) Enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and inexpensive manner;
- (d) Establish effective requirements for notification of commencement of proceedings;
- (e) Establish basic safeguards to protect both debtors and creditors from improper use of the [insolvency law] [the application procedure].

³Highly regulated entities such as banks and insurance companies may require specialized treatment which can appropriately be provided in a separate insolvency regime or through special provisions in the general insolvency law. Where a special regime or special provisions have been developed, those entities may be excluded from the provisions of the general insolvency regime.

⁴“Establishment” should be defined to mean any place of operations where the debtor carries out non-transitory economic activity with human means and goods or services: UNCITRAL Model Law on Cross-Border Insolvency, art. 2(f).

*Recommendations**Eligibility for application*

(16) The insolvency law should provide that an application to commence insolvency proceedings is to be made to the [appropriate] [specified] court and clearly state who may make an application. This should include the debtor and creditors.

Commencement criteria

(17) The criteria for commencement of insolvency proceedings should be:

(a) In the case of a debtor application, that the debtor is or will be unable to pay its mature debts [or alternatively, that its liabilities exceed the value of its assets];

(b) In the case of a creditor application, that the debtor is unable to pay its mature debts [or alternatively, that its liabilities exceed the value of its assets].

(18) The insolvency law should provide that if the debtor fails to pay one or more of its mature debts, the debtor is presumed to be unable to pay its debts.⁵

Commencement on debtor application

(19) Where the application for commencement is made by the debtor, proceedings should be commenced by either:

(a) The application functioning as automatic commencement of proceedings; or

(b) The court, which should be required to promptly determine whether the insolvency proceeding should be commenced.

Commencement on creditor application

(20) Where the application for commencement is made by a creditor, the insolvency law should require that:

(a) Notice of the application promptly be given to the debtor;

(b) The debtor be given the opportunity to respond to the application; and

(c) The court promptly determine whether the insolvency proceedings should be commenced.

Notification of commencement

(21) Notice of the commencement of insolvency proceedings should be given to creditors and published in [a publication such as the official government gazette or a widely circulated national newspaper].

(22) Known creditors should be notified individually, unless the court considers that, under the circumstances, some other or additional form of notification would be more appropriate. The notification to creditors should specify:

(a) Any applicable time period for submitting a claim, the manner in which the claim should be made and the place at which the claim can be submitted;

(b) The procedure and any form requirements necessary for submitting a claim; and

(c) The consequences of the failure to submit a claim.

(23) The insolvency law should allow the court to deny an application or refuse to commence proceedings if the court determines that:⁶

(a) The application is an improper use of the insolvency law; or

(b) In an application for liquidation, [that the debtor is solvent] [that the commencement criteria have not been met].

*III. Treatment of assets on commencement of insolvency proceedings**A. Assets to be affected [A/CN.9/WG.V/WP.58, paras. 40-45; 50]**Purpose*

The purpose of provisions relating to assets affected by the commencement of insolvency proceedings is to:

(a) Identify those assets that will constitute the insolvency estate;

(b) Indicate the manner in which rights in those assets will be affected by the commencement of insolvency proceedings;

(c) Identify those assets that will specifically be excluded from the insolvency estate;

(d) Indicate the manner in which assets owned by third parties and assets subject to a security interest will be affected by the commencement of insolvency proceedings.

*Recommendations**Assets constituting the insolvency estate*

(24) The assets constituting the insolvency estate should include:

(a) Assets owned by the debtor, including both tangible and intangible assets, irrespective of whether they are in the possession of the debtor and whether they are subject to a security interest in favour of a creditor [determined in accordance with the property and secured transactions law of the State]; and

(b) Assets acquired after commencement of the insolvency proceedings.

⁵Where the debtor has not paid a mature debt and the creditor has obtained a judgement against the debtor in respect of that debt, there would be no need for a presumption to establish that the debtor was unable to pay its debts.

⁶In certain circumstances it may be appropriate for the proceedings, once commenced, to be converted from liquidation to reorganization or from reorganization to liquidation: see chap. I, sect. B.

Assets that may be excluded: natural persons

(25) Where the debtor is a natural person, the insolvency law should specify the assets to be excluded from the insolvency estate, specifically those required to preserve the personal rights of the debtor, which may include assets acquired after commencement of the insolvency proceedings.

B. Protection and preservation of the insolvency estate
[A/CN.9/WG.V/WP.58, paras. 53-79 and 81-83]

Purpose

The purpose of provisions on protection and preservation of the insolvency estate is to:

(a) Provide for the application of measures that will ensure the assets are not diminished by the actions of the [various interested parties] [debtor, creditors or third parties];

(b) Determine the scope of those measures and the parties to whom they will apply;

(c) Establish the conditions for application of those measures, including method, time and duration of application;

(d) Establish the grounds for relief from the application of those measures.

Recommendations

Provisional measures

(26) The insolvency law should provide that the court may grant relief of a provisional nature, at the request of any interested party, [where relief is urgently needed to protect the assets of the debtor or the interests of the creditors,] between the filing of an application to commence insolvency proceedings and commencement of the proceedings, including:

(a) Staying execution against the debtor's assets;

(b) Entrusting the administration of realization of all or part of the debtor's assets to an interim insolvency representative or other person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and

(c) Any other relief mentioned in recommendation (28)(c).

(27) Where provisional measures of the kind referred to in recommendation (26) are granted by the court they should terminate when the measures referred to in recommendation (28) take effect.

*Measures automatically applicable on commencement*⁷

(28) Upon the commencement of insolvency proceedings, the insolvency law should provide that:

(a) Commencement or continuation of individual actions or proceedings concerning the debtor's assets, rights, obligations or liabilities [except to the extent those individual actions or proceedings are considered necessary by the court to preserve or quantify a claim against the debtor] are stayed;

(b) Execution against the debtor's assets is stayed; and

(c) The debtor's right to transfer, encumber or otherwise dispose of any assets is suspended.⁸

*Discretionary measures on commencement*⁹

(29) The insolvency law should provide that, where necessary to protect the interests of the creditors, assets of the debtor, or the ability to reorganize the debtor's business, the court may, following the commencement of insolvency proceedings, grant additional relief.

Time and duration of application

(30) The insolvency law should clearly state the specific time at which measures referred to in recommendations (26) and (28) become effective.¹⁰

(31) The insolvency law should provide that the measures applicable on commencement of insolvency proceedings (of the kind referred to in recommendation (28)), will apply (subject to recommendation (32)):

(a) For the duration of the insolvency proceedings;

(b) In respect of secured creditors in liquidation proceedings, for a period of [30-60] days, unless the court extends that period [for an additional [...] day period] upon a showing that:

(i) An extension is necessary to maximize the value of assets for the benefit of creditors; and

(ii) The secured creditor will not suffer unreasonable harm as a result of an extension;

Secured creditors

(32) The insolvency law should provide that a secured creditor is entitled to relief from the type of measures referred to in recommendation (28)(a) and (b) on grounds that may include:

(a) That the economic value of the secured asset is eroding [or the asset is not protected against the erosion of its value];

(b) That the secured asset has no value to the estate and is not necessary either to a reorganization of the debtor's business or a sale of the business as an ongoing business concern;

⁸The limitation on the debtor's right to transfer or dispose of property may be subject to an exception for those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

⁹See art. 21, UNCITRAL Model Law on Cross-Border Insolvency.

¹⁰For example, at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time.

⁷See art. 20, UNCITRAL Model Law on Cross-Border Insolvency.

(c) That there is no reasonable prospect for a reorganization of the debtor's business;

(d) That, in reorganization, the plan is not approved within [...] days.

(33) Protection against diminution of the value of secured assets may be provided by cash payments, provision of additional security or such other means as the court determines will provide such protection.

Modification or termination of measures

(34) The insolvency law should provide that the court may, at the request of the insolvency representative or any person affected by measures of the kind referred to in recommendations (26) and (28), or at its own motion, modify or terminate those measures.

C. Use and disposition of assets [New section: A/CN.9/WG.V/WP.58, paras. 46-49; 51; 80; 115]

Purpose

The purpose of provisions on use and disposition of assets is to:

(a) Address the manner in which assets may be used and disposed of in the insolvency proceedings, including methods for sale of assets;

(b) Establish the limits to powers of use and disposition;

(c) Provide for the abandonment of burdensome assets and for the surrender of unprofitable securities.

Recommendations

(35) When continued operation of the business of the debtor is authorized under liquidation or reorganization, the insolvency law should:

(a) Permit the insolvency representative to sell or lease property in the ordinary course of business;

(b) Permit the insolvency representative to use, sell or lease property other than in the ordinary course of business, subject to approval by [the court] [creditors] [and in accordance with recommendations on the use of secured assets and third-party assets].

Assets subject to security interests and third-party-owned assets

(36) Assets subject to security interests [secured assets] and assets owned by a third party that are in the possession of the debtor at the date of commencement may be used by the insolvency representative where those assets [will be of benefit to][are necessary for] the conduct of the insolvency proceedings.¹¹

¹¹The use of these assets will be subject to other provisions of the insolvency law including those relevant to treatment of contracts, avoidance and [...].

Abandonment and surrender

(37) The insolvency law should permit the insolvency representative to abandon any assets that are burdensome to the estate or that are not of benefit to the estate.

(38) The insolvency law should permit the insolvency representative to surrender assets subject to a valid security interest to the secured creditor where the asset is determined to be of no value to the insolvency estate or cannot be realized in a reasonable period of time by the insolvency representative.

Methods for sale of assets

(39) The insolvency law should provide for methods of sale that will maximize the value of the assets being sold, permitting both public auctions and private sales and requiring that adequate notice of any sale be provided to creditors. Private sales may be subject to supervision by the court or approval by creditors.

[Ability to sell free and clear of security interests, charges and other encumbrances]

(40) The insolvency law may permit the insolvency representative to sell assets of the insolvency estate free and clear of any interest of an entity other than the estate, subject to certain conditions. These may include that law other than insolvency law permits such a sale; the entity consents; the priority of interests in the proceeds of sale of the asset is preserved; [...].

D. Treatment of contracts [A/CN.9/WG.V/WP.58, paras. 84-114]

Purpose

The purpose of provisions on treatment of contracts is to:

(a) Establish the manner in which contracts that have not or not fully been performed by either the debtor and its counterparty should be addressed in the insolvency law, including the relationship between the insolvency law and general contract law, with the objective of maximizing the value and reducing the liabilities of the estate;

(b) Define the scope of the powers to deal with those contracts and the situations in which those powers may be exercised;

(c) Identify the contracts that should be excluded from the exercise of those powers.

Recommendations

(41) The insolvency law should address the treatment of contracts that have not or not fully been performed by either the debtor and its counterparty.

(42) The insolvency law may render unenforceable as against the insolvency representative any contract provision that would provide a right to terminate a contract upon, or identify as an event of default:

- (a) The commencement of, or application for commencement of, insolvency proceedings; or
- (b) The appointment of an insolvency representative.

Continuation

(43) The insolvency law should provide that the insolvency representative can [elect to] continue a contract where continuation would be beneficial to the insolvency estate.

(44) In the period after the commencement of an insolvency proceeding, and before a contract is continued or rejected, if the counterparty has performed to the benefit of the insolvency estate, the insolvency law should provide that the benefits conferred upon the insolvency estate pursuant to the contract are payable as an expense of administering the estate.¹²

(45) Where a contract is continued, the insolvency law should provide that damages for the subsequent breach of that contract should be payable as an expense of administering the estate.

Continuation of contracts where the debtor is in breach

(46) Where the debtor [is in default under][has breached] a contract, and the insolvency representative seeks to continue that contract, the insolvency law may take different approaches to the issue of curing the breach:

(a) The insolvency representative may have the power to [elect to] continue that contract, provided the default is cured and the non-breaching counterparty is returned to the position it was in before the breach, and the insolvency representative gives appropriate assurances as to the [debtor's][insolvency estate's] ability to perform under the continued contract;

(b) The insolvency representative may have the power to [elect to] continue that contract without having to cure the breach, provided the insolvency representative gives assurance as to satisfaction of post-commencement claims arising from the contract. The counterparty [should submit][will have] a pre-commencement claim in respect of the default.

Rejection

(47) The insolvency law should provide that the insolvency representative can elect to reject a contract.

(48) Where a contract is rejected, the insolvency law should provide that the rejection gives rise to a [ordinary unsecured] [pre-commencement] claim for the damages arising from the rejection, which would be determined in accordance with the general rules on damages. [Claims relating to the rejection of a long-term contract may be limited by the insolvency law.]

Timing of continuation and rejection

(49) Where the insolvency representative elects to reject a contract, the insolvency law should indicate the date on which the rejection will be effective.

(50) The insolvency law may provide a time limit within which the insolvency representative is to act to elect to continue or reject a contract, which time period may be extended by the court. The insolvency law may specify the consequences of the failure of the insolvency representative to act.

Assignment of contracts

Variant A

(51) [The insolvency law need not provide rules relating to assignment of contracts if this issue is addressed by other law, such as general contract law, and it is considered that such issues should be determined by the application of that other law.]

(52) Where it is considered desirable to have special provisions relating to assignment of contracts in the insolvency law, the insolvency law might provide that the insolvency representative can [elect to] assign a contract that has been continued.

(53) Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:

(a) The assignee can perform the contractual obligations;

(b) The counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment;

(c) The assignment is necessary for the reorganization of the debtor.

Variant B

(51) The insolvency law [may][should] provide that the insolvency representative can [elect to] assign a contract that has been continued.

(52) Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:

(a) The assignee can perform the contractual obligations;

(b) The counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment;

(c) The assignment is necessary for the reorganization of the debtor.

Special treatment of certain contracts

(54) The insolvency law may provide special rules for the treatment of labour and [...] contracts.¹³

¹²See chap. V, sect. C.

¹³For treatment of financial and related contracts, see chap. III, sect. F.

Review of decisions concerning treatment of contracts

(55) The insolvency law should permit interested parties to seek judicial review of decisions taken by the insolvency representative with respect to continuation and rejection. Grounds for review may include: [...].¹⁴

E. Avoidance action
[A/CN.9/WG.V/WP.58, paras. 142-151]

Purpose

The purpose of avoidance provisions is to:

- (a) Preserve the integrity of the estate and the fair treatment of creditors;
- (b) Establish the circumstances in which transactions [occurring] prior to the commencement of insolvency proceedings involving the debtor may be considered injurious and therefore subject to avoidance;
- (c) Enable the insolvency representative to take proceedings to avoid those transactions;
- (d) Facilitate the recovery of money or assets from persons involved in transactions that have been avoided.

Recommendations

(56) The insolvency law should include provisions which apply retrospectively and are designed to overturn past transactions to which the debtor was a party and which have the effect of either reducing the net worth of the debtor or of upsetting the principle of fair treatment of creditors.

Transactions subject to avoidance

(57) The insolvency law should provide that the insolvency representative may commence proceedings in court to set aside as void the following types of transactions:

- (a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims by transferring assets to any third party where the third party knew of that intent (fraudulent transactions);
- (b) Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was made in exchange for a nominal or less than equivalent value (undervalued transactions) which occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent; and

(c) Transactions involving creditors where the creditor obtains more than its pro rata share of the debtor's assets (preferential transactions) which occurred at a time when the debtor was insolvent.

Establishing the suspect period

(58) The insolvency law should establish that a transaction with the characteristics described in recommendation (57) may be set aside if it occurred within a specified period (the suspect period) [prior to] [calculated retrospectively from] the [application for] commencement of the insolvency proceeding. The insolvency law may specify different suspect periods for different types of transactions.

Time limitations on commencement of avoidance actions

(59) Following commencement of the insolvency proceedings the period within which an avoidance action may be commenced in respect of a transaction of which the insolvency representative is aware, may be limited by the insolvency law or by applicable procedural law.

Evidentiary issues

(60) The insolvency law should specify the elements to be proved in order to establish a case for avoidance and also possible defences to those actions.

Related person¹⁵ transactions

(61) The insolvency law should provide that the insolvency representative may commence proceedings in court to set aside as void undervalued and preferential transactions involving related persons.

(62) The insolvency law should clearly establish the suspect period for the types of transactions referred to in recommendation (61), which would generally be longer than the time periods applicable to both undervalued and preferential transactions that do not involve related persons.

(63) The insolvency law may provide that special evidential presumptions apply in the case of avoidance actions against related persons.

Pursuit of avoidance actions

(64) The insolvency law may provide alternative approaches to address situations where the insolvency representative does not pursue an avoidance action either on the basis of an assessment that the action is not likely to succeed or that it will impose costs upon the insolvency estate. These approaches may include permitting individual

¹⁴Note to the Working Group: The Working Group may wish to consider whether this type of provision should be included under each topic heading (see, for example, recommendations (64) and (83)) or as a general provision, perhaps under chap. IV, sect. B, on the insolvency representative along the following lines: "The insolvency law need not provide rules relating to the right of interested parties to seek review of decisions taken by the insolvency representative in the administration of the proceedings if that right to review exists under other law and it is considered that that issue should be determined by the application of that other law. Where it is considered desirable for reasons of clarity and transparency to include special provisions in the insolvency law, the insolvency law might provide also the grounds upon which such a review might be sought."

¹⁵Note to the Working Group: The Working Group may wish to consider including the term "related party" in the glossary, with a definition along the following lines: "A related person means a person who is or has been a director or officer of a corporation in liquidation, a shareholder or member of such corporation, a director or officer or shareholder of a corporation that is related to the corporation in liquidation, and includes any relative of such a person; a 'relative' in relation to a related person means the spouse, parent, grandparent, son, daughter, brother or sister of the related person."

creditors or the creditor committee to pursue the actions and allowing the creditor(s) who pursue the action to retain an amount of any sum recovered towards satisfaction of their claim, or to pay the costs of the action from the insolvency estate in the event that the action is successful or to change the priority of the claim of the creditor pursuing the action.

Review of decisions concerning avoidance

(65) The insolvency law should permit interested parties to seek judicial review of decisions taken by the insolvency representative with respect to avoidance. Grounds for review may include: [...].

F. Financial contracts: netting and set-off [A/CN.9/WG.V/WP.58, paras. 116-123]

(66) In general, netting and close-out arrangements should be legally protected and should, to the greatest extent possible, not be unwound.

(67) A pre-commencement right of set-off existing under general law should be protected during liquidation proceedings and generally should be exercisable by both creditors and the insolvency estate. Moreover, the law should also permit post-commencement set-off if the mutual claims arise under the same [transaction] [agreement]. In addition, countries may also wish to consider allowing for post-commencement set-off in other circumstances, particularly with respect to mutual financial obligations that derive from financial contracts¹⁶ defined by law.¹⁷

(68) In countries where post-commencement set-off is not permitted for mutual financial obligations or where the insolvency representative is able to interfere with contract termination provisions, it may be necessary to make an exception to these rules so that “close-out netting” provisions contained in financial contracts between the debtor and another party can be applied with certainty.¹⁸

IV. Participants and institutions

A. The debtor [A/CN.9/WG.V/WP.58, paras. 152-170]

Purpose

The purpose of provisions concerning the debtor is to:

(a) Establish the rights and obligations [responsibilities] of the debtor [and persons associated with the debtor] during the continuation of the insolvency proceedings;

¹⁶The definition from the United Nations Convention on Assignment of Receivables in International Trade, 2001, art. 5(k), provides: “Financial contract” means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above.

¹⁷See *Orderly and effective insolvency procedures*, International Monetary Fund publication, 1999: Principal conclusion, p. 43.

¹⁸*Ibid.*, p. 44.

(b) Address the remedies available for failure of the debtor to meet its obligations;

(c) Address issues relating to management of the debtor in both liquidation and reorganization.

Recommendations

Right to be heard

(69) The insolvency law should provide that [in both liquidation and reorganization proceedings,] the debtor has a right to be heard in the proceedings.

Right to participate and request information

(70) The insolvency law may also provide that the debtor is entitled to participate in insolvency proceedings, particularly reorganization proceedings, and to request information from the insolvency representative and the court.

Obligations

(71) The insolvency law should clearly identify the debtor’s obligations in respect of both liquidation and reorganization proceedings. The debtor’s obligations should include:

(a) To cooperate with and assist the insolvency representative to perform its duties;

(b) To provide accurate, reliable and complete information relating to its financial position and affairs that might reasonably be requested by the court, the insolvency representative or the creditor committee;

(c) To enable the insolvency representative to take effective control of the insolvency estate;

(d) To prepare a list of creditors and their claims in cooperation with the insolvency representative and revise and amend the list as claims are processed.

Confidentiality

(72) Where information provided by the debtor is commercially sensitive, appropriate provisions to protect confidentiality should apply, whether set forth in the insolvency law or applicable procedural law.

Continued operation of the debtor’s business

(73) The law should address the issue of the role to be played by the debtor in the continuing operation of the business. Different approaches may be taken, including:

(a) Total displacement of the debtor from any role in the business and the appointment of an insolvency representative;

(b) Limited displacement where the debtor may continue to operate the business on a day-to-day basis, subject to the supervision of an appointed insolvency representative, in which event the division of responsibilities between the debtor and the insolvency representative should be specified in the insolvency law;

(c) Retention of full control of the business (debtor-in-possession) with no insolvency representative appointed,

with provision for displacement of the debtor in specified circumstances.

Sanctions for failure to comply

(74) The insolvency law should provide sanctions for the debtor's failure to comply with the specified obligations.

B. The insolvency representative [A/CN.9/WG.V/WP.58, paras. 171-186]

Purpose

The purpose of provisions concerning the insolvency representative is to:

- (a) Specify the qualifications required for appointment as an insolvency representative;
- (b) Establish a mechanism for the appointment of insolvency representatives;
- (c) Define the powers and functions of the insolvency representative;
- (d) Provide for the liability, removal and replacement of an insolvency representative.

Recommendations

Qualifications

(75) The insolvency law may specify the qualifications and personal qualities required for appointment as an insolvency representative. Relevant criteria include that the insolvency representative is independent and impartial, has the requisite knowledge of relevant commercial law and has experience in commercial and business matters.

Appointment

(76) The insolvency law should establish the mechanism for appointment of the insolvency representative on commencement of the proceedings. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of law, where the insolvency representative is a government or administrative agency or official.

Conflict of interest

(77) The insolvency law should require a person proposed for appointment as an insolvency representative to disclose circumstances that may lead to a conflict of interest or lack of independence.

Powers and functions

(78) The insolvency law should clearly specify the insolvency representative's powers and functions including:

- (a) Control of the inventory, collection, sale and distribution of assets;
- (b) Obtaining information concerning the debtor, its assets, liabilities, past transactions and [...];

(c) Ensuring the debtor's compliance with its obligations;

(d) Assisting the debtor to prepare a list of creditors and their claims and ensuring that the list is revised and amended as claims are admitted;

(e) Verification and admission of claims;

(f) Management of the business in reorganization and in liquidation where the business is to be sold as a going concern;

(g) Provision of information and reporting on the conduct of the proceedings;

(h) Appointment and remuneration of professionals to assist the insolvency representative;

(i) General administration of the estate;

(j) Other matters as determined by the court.

Liability

(79) The insolvency law should address the consequences, including possible personal liability for, or arising from, the insolvency representative's failure to perform or the performance of its powers and functions.

Removal and replacement

(80) The insolvency law should establish the circumstances in which the insolvency representative can be removed and the procedure for removal. Circumstances in which the insolvency representative may be removed include:

(a) For incompetence, negligence, failure to perform or failure to exercise the proper degree of care in the performance of its powers and functions;

(b) Where it is found that the specific insolvency proceedings require a particular or different competency that the appointed representative does not have;

(c) Where the insolvency representative has engaged in illegal acts; or

(d) Where conflicts of interest arise in circumstances that would justify removal.

(81) The procedure for removal of the insolvency representative will reflect the manner in which the insolvency representative was appointed, but may include removal by the court on an application by the creditors or the creditor committee; removal by the court on its own motion; removal by the creditors where the creditors have appointed the insolvency representative and [...].

(82) In the event of the death, resignation, inability to perform or removal of the insolvency representative, the insolvency law should provide for appointment of a successor.

Remuneration

(83) The insolvency law should provide for the remuneration of the insolvency representative, specify a mechanism for fixing that remuneration and establish priority for payment of that remuneration.

Judicial review

(84) [A general provision for review of decision taken by the insolvency representative for example, on treatment of contracts, avoidance actions, admission of claims, etc. see footnote 14]

*C. Creditors [A/CN.9/WG.V/WP.58, paras. 192-212]**1. Categories of creditors and their claims**2. Participation of creditors in insolvency proceedings**Purpose*

The purpose of provisions on participation of creditors in insolvency proceedings is to:

(a) Establish the functions and responsibilities of the general body of creditors;

(b) Provide for the participation in insolvency proceedings of the general body of creditors by the appointment of a creditor committee;

(c) Provide a mechanism for the appointment of a committee;

(d) Establish the functions and responsibilities of the creditor committee.

*Recommendations**General body of creditors [assembly of creditors]*

(85) The insolvency law should establish the powers and functions of the general body of creditors. These should include:

(a) Approval or rejection of a reorganization plan;

(b) [Involvement in] [advising on] issues referred by the insolvency representative.¹⁹

(86) The insolvency law should specify the matters on which a vote of the general body of creditors is required and establish the relevant voting requirements.

(87) Creditors should have the right to be heard in the insolvency proceedings.

Creditor committee

(88) The insolvency law should provide for the general body of creditors to actively participate in the insolvency proceedings through a creditor committee. Where the interests and categories of creditors involved in the insolvency proceeding are diverse and participation will not be facilitated by the appointment of a single committee, the insolvency law may provide for the appointment of different creditor committees.

Creditors that may be appointed

(89) The insolvency law should specify the categories of creditors that may or may not be appointed to the committee. The creditors who [may] [should] not be appointed to the creditor committee would include related persons such as creditors related to the debtor (whether personally or as a director, manager or adviser of the debtor) and creditors with a personal interest in the affairs of the debtor where that interest has the potential to affect the creditor's impartiality in carrying out the functions of the committee (for example, a competitor of the debtor).

Participation of secured creditors

(90) Where secured creditors have surrendered their security to the insolvency representative, the insolvency law should enable them to participate in the proceedings to the same extent as ordinary unsecured creditors. Where secured creditors rely on secured assets to pay part or all of their claims, the insolvency law should limit their participation in the proceedings.

Mechanism for appointment

(91) The insolvency law should establish the mechanism for appointment of the creditor committee. Different approaches may include selection of the creditor committee by the general body of creditors or appointment by the court or other administrative body.

Functions

(92) The insolvency law should establish the powers and functions of the creditor committee including:

(a) In both liquidation and reorganization proceedings, a general advisory function, providing advice and assistance to the insolvency representative;

(b) A supervisory function with respect to development of the reorganization plan, the sale of significant assets and in other matters as directed by the court or determined in cooperation with the insolvency representative;

(c) The right to be heard in insolvency proceedings.

Employment and remuneration of professionals

(93) The insolvency law should permit the creditor committee, subject to approval by [the court] [the general body of creditors], to employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions.

Liability

(94) The insolvency law should provide that members of the creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found, for example, to have acted fraudulently.

¹⁹These issues may include advising on continuation of the business in liquidation; distribution of assets; post-commencement financing; compensation of professionals; treatment of judicial proceedings to which the debtor was a party at the time of commencement; and [...].

Removal and replacement

(95) The insolvency law should provide for removal and replacement of members of the creditor committee and specify the grounds, including [gross] negligence, [lack of the necessary skills], [incompetence or inefficiency].

Procedural rules for the committee

(96) The insolvency law may provide for the establishment of rules to govern the performance of the functions and decision-making of the creditor committee, including rules relating to majorities and voting.

D. Institutional framework
[New section]

Recommendations

(97) The insolvency law should address the institutional framework required for implementation of the insolvency law.

(98) To ensure that the insolvency law is applied with predictability, the insolvency law should provide adequate guidance on how the court or other body supervising the insolvency process should exercise its powers and functions under the insolvency law.

V. Management of proceedings

A. Treatment of creditor claims
[A/CN.9/WG.V/WP.58, paras. 213-252]

Purpose

The purpose of provisions on treatment of creditor claims is to:

- (a) Define the claims that can be submitted;
- (b) Enable persons who have a claim against a debtor to make claims against the insolvency estate;
- (c) Establish a mechanism for verification and admission or rejection (in full or in part) of claims;
- (d) Provide for review of disputed claims;
- (e) Establish the treatment of particular claims, including those of secured creditors, foreign creditors, creditors whose claims are in a foreign currency, conditional or non-monetary claims, claims for interest, and claims in respect of non-mature liabilities.

Recommendations

(99) Claims that may be submitted should include all rights to payment which arise from acts or omissions by the debtor prior to commencement of the insolvency proceedings, whether mature or unmature, whether of a determined [liquidated] or undetermined [unliquidated] amount, whether fixed or contingent. The insolvency law should identify claims that will not be affected by the insolvency proceedings.²⁰

²⁰These claims may include, for example, fines, penalties and taxes. The claims will continue to exist and would not be included in any discharge.

Equal treatment

(100) The insolvency law should provide that all creditors, including foreign creditors, are treated equally with respect to the submission and treatment of claims.

Timing of claims

(101) The insolvency law should establish the time in which claims can be submitted, either:

(a) Within a specified time after [the commencement of proceedings] [notice of commencement of proceedings]; or

(b) At any time prior to final distribution or at a specified time prior to the consideration of a reorganization plan.

Consequences of failure to claim

(102) The insolvency law should address the consequences that apply where a claim is not submitted within the specified time.

Foreign currency claims

(103) In respect of foreign currency claims, the insolvency law should indicate whether the conversion of the claim into local currency would be determined by reference to the time of the application for or the commencement of insolvency proceedings.

Evidence of claims

(104) The insolvency law should provide that a creditor may be required to provide evidence of its claim to the court or alternatively, to the insolvency representative without having to personally appear.

Admission or rejection of claims

(105) The insolvency law should provide for admission or rejection of any claim, in full or in part, by the insolvency representative. Where the insolvency representative rejects a claim it should be required to give reasons for the rejection. Creditors whose claims have been rejected or disputed should have a right to review. An interested party may seek review of the admission of any claim.

Provisional admission

(106) To facilitate the conduct of the proceedings and in particular the voting of creditors, the insolvency law should provide that claims of undetermined value, secured claims and claims disputed in the insolvency proceedings can be provisionally admitted by the insolvency representative pending valuation of the claim, or resolution of the dispute by the court.

(107) Valuation of a claim may be undertaken by the insolvency representative or by the court. Where the valuation is made by the insolvency representative, it should be subject to review by the court where disputed by an interested party.

Effects of admission

(108) The insolvency law should establish the effect of admission, including provisional admission, of a claim. These effects may include:

(a) Permitting the creditor to vote at a meeting of the general body of creditors, including on approval or rejection of a reorganization plan;

(b) Determining the [class in which the creditor is entitled to vote] [the priority to which the creditor's claim is entitled];

(c) Determining the amount for which the creditor is entitled to vote;

(d) Except in the case of provisional admission of a claim, permitting the creditor to participate in a distribution.²¹

Claims by related parties

(109) The insolvency law should specify the treatment to be accorded to claims by related parties. Different approaches may include:

(a) Subjection of the claim to careful scrutiny;

(b) Restriction of the voting rights of the related party;

(c) Subordination of the claim;

(d) Limitation of the amount of the claim.

B. Post-commencement finance and credit
[A/CN.9/WG.V/WP.58, paras. 187-191]

Purpose

The purpose of provisions on post-commencement finance and credit is to:

(a) Permit finance and credit to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor;

(b) Provide appropriate protection for the providers of post-commencement finance;

(c) Provide appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance and credit.

Recommendations

(110) The insolvency law should permit the insolvency representative to obtain post-commencement finance where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor. The insolvency law may provide that authorization of the court is required.

²¹However, when making a distribution, the insolvency representative should take account of claims that have been provisionally admitted, or submitted but not yet admitted (see recommendations on distribution, chap. V, sect. C).

(111) The insolvency law should permit the insolvency representative to obtain post-commencement credit where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the debtor.

Security for post-commencement finance

(112) The insolvency law should enable security to be provided for repayment of post-commencement finance, including security on unencumbered assets and a junior or lower priority security on encumbered assets.

(113) The insolvency law should provide that a security over the assets of the debtor to secure post-commencement finance does not have priority ahead of any existing security over the same assets unless the insolvency representative notifies the existing security holder and obtains their agreement or follows the procedure in recommendation (114).

(114) The insolvency law should provide that where the holder of the existing security does not agree, the court may authorize the [granting] [creation] of that security provided specified conditions are satisfied, including:

(a) That the existing secured creditor has sufficient security in the assets that it will not [be harmed] [suffer unreasonable harm] by a priority given to the post-commencement finance;

(b) The secured creditor was given notice and the opportunity to be heard by the court;

(c) The debtor can prove that it cannot obtain the finance in any other way; and

(d) The interests of the existing security holder will be adequately protected.

Priority for post-commencement finance

(115) The insolvency law should establish the priority that may be provided for post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of payment of ordinary unsecured creditors (an administrative priority).

C. Distribution following liquidation of assets
[A/CN.9/WG.V/WP.58, paras. 253-255]

Purpose

The purpose of provisions on distribution is to:

(a) Establish the order in which claims should be paid from the estate of the debtor following realization of the assets in liquidation;

(b) Ensure that creditors of the same class are treated equally and are paid proportionately out of the assets of the estate.

Recommendations

(116) The insolvency law should establish the order in which claims, other than secured claims, are to be paid

from the estate of the debtor following sale of the assets in liquidation.

(117) The insolvency law should minimize priorities. Where priorities are granted by operation of law other than the insolvency law, they should be clearly set forth in the insolvency law.

(118) Secured claims should be paid from the proceeds of the realization of the security, subject to any claims that are superior in priority, if any.²²

(119) With respect to the payment of classes of claims other than secured claims, the insolvency law should provide that the amount available for distribution to creditors be paid in the following order:

(a) Administrative costs and expenses, including those in connection with the appointment, performance of the powers and functions and remuneration of the insolvency representative and the creditor committee;

(b) Pre-commencement claims with priority;

(c) Ordinary pre-commencement claims;

(d) Deferred or subordinated pre-commencement claims;

(e) The debtor.

(120) With respect to the payment of claims of the same class, the insolvency law should provide, as a general principle, that claims in each class are ranked equally as between themselves. All the claims in a particular class should be paid in full before the next class is paid. If there are insufficient funds to pay them in full they should be paid in proportion.

(121) The insolvency law should provide that distributions be made promptly and that they may be paid as far as possible on an interim or regular basis. In making a distribution an insolvency representative is required to make provision for provisionally admitted claims, and submitted claims that are not yet admitted.

D. Discharge [A/CN.9/WG.V/WP.58, paras. 256-260]

Purpose

The purpose of provisions on discharge is to:

(a) Enable an individual debtor to be finally discharged from liabilities for pre-commencement debts, thus providing the debtor with a fresh start;

²²Note to the Working Group: The European Bank for Reconstruction and Development has suggested that the Guide consider the proposition that a secured creditor should share some of the burden of a financial failure, at least with respect to involuntary creditors, such as tort claimants and employees and in particular where the secured creditor holds an "enterprise mortgage" over every asset of the debtor entity. To this end, the following drafting for the protection of employees' rights is proposed to be added at the end of this recommendation: "... provided, however, that if a secured creditor holds a lien or mortgage over substantially all the assets of the debtor, the proceeds from the realization of the security should be paid first to satisfy all accrued and unpaid employee wage claims (if not otherwise guaranteed by a State agency) and then to satisfy all personal injury claims (not covered by insurance) and then to the secured creditor in accordance with the first clause of this recommendation."

(b) Establish the circumstances under which discharge will be granted and the terms of that discharge.

Recommendations

(122) Where the insolvency law allows the insolvency of individuals engaged in business activity, the issue of discharge of the debtor from liability for pre-commencement debts following [liquidation of the assets of the estate] [termination of the liquidation proceedings] should be addressed. Different approaches may be taken:

(a) The debtor may be discharged completely and immediately where the debtor [is honest] [and] has not acted fraudulently [acts in good faith];

(b) The discharge may not apply until after the expiration of a specified period of time following [distribution] [commencement], during which period the debtor is expected to make a good faith attempt to satisfy its obligations;

(c) Certain debts may be excluded from the discharge, such as those that were not disclosed by the debtor;²³

(d) The discharge may be subject to certain conditions, such as restricting access to new credit or preventing the carrying on of business for a certain period of time.

E. Closing [and re-opening] of proceedings [New section]

(123) After an insolvency estate is fully administered [and the insolvency representative discharged] provision should be made for the insolvency proceedings to be closed.

(124) [reopening]

VI. Reorganization: additional issues

A. The reorganization plan [A/CN.9/WG.V/WP.58, paras. 261-299]

Purpose

The purpose of provisions relating to the reorganization plan is to:

(a) Facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment;

(b) Facilitate maximization of the value of the insolvency estate;

(c) Facilitate the negotiation and approval of a reorganization plan and establish the effect of approval, including a mechanism to bind all creditors and other interested parties;

²³Where the insolvency law provides that certain claims will not be affected by the insolvency proceedings, those claims will also be excluded from the discharge, but do not need to be specifically included in this section: see recommendations on treatment of creditor claims, chap. V, sect. A, and footnote 20.

(d) Address the consequences of a failure to propose an acceptable reorganization plan or inability to have the plan approved by creditors, including conversion of the proceedings to liquidation in certain circumstances;

(e) Provide for the implementation of the reorganization plan, including discharge of debts and claims, and the consequences of failure of implementation.

Recommendations

Preparation of the plan: timing

(125) The insolvency law should provide that the reorganization plan is [prepared] [filed] on or after the making of an application to commence insolvency proceedings, but no later than the end of a specified time period after commencement of the insolvency proceeding.

(a) The time period may be set by the court or alternatively fixed by the insolvency law;

(b) The court should be authorized to extend the time period in appropriate circumstances.

Preparation of the plan: parties responsible

(126) The insolvency law should specify the parties responsible for the preparation of the reorganization plan.

(127) In providing for the preparation of the reorganization plan, the insolvency law should adopt a flexible approach that potentially involves all parties central to the insolvency proceedings, that is, the debtor, the creditors and the insolvency representative. The insolvency law may combine different elements:

(a) An exclusive period may be given to one party to propose a plan. To encourage debtors to apply for commencement of proceedings at an early stage of financial difficulty, it [may] [should] be the debtor that is given that opportunity. The party provided with the exclusive period may be required to consult with other parties in order to ensure that the most acceptable plan will be proposed;

(b) Where no acceptable plan is forthcoming within the exclusive period, other parties, such as the insolvency representative, creditors or the creditor committee in collaboration with the insolvency representative may be given the opportunity to propose a plan.

Content of the plan

(128) The insolvency law should specify the minimum contents of a reorganization plan, which should include:

(a) The classes of creditors and the treatment respectively provided for each of them by the plan (for example, how much they will receive and the timing of payment);

(b) Treatment of contracts, including employment contracts;

(c) Means for the implementation of the plan, which may include:

- (i) The possibility of sale of the business as a whole;
- (ii) Proposed changes in the capital structure of the debtor's business.

Explanatory statement

(129) The insolvency law should require a reorganization plan submitted for the approval of creditors to be accompanied by a disclosure statement that will enable creditors to make an informed decision about the plan. The statement should include:

(a) The financial situation of the debtor including asset and liability and cash flow statements;

(b) A comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;

(c) The basis upon which the business would be able to keep trading and could be successfully reorganized; and

(d) Information showing that, having regard to the effect of the plan, the assets of the debtor will exceed its liabilities.

Approval of the plan

(130) The insolvency law should establish a mechanism for voting on approval of the reorganization plan. This should address the manner in which the vote can be conducted, either at a meeting of creditors convened for that purpose or voting by mail or other means, including electronic means, and whether or not creditors should vote in classes according to their respective rights.

(131) The insolvency law should establish the majority required for approval of the reorganization plan. The majority should be limited to those creditors actually voting. Unanimity or a simple majority based upon numbers of creditors voting is not recommended. A simple majority based on number of creditors voting and a majority in amount of claims of those voting should be required. The required majority in amount of claims may be a simple majority or greater for example, two thirds. [Where creditors vote in classes the requisite majority of each class may be required.]

Binding dissenting creditors

(132) The insolvency law should address the treatment of creditors who do not vote in support of the reorganization plan and provide a mechanism for binding those creditors to the plan, provided certain criteria are met. The criteria may include that the dissenting creditors will receive at least as much under the plan as they would have received in liquidation; that creditors with lower-ranking claims, the debtor and shareholders of the debtor will not receive more under the plan than the dissenting creditors; that no creditor to be treated equally with the dissenting creditor will receive an advantage over the dissenting creditor; and that, where creditors vote in classes, a majority of classes has approved the plan with the requisite majorities].

Confirmation of the plan

(133) Where the insolvency law provides for the court to confirm the reorganization plan, the court should refuse to confirm the plan if:

(a) The approval process was improperly conducted;

- (b) Creditors will not receive at least as much under the plan as they would have received in liquidation; or
- (c) The plan contains provisions forbidden by law.

Effect of the plan

(134) A confirmed reorganization plan should bind the debtor, creditors and equity owners and discharge the debtor from any debt arising before [confirmation] [commencement of the proceedings].

Challenges to the plan

(135) The insolvency law should allow interested parties to challenge the approval of the reorganization plan and specify the time at which that challenge may be made. The law may include criteria against which the challenge can be assessed, including *[criteria same as for confirmation]*:

- (a) The approval process was improperly conducted;
- (b) Creditors will not receive at least as much under the plan as they would have received in liquidation; or
- (c) The plan contains provisions forbidden by law.

Post-approval [confirmation] amendment of the plan

(136) The insolvency law should include limited provision for amendment of the reorganization plan, specifying the parties that may propose amendments and the time at which the plan may be amended. The limited circumstances in which the plan may be amended may include where, after approval [and confirmation], implementation of the plan breaks down or the plan is found to

be incapable of implementation in whole or in part, and the matter can be easily remedied. The amended plan should be subject to approval by the creditors and satisfy the rules for confirmation.

Supervision of implementation

(137) The insolvency law may provide for court supervision of the implementation of the reorganization plan or for the court to authorize the appointment of a supervisor or the insolvency representative to undertake that function.

Termination of implementation

(138) The insolvency law should provide that where implementation of the reorganization plan fails and the plan cannot be amended:

- (a) The plan can be terminated; and
- (b) If the reorganization proceedings have not closed, the proceedings can be converted to liquidation.

Closing [and reopening] of proceedings

(139) After an insolvency estate is fully administered [and the insolvency representative discharged] the court should close the proceedings.

(140) [reopening].

B. Expedited reorganization proceedings [see A/CN.9/WG.V/WP.61/Add.1]

A/CN.9/WG.V/WP.61/Add.1

Note by the Secretariat on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-sixth session

ADDENDUM

EFFECTIVE AND EFFICIENT INSOLVENCY REGIMES

PART TWO. CORE PROVISIONS

VI. REORGANIZATION: ADDITIONAL ISSUES

B. Expedited reorganization proceedings

[New: see A/CN.9/507, paras. 244-246]

Purpose

The purpose of provisions relating to expedited reorganization proceedings is to:

- (a) Recognize that out-of-court reorganization is a cost-effective, efficient tool for the rescue of financially troubled businesses;

- (b) Encourage, facilitate and preserve the benefits of out-of-court reorganizations that are supported by a majority of each affected class of creditors [and equity holders] by providing for an expedited reorganization procedure under the insolvency law that binds minority members of each affected class of creditors [and equity holders] who do not accept the reorganization plan negotiated out-of-court;

- (c) Provide safeguards for dissenting affected creditors.

Recommendations

Commencement of expedited reorganization proceedings

- (1) A debtor [that is eligible under the insolvency law] may file an application to commence expedited reorganization proceedings [to implement a plan of reorganization that has been voted on and accepted by a majority of each affected class of creditors [and equity holders] prior to commencement of insolvency proceedings.]

(2) The application should comply with the requirements for commencement of reorganization proceedings and be accompanied by the following additional materials:

- (a) The reorganization plan;
- (b) A description of the out-of-court reorganization activity that preceded the filing of the commencement application, including the information provided to affected creditors [and equity holders] to enable them to make an informed decision about the plan [or a summary of that information];
- (c) A report of the votes of affected classes of creditors [and equity holders];
- (d) A financial analysis prepared by [the debtor] [an independent expert] demonstrating that the reorganization plan provides that dissenting creditors will receive at least as much as they would have received in liquidation proceedings under the insolvency law; and
- (e) A list of the members of any creditor committees formed during the course of the out-of-court reorganization.

(3) The insolvency law should provide that the application will function as automatic commencement of proceedings, and that:

- (a) The effects of commencement should be limited to the debtor and classes of creditors [and equity holders] affected by the plan;
- (b) Any creditor committee formed during the course of the out-of-court reorganization should be treated as a creditor committee appointed under the insolvency law;
- (c) Provisions of the insolvency law that apply to reorganization proceedings shall also apply to expedited reorganization proceedings except as provided in this section; and
- (d) A hearing on the confirmation of the reorganization plan should be held as expeditiously as possible.

(4) Notice of the commencement of proceedings should promptly be provided to creditors [and equity holders] affected by the reorganization plan and should:

- (a) Indicate the amount of each creditor's claim according to the debtor;
- (b) Indicate the time period for submitting a claim in a different amount if the creditor disagrees with the debtor's statement of claim, and specify the place where the claim can be submitted;
- (c) Indicate the time and place for the hearing on confirmation of the reorganization plan, and for the submission of any objection to confirmation.

Confirmation of the plan

(5) The court should confirm the reorganization plan where it determines that:

- (a) The plan satisfies the requirements for confirmation of a plan in non-expedited reorganization proceedings, insofar as those requirements apply to affected creditors [and equity holders];
- (b) The information provided to affected creditors [and equity holders] during the out-of-court reorganization was sufficient to enable them to make an informed decision about the plan [and any pre-commencement solicitation of acceptances to the plan complied with applicable non-insolvency law];
- (c) Dissenting creditors [and equity holders] will receive as much under the reorganization plan as they would in a liquidation proceeding under the insolvency law.

A/CN.9/WG.V/WP.61/Add.2

Note by the Secretariat on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-sixth session

ADDENDUM

BACKGROUND REMARKS

The present note sets forth the revised structure for the commentary section of the draft guide. The order of commentary contained in documents A/CN.9/WG.V/WP.57 and A/CN.9/WG.V/WP.58 will be revised in accordance with the chapter and section headings set forth below.

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**J. Note by the Secretariat on the report on the
fourth UNCITRAL-INSOL Judicial Colloquium on
Cross-Border Insolvency, 2001 (A/CN.9/518) [Original: English]**

1. The present note contains a report of the discussion and conclusions reached at the fourth Multinational Judicial Colloquium on Cross-Border Insolvency, held on 16 and 17 July 2001 in London, organized by the secretariat of the United Nations Commission on International Trade Law (UNCITRAL) and the International Federation of Insolvency Professionals (INSOL International).

2. Over 60 judges and government officials attended from 29 States, representing a broad range of practical experience and perspectives from diverse legal systems. The Colloquium considered the progress of adoption of the Model Law on Cross-Border Insolvency and application of the legislation enacting the Model Law to cross-border issues, as well as draft guidelines for judicial cooperation and aspects of judicial training and education. It provided an opportunity for judges to have contact with each other and to further their understanding of the various national approaches to cross-border insolvency cases, including current legislative action.

Adoption of the Model Law

3. The Colloquium heard a report on the progress of adoption of the Model Law and a summary of the enacting legislation, highlighting the different approaches that had been taken to particular provisions. A hypothetical cross-border insolvency case was examined and the solutions offered by the different enacting laws were considered.

4. One concern was that while the Model Law as such provided a degree of flexibility to enacting States in framing their legislation, approaching the text as if it were a menu from which to choose provisions could result in significant differences in enacting legislation. It was suggested that that result had the potential to lead to confusion if those involved in cross-border cases relied on the fact of adoption of the Model Law, rather than considering the specific provisions of enacting laws.

5. Notwithstanding the differences in enacting legislation, consideration of a hypothetical cross-border insolvency case showed the potential complexity of cross-border cases and provided a practical illustration of how adoption of the Model Law could facilitate the conduct of those cases. It was observed that with enactment of the Model Law, the different legal traditions of common law and civil law countries could be brought closer together on cross-border issues by establishing the clear, precise legislative framework needed to facilitate the conduct of cases with cross-border elements. However, it was noted that it was often difficult to retain the language of the Model Law as custom and culture played a role in the development of legislation and changes were often required to tailor the law to meet local needs.

6. It was noted that some countries had included provision for reciprocity to govern recognition of foreign

proceedings and foreign representatives. Some concern was expressed that that approach had the potential not only to create a lack of clarity as to how the Model Law might be applied, but also to defeat the universality of the Model Law. In addition, it was noted that a policy of providing recognition and assistance only on a reciprocal basis had the potential to prevent a country which adopted that policy from freely offering assistance and providing recognition on the basis of what would serve its best interests and those of its creditors and debtors.

7. It was observed that current work being undertaken by UNCITRAL and INSOL on effective and efficient insolvency regimes would also facilitate the handling of issues in the cross-border insolvency context.

Facilitating judicial cooperation

8. There was a general recognition among participants that the number of cross-border insolvency cases was increasing around the world and that judges would increasingly have to assume that they could be involved in insolvency proceedings with cross-border elements. It was suggested that that possibility underlined the necessity of fostering cross-border judicial communication and cooperation generally to increase the efficiency, effectiveness and fairness of all kinds of insolvency proceedings. That need was generally supported. Specific goals of cooperation might include gathering information about liabilities and assets located in foreign countries; preventing dissipation of assets; preventing fraudulent conduct by the debtor, creditors and third parties; maximizing the value of assets; allowing the access and recognition of foreign creditors; facilitating the administration of cross-border insolvency proceedings; and finding the best solutions for the reorganization of an insolvent enterprise.

9. Participants observed that a number of typical issues needed to be addressed in order to facilitate the achievement of those goals. These included issues of culture, language and legal traditions; the absence of a uniform legislative framework for judicial cooperation and direct communication among judges in cross-border insolvency cases; judges' lack of experience and familiarity with direct oral communication with their judicial colleagues and with insolvency practitioners in foreign countries and their lack of confidence in embarking upon that communication; ethical questions, such as how to preserve equality among the parties and the transparency of the process; and the need to change national legal rules to facilitate and to encourage judicial cooperation and communication. Another difficulty identified was that of becoming familiar with the insolvency laws of other countries, especially where close cooperation with a particular country was urgently required.

10. A further issue touched upon was that of the territoriality of insolvency. It was noted that while some

countries recognized the worldwide effects of an insolvency order, others might be reluctant to give effect to a foreign order to insulate local assets and minimize the impact of foreign proceedings. It was observed that such “ring-fencing” had the potential to undermine the confidence of foreign investors and was contrary to the idea of the “rule of law” in international trade relations.

11. It was suggested that the means of addressing some of the issues were readily available. In terms of the legislative framework, the UNCITRAL Model Law on Cross-Border Insolvency could be adopted as a simple, and at the same time highly effective, means of establishing the basic principles needed. It was observed that the process of fostering cooperation could be incremental, with the Model Law establishing the first step. It was noted that in some jurisdictions a further degree of cooperation was tentatively developing with the courts taking the step, in giving assistance to a foreign insolvency court, of making orders that neither the domestic court nor the foreign court could have made in a domestic situation.

12. To address other issues it was noted that there was the possibility of developing guidelines for judicial cooperation to facilitate a common approach (see below). In the technical field, advances in communication technology provided new ways in which communication could be achieved. In terms of the availability of information on legislation, it was noted that a number of different resources, including databases available on the Internet, were being developed to facilitate dissemination of that information, including global and local initiatives in both the private and public sectors. It was generally agreed that it was important to foster relationships between judges and between judges and insolvency professionals through meetings such as the UNCITRAL/INSOL colloquiums to enable judges to meet, to exchange ideas and experiences, to learn about the difficulties faced and to share their concerns. It was suggested that those meetings should continue, and be increased and complemented perhaps with regional forums, as well as the development of permanent avenues for discussion and virtual forums.

Guidelines for judicial cooperation

13. The Colloquium considered a draft of guidelines for judicial cooperation and communication.¹ While a number of concerns were raised with regard to the level of detail contained in the draft provisions and a number of procedural issues, there was a general view that such guidelines would be useful to foster a common approach to issues of cooperation and, in particular, communication. In that regard, it was noted that a degree of confusion existed between the different levels at which communication might be required. Court to court communications involved discussions between the judges in very general terms on issues such as objectives, agendas and the scheduling of hearings. It was noted that that form of communication required the

prior agreement of the parties to ensure transparency, as well as the availability of transcripts and the maintenance of proper records to avoid future disputes. Communication with insolvency professionals, however, raised different issues such as the need for the court at all times to maintain its impartiality and independence, whether from the parties or the insolvency practitioner who represented the debtor.

14. It was also recognized that emergency procedures were often required to facilitate quick action, even without the presence of all parties. It was noted that some countries allowed a party to make an application for emergency orders in the absence of any other competing parties. Those procedures were subject to rules to protect the position of the absent parties and the orders made were generally for a limited duration until the other parties had the opportunity to present to the court their views on the application.

Judicial training

15. There was a general recognition among participants of a need for judicial education and training (including on a continuing basis) to ensure proper and efficient functioning not only of the regime for cross-border cases, but also for insolvency laws in general. It was suggested that training and education programmes should be based on an assessment of needs that would enable the programmes and their delivery to be tailored to the requirements (legal, social and cultural) of the local jurisdiction and be compatible with its budget, the caseload demands of judges and the availability of international assistance, including both financial and human resources.

16. Participants noted that training and education programmes also needed to take into account the specific role that a judge played in insolvency matters in a particular jurisdiction, recognizing that most countries did not have specialized bankruptcy courts and that in some jurisdictions the judicial role was more one of supervising the reorganization process. In those jurisdictions, judicial involvement might be restricted to resolving disputes, whereas in others judges might be required to take a more pro-active role in the insolvency process.

17. It was noted that education and training could be delivered in a number of different ways including through programmes involving direct contact between educators and judges; use of technology such as two-way video conferencing; and delivery systems that have an extended shelf life capable of repeated access by judges, such as videos, CD-ROMs and the Internet. It was suggested that international organizations had a role to play in fostering contacts between insolvency professionals and providing access to resources such as best practice principles and insolvency legislation in different languages to facilitate access and use.

18. A further observation was that training and education should be coordinated between the judiciary and insolvency practitioners and counsel who appear in insolvency matters, with no restriction on which parties could give and receive training. For example, it was desirable that there

¹The draft guidelines acknowledged the work initiated in the North American Free Trade Agreement (NAFTA) region by the American Law Institute.

would be no restrictions on judges training judges; judges assisting in the training of practitioners and practitioners assisting in the training of judges.

Conclusions

19. Discussion at the Colloquium reflected a number of conclusions, including (a) a consensus view that the UNCITRAL Model Law on Cross-Border Insolvency should be widely promoted and adopted, with as few changes as possible to ensure a basic, effective and uniform framework for the conduct of cross-border insolvency cases; (b) there was a need to facilitate judicial cooperation and communication, through the dissemination of information on insolvency law and legislation, development of

guidelines on judicial communication and the provision of continuing opportunities for judges, particularly those from developing countries, to meet and share their experience in multinational forums, such as the UNCITRAL/INSOL colloquiums; and (c) there was a need for judicial training and education programmes to ensure the efficient and effective conduct of cross-border, as well as domestic, insolvency cases. It was noted that many countries had indicated their willingness to provide experienced judges and insolvency professionals to assist with training and education and that a number of international professional organizations, such as INSOL International and the International Bar Association, were already actively involved in programmes delivering training and assistance. It was also noted that the UNCITRAL Trust Fund for Technical Assistance could have a role to play in providing training and assistance.

IV. ELECTRONIC COMMERCE

A. Report of the Working Group on Electronic Commerce on the work of its thirty-ninth session (New York, 11-15 March 2002) (A/CN.9/509) [Original: English]

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I. INTRODUCTION

1. At its thirty-third session, in 2000, the United Nations Commission on International Trade Law (UNCITRAL) held a preliminary exchange of views on proposals for future work in the field of electronic commerce. Three topics were suggested as indicating possible areas where work by the Commission would be desirable and feasible. The first dealt with electronic contracting, considered from the perspective of the United Nations Convention on Contracts for the International Sale of Goods (the “United Nations Sales Convention”);¹ the second was online dispute settlement; and the third topic was dematerialization of documents of title, in particular in the transport industry.

2. The Commission welcomed the proposal to study further the desirability and feasibility of undertaking future work on those topics. The Commission generally agreed that, upon completing the preparation of the Model Law on Electronic Signatures, the Working Group on Electronic Commerce would be expected to examine, at its thirty-eighth session, some or all of the above-mentioned topics, as well as any additional topic, with a view to making more specific proposals for future work by the Commission at its

thirty-fourth session (Vienna, 25 June-13 July 2001). It was agreed that work to be carried out by the Working Group could involve consideration of several topics in parallel as well as preliminary discussion of the contents of possible uniform rules on certain aspects of the above-mentioned topics.² The Working Group considered those proposals at its thirty-eighth session, in 2001, on the basis of a set of notes dealing with a possible convention to remove obstacles to electronic commerce in existing international conventions (A/CN.9/WG.IV/ WP.89); dematerialization of documents of title (A/CN.9/WG.IV/WP.90); and electronic contracting (A/CN.9/WG.IV/WP.91).

3. The Working Group held an extensive discussion on issues related to electronic contracting (see A/CN.9/484, paras. 94-127). The Working Group concluded its deliberations on future work by recommending to the Commission that work towards the preparation of an international instrument dealing with certain issues in electronic contracting be started on a priority basis. At the same time, it was agreed to recommend to the Commission that the Secretariat be entrusted with the preparation of the necessary studies concerning three other topics considered by the Working Group, namely: (a) a comprehensive survey of

¹United Nations, *Treaty Series*, vol. 1489, No. 25567.

²*Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 384-388.

possible legal barriers to the development of electronic commerce in international instruments; (b) a further study of the issues related to transfer of rights, in particular rights in tangible goods, by electronic means and mechanisms for publicizing and keeping a record of acts of transfer or the creation of security interests in such goods; and (c) a study discussing the UNCITRAL Model Law on International Commercial Arbitration, as well as the UNCITRAL Arbitration Rules, to assess their appropriateness for meeting the specific needs of online arbitration (see A/CN.9/484, para. 134).

4. At the thirty-fourth session of the Commission, in 2001, there was wide support for the recommendations made by the Working Group, which were found to constitute a sound basis for future work by the Commission. The views varied, however, as regards the relative priority to be assigned to the topics. One line of thought was that a project aiming at removing obstacles to electronic commerce in existing instruments should have priority over the other topics, in particular over the preparation of a new international instrument dealing with electronic contracting. It was said that references to "writing", "signature", "document" and other similar provisions in existing uniform law conventions and trade agreements already created legal obstacles and generated uncertainty in international transactions conducted by electronic means. Efforts to remove those obstacles should not be delayed or neglected by attaching higher priority to issues of electronic contracting.

5. The prevailing view, however, was in favour of the order of priority that had been recommended by the Working Group. It was pointed out, in that connection, that the preparation of an international instrument dealing with issues of electronic contracting and the consideration of appropriate ways to remove obstacles to electronic commerce in existing uniform law conventions and trade agreements were not mutually exclusive. The Commission was reminded of the common understanding reached at its thirty-third session that work to be carried out by the Working Group could involve consideration of several topics in parallel as well as preliminary discussion of the contents of possible uniform rules on certain aspects of the above-mentioned topics.³

6. There were also differing views regarding the scope of future work on electronic contracting, as well as the appropriate moment to begin such work. Pursuant to one view, the work should be limited to contracts for the sale of tangible goods. The opposite view, which prevailed in the course of the Commission's deliberations, was that the Working Group should be given a broad mandate to deal with issues of electronic contracting, without narrowing the scope of work from the outset. It was understood, however, that consumer transactions and contracts granting limited use of intellectual property rights would not be dealt with by the Working Group. The Commission took note of the preliminary working assumption made by the Working Group that the form of the instrument to be prepared could

be that of a stand-alone convention dealing broadly with the issues of contract formation in electronic commerce (see A/CN.9/484, para. 124), without creating any negative interference with the well-established regime of the United Nations Sales Convention (see A/CN.9/484, para. 95) and without unduly interfering with the law of contract formation in general. Broad support was given to the idea expressed in the context of the thirty-eighth session of the Working Group that, to the extent possible, the treatment of Internet-based sales transactions should not differ from the treatment given to sales transactions conducted by more traditional means (see A/CN.9/484, para. 102).

7. As regards the timing of the work to be undertaken by the Working Group, there was support for commencing consideration of future work without delay during the third quarter of 2001. However, strong views were expressed that it would be preferable for the Working Group to wait until the first quarter of 2002, so as to afford States sufficient time to hold internal consultations. The Commission accepted that suggestion and decided that the first meeting of the Working Group on issues of electronic contracting should take place in the first quarter of 2002.⁴

8. The Working Group on Electronic Commerce, which was composed of all States members of the Commission, held its thirty-ninth session in New York, from 11 to 15 March 2002. The session was attended by representatives of the following States members of the Working Group: Austria, Benin, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, Fiji, France, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Russian Federation, Rwanda, Sierra Leone, Singapore, Spain, Sweden, Thailand, Uganda, United States of America and Uruguay.

9. The session was attended by observers from the following States: Argentina, Australia, Bangladesh, Belgium, Cyprus, Czech Republic, Denmark, Dominican Republic, Finland, Indonesia, Iraq, Ireland, Israel, Malta, New Zealand, Nigeria, Norway, Peru, Philippines, Poland, Portugal, Republic of Korea, Saudi Arabia, Switzerland, Tunisia and Turkey.

10. The session was also attended by observers from the following international organizations: (a) organizations of the United Nations system: United Nations Conference on Trade and Development, World Bank, World Intellectual Property Organization and United Nations Industrial Development Organization; (b) intergovernmental organizations: European Space Agency, Hague Conference on Private International Law, Inter-American Development Bank and Organisation for Economic Cooperation and Development; and (c) non-governmental organizations invited by the Commission: Association of the Bar of the City of New York, International Association of Ports and Harbors, International Chamber of Commerce, International Law Institute, International Union of Marine Insurance, Internet Law and Policy Forum and Union internationale du Notariat.

³Ibid., *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 293.

⁴Ibid., para. 295.

11. The Working Group elected the following officers:

Chairman: Jeffrey Chan Wah Teck (Singapore)

Rapporteur: André Akam Akam (Cameroon)

12. The Working Group had before it the following documents: (a) provisional agenda (A/CN.9/WG.IV/ WP.92); (b) note by the Secretariat containing information on the progress made thus far by the Secretariat in connection with the Working Group's consideration of ways to remove obstacles to electronic commerce in existing international conventions (A/CN.9/WG.IV/WP.94); (c) note by the Secretariat discussing selected issues on electronic contracting, containing, as its annex I, an initial draft tentatively entitled "Preliminary draft convention on [international] contracts concluded or evidenced by data messages" (A/CN.9/WG.IV/WP.95); and (d) note by the Secretariat transmitting comments that had been formulated by an ad hoc expert group established by the International Chamber of Commerce to examine the issues raised in document A/CN.9/WG.IV/WP.95 and the draft provisions set out in its annex I (A/CN.9/WG.IV/WP.96).

13. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Electronic contracting: provisions for a draft convention.
4. Legal barriers to the development of electronic commerce in international instruments relating to international trade.
5. Other business.
6. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

14. The Working Group reviewed the preliminary draft convention contained in annex I of the note by the Secretariat (A/CN.9/WG.IV/WP.95). The decisions and deliberations of the Working Group with respect to the draft convention are reflected in section III below. The Secretariat was requested to prepare a revised version of the preliminary draft convention, based on those deliberations and decisions for consideration by the Working Group at its fortieth session, tentatively scheduled to take place in Vienna, from 14 to 18 October 2002.

15. The Working Group began its deliberation by considering the form and scope of the preliminary draft convention (see paras. 18-40). The Working Group agreed to postpone a discussion on exclusions from the draft convention until it had had an opportunity to consider the provisions related to location of the parties and contract formation. In particular, the Working Group decided to proceed with its deliberations by firstly taking up articles 7 and 14, both of which dealt with issues related to the location of the parties (see paras. 41-65). After it had completed its initial review

of those provisions, the Working Group proceeded to consider the provisions dealing with contract formation in articles 8-13 (see paras. 66-121). The Working Group concluded its deliberations on the draft convention with a discussion on draft article 15 (see paras. 122-125). The Working Group agreed that it should consider articles 2-4, dealing with the sphere of application of the draft convention, and articles 5 (definitions) and 6 (interpretation) at its fortieth session.

16. The Working Group took note of the progress made thus far by the Secretariat in connection with a survey of possible legal barriers to the development of electronic commerce in international instruments on the basis of a note by the Secretariat containing information on that survey (A/CN.9/WG.IV/WP.94). The Working Group requested the Secretariat to seek the views of member and observer States on the survey and the preliminary conclusions indicated therein and to prepare a report compiling such comments for consideration by the Working Group at a later stage. The Working Group took note of a statement stressing the importance that the survey being conducted by the Secretariat should reflect trade-related instruments emanating from the various geographical regions represented on the Commission. For that purpose, the Working Group requested the Secretariat to seek the views of other international organizations, including organizations of the United Nations system and other intergovernmental organizations, as to whether there were international trade instruments in respect of which those organizations or their member States acted as depositaries that those organizations would wish to be included in the survey being conducted by the Secretariat.

17. The Working Group considered oral reports by the Secretariat on developments concerning online arbitration and on the status of consideration by the Secretariat of issues related to transfer of rights by electronic means, in particular, transfer of rights in tangible goods. The Working Group agreed on the importance of both topics, which should be kept under review by the Secretariat for consideration by the Working Group at an appropriate stage.

III. ELECTRONIC CONTRACTING: PROVISIONS FOR A DRAFT CONVENTION

General comments

18. Before considering the individual provisions for a draft convention on electronic contracting, the Working Group engaged in a general exchange of views concerning the form and scope of the instrument, its underlying principles and some of its main features.

1. Form of the instrument

19. The Working Group took note of the fact that the form of a preliminary draft of an international convention dealing with issues of electronic contracting had been chosen so as to reflect a preliminary working assumption made by the Working Group, of which the Commission had taken note at its thirty-fourth session, in 2001, namely, that

the form of the instrument to be prepared could be that of a stand-alone convention dealing broadly with issues of contract formation in electronic commerce (see A/CN.9/484, para. 124).

20. The Working Group heard various statements in support of preparing an international convention dealing with issues of electronic contracting, which was said to be best suited to ensuring the degree of uniformity and legal certainty required by international trade transactions. While the view was also expressed that it would instead be preferable to prepare a non-binding instrument, such as recommendations on guidelines on electronic contracting, the Working Group maintained its preliminary working assumption that it should focus on the preparation of a stand-alone convention. The Working Group was agreed that its working assumption would be without prejudice to a final decision, at an appropriate stage, concerning the form of the instrument under consideration. A widely shared view, in that connection, was that the Working Group should keep a flexible approach to the question of the form of the instrument until it had considered in more detail the scope of the instrument and its substantive provisions.

2. *Scope of the instrument*

21. The Working Group heard expressions of support for a proposal that its work should not be limited to electronic contracts, but should apply to commercial contracts in general, irrespective of the means used in their negotiation. It was suggested that the main objective of the Commission's work should be to eliminate legal barriers to international transactions that generally resulted from international disharmony of contract law. Disharmony in the area of contract formation, however, was not specific to electronic contracts. With a few exceptions (such as contracts for the sale of goods, which benefited from the harmonized regime established by the United Nations Sales Convention), the formation of most international commercial contracts was not subject to widely accepted uniform legislative regimes.

22. The Working Group heard various arguments for not regulating electronic contracts separately from commercial contracts in general. It was said that the preparation of an instrument dealing specifically with issues related to electronic contracting carried with it the risk of establishing a duality of regimes depending on the means used for contract formation. The result might be that a contract other than, for example, a sales contract governed by the United Nations Sales Convention would benefit from an internationally harmonized regime when it was concluded by electronic means but not if it was concluded by other means, such as by paper-based communications.

23. The Working Group was sympathetic to the arguments put forward in favour of broadening the scope of the draft convention so as to deal generally with issues of contract formation irrespective of the means used by the parties for negotiating their contracts. The prevailing view within the Working Group, however, was that it might be overly ambitious, at the current stage, to engage in harmonizing contract law in general. It was pointed out that the

mandate of the Working Group was limited to issues of electronic contracting and that expanding the scope of the work would require further consideration by the Commission of the feasibility of achieving international consensus on broad issues of contract formation (for further discussion on this matter, see paras. 68-70). The practical importance of working on electronic contracting was also emphasized. If contracts concluded by electronic means were not fundamentally different from contracts concluded by other means, they posed a number of practical questions that required specific attention.

24. Having agreed that its work should focus on issues related to electronic contracting, the Working Group proceeded to consider other general comments relating to the scope of the draft convention. Those general comments were essentially concerned with the following issues: the notion of "electronic contracting"; whether the draft convention should be limited to issues of contract formation or whether it could deal with certain issues of contract performance; whether the draft convention should deal only with commercial contracts or whether it should also cover transactions involving consumers; whether the draft convention should deal only with international contracts or whether it should apply without distinction to both domestic and international transactions.

25. The Working Group took note of the general comments made on those issues and decided to revert to them when considering the provisions dealing with the sphere of application of the draft convention at its fortieth session.

3. *Underlying principles*

26. It was widely agreed that the draft convention should give full recognition to the principles of freedom of contract and party autonomy, which were recognized in various texts that had been prepared by the Commission, such as the United Nations Sales Convention.

27. The Working Group noted that its work on electronic contracting was evolving against the background of earlier instruments that had been prepared by the Commission, in particular the United Nations Sales Convention and the UNCITRAL Model Laws on Electronic Commerce and Electronic Signatures. While every effort should be made to avoid interfering unduly with the legal regime established by those instruments, in particular the United Nations Sales Convention, the Working Group took note of the suggestion that its work on electronic contracting might require formulating specific solutions for issues not dealt with in those earlier instruments or adapting some of the provisions of those instruments, in particular the model laws, to the current context.

Article 1. *Scope of application*

28. The text of the draft article read as follows:

Variant A

"1. This Convention applies to contracts concluded or evidenced by means of data messages.

“2. Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

“[3. A State may declare that it will apply this Convention only to contracts concluded between parties having their places of business in different States or [when the rules of private international law lead to the application of the law of a Contracting State or] when the parties have agreed that it applies.]

“[4. Where a State makes a declaration pursuant to paragraph 3, the fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.]”

Variant B

“1. This Convention applies to international contracts concluded or evidenced by means of data messages.

“2. For the purposes of this Convention a contract is considered international if, at the time of the conclusion of the contract, the parties have their places of business in different States.

“3. This Convention also applies [when the rules of private international law lead to the application of the law of a Contracting State or] when the parties have agreed that it applies.

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

“5. [Neither] The nationality of the parties [nor the civil or commercial character of the parties or of the contract] is [not] to be taken into consideration in determining the application of this Convention.”

Choice between variants A and B

29. The Working Group noted that the fundamental difference between variants A and B was that variant A made the draft convention applicable, in principle, to any contract “concluded or evidenced by means of data messages”, without distinction between domestic and international contracts, whereas variant B made the draft convention applicable only to “international” contracts. The Working Group thus proceeded to consider which of the two approaches should be used to define the geographical sphere of application of the draft convention.

30. In favour of the approach embodied in variant A, it was said that parties communicating through electronic

means might not always know in advance the location of their counterparts’ places of business. Thus, making the application of the draft convention dependent upon whether the parties were located in different States might reduce the benefit of legal certainty and predictability that the draft convention sought to provide. It was also suggested that the provisions of the draft convention might also be relevant to purely domestic transactions, since they dealt with issues that arose in connection with most distance contracts and not exclusively in connection with international contracts.

31. The prevailing view within the Working Group, however, was that the draft convention should be limited to international contracts so as not to interfere with domestic law. Such a limitation was desirable in order to ensure consistency with the approach taken in most of the instruments that had been prepared thus far by the Commission.

32. Having agreed on retaining variant B as its working assumption, the Working Group proceeded to consider its individual provisions.

Paragraph 1

33. Several questions were raised concerning the meaning of the phrase “contracts concluded or evidenced by means of data messages” and its appropriateness to describe the substantive field of application of the draft convention.

34. It was pointed out that it was potentially misleading to state that the draft convention “applied to contracts” since its provisions only dealt with certain issues related to the use of data messages, in particular in the context of contract formation. The formulation of paragraph 1 was also criticized as being too restrictive and not in accordance with the principle of media neutrality, since, in practice, many contracts were concluded by a mixture of oral conversations, telefaxes, paper contracts, electronic mail (e-mail) and web communication. If the provision was read as applying only to contracts concluded exclusively by means of data messages, it might cause an undesirable limitation in the field of application of the draft convention. In turn, if paragraph 1 was also intended to cover contracts formed by a combination of means, including data messages, it should be reformulated so as to avoid questions as to the extent to which data messages needed to be used in order to trigger the application of the draft convention.

35. Furthermore, it was pointed out that practical use of data messages was not confined to the context of contract formation, as data messages were used for the exercise of a variety of rights arising out of the contract (such as notices of receipt of goods, notices of claims for failure to perform or notices of termination) or even for performance, as in the case of electronic fund transfers. As currently drafted, paragraph 1 was felt to be too narrow, thus depriving all electronic communications used in commercial transactions other than for purposes of contract formation of the benefits of legal certainty that the draft convention was intended to achieve.

36. Having considered the various comments that had been made, the Working Group agreed that the definition

of the substantive field of application should be revised by focusing on the use of data messages in the context of commercial transactions, as was the case of article 1 of the UNCITRAL Model Law on Electronic Commerce, rather than on “contracts concluded by data messages”.

Paragraph 2

37. It was noted that the United Nations Sales Convention only applied to international contracts if both parties were located in contracting States of the Convention. In order to ensure consistency between the two texts, it was suggested that similar wording should be used in the draft paragraph. It was agreed that a future version of the draft paragraph would offer an additional phrase reflecting that suggestion, for future consideration by the Working Group.

Paragraph 3

38. It was suggested that the words “when the rules of private international law lead to the application of the law of a Contracting State”, which appeared in square brackets, should be deleted since they might cause an expansion of the scope of application of the draft convention beyond what was initially contemplated by the Working Group. It was suggested that such expansion, owing to its inherent *ex post facto* nature, would significantly reduce certainty at the time of contracting. The initial reaction of the Working Group was that the proposal needed to be considered further, since the phrase in question also appeared in article 1, subparagraph (b), of the United Nations Sales Convention, and the majority of States that had adhered to the Convention had not excluded the application of that provision, as authorized by article 95 of the Convention.

39. The Working Group took note of the views that had been expressed. It was agreed that the matter might require further consideration by the Working Group when considering a revised version of the draft convention.

Paragraphs 4 and 5

40. In order to ensure consistency between the two texts, it was agreed that the language in paragraphs 4 and 5 of the draft convention should be aligned with the corresponding language in article 1, paragraphs 2 and 3, of the United Nations Sales Convention and that the square brackets around paragraph 4 and within paragraph 5, where appropriate for that purpose, should be removed.

Article 7. Location of the parties

41. The draft article, as considered by the Working Group, read as follows:

“1. For the purposes of this Convention, a party is presumed to have its place of business at the geographic location indicated by it in accordance with article 14 [, unless it is manifest and clear that the party does not have a place of business at such location and that such indication is made solely to trigger or avoid the application of this Convention].

“2. If a party has more than one place of business, the place of business for the purposes of this Convention is that which has the closest relationship to the relevant contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract.

“3. If a natural person does not have a place of business, reference is to be made to the person’s habitual residence.

“4. The location of the equipment and technology supporting an information system used by a legal entity for the conclusion of a contract, or the place from which such information system may be accessed by other persons, in and of themselves, do not constitute a place of business [, unless such legal entity does not have a place of business].

“5. The sole fact that a person makes use of a domain name or electronic mail address connected to a specific country does not create a presumption that its place of business is located in such country.”

42. As a general comment, it was noted that the purpose of the draft article was to offer elements that allowed the parties to ascertain the location of the places of business of their counterparts, thus facilitating a determination, among other elements, as to the international or domestic character of a transaction and the place of contract formation. As such, the draft article was one of the central provisions in the preliminary draft convention and one that might be essential, if the sphere of application of the preliminary draft convention was defined along the lines of variant B of draft article 1.

Paragraph 1

43. It was pointed out that draft paragraph 1 built upon a proposal that had been made at the thirty-eighth session of the Working Group, to the effect that the parties in electronic transactions should have the duty to disclose their places of business (see A/CN.9/484, para. 103). That duty was reflected in draft article 14, paragraph 1 (b). It was also pointed out that, in line with the spirit of the Working Group’s consideration of this matter at its thirty-eighth session (see A/CN.9/484, paras. 96-104), draft paragraph 1 was not intended to create a new concept of “place of business”.

44. The Working Group noted that considerable legal uncertainty was caused at present by the difficulty of determining where a party to an online transaction was located. While that danger had always existed, the global reach of electronic commerce had made it more difficult than ever to determine location. That uncertainty, it was also noted, could have significant legal consequences, since the location of the parties was important for issues such as jurisdiction, applicable law and enforcement. Accordingly, there was wide agreement within the Working Group as to the need for provisions that facilitated a determination by the parties of the places of business of the persons or entities they had commercial dealings with. The views differed, however, as to whether a provision along the lines of

the draft paragraph offered an adequate solution to meet that need.

45. Pursuant to one view, the draft paragraph was not needed since the definition of “place of business” in draft article 5 already provided the elements that allowed the parties to ascertain each other’s places of business. The prevailing view, however, was that the elements used in the definition of “place of business” might not be apparent to the parties solely on the basis of their communications and that further elements should be offered, in particular a provision that enabled the parties to rely on representations made to them in the course of their dealings and attached certain legal consequences to those representations.

46. It was noted that, for that purpose, the draft paragraph created a presumption that a party was located at the place stated by it to be its place of business pursuant to article 14. That formulation was criticized, however, as being excessively narrow, since the latter provision only required parties offering goods or services through an information system that was generally accessible to the public to make available certain information, including an indication of its place of business, to parties accessing such an information system. It was suggested that the draft paragraph should be broadened so as to cover all parties to transactions falling under the convention and not only those which offered services through open systems such as the Internet. A widely shared view in that connection was that an indication of the place of business for the purposes of draft article 7 should also be contemplated for parties offering goods or services through systems other than generally accessible communications systems, as well as for parties ordering goods or services through both types of system.

47. Pursuant to another view, the essential difficulty raised by the draft paragraph was that, by establishing a rebuttable presumption concerning a party’s location, the draft provision exacerbated, rather than reduced, legal uncertainty in electronic transactions. It was said that the possibility of adducing evidence that a party was located at a place other than the place of business it had indicated might give opportunity for protracted litigation concerning the applicability of the draft convention. In order to overcome those difficulties, it was suggested that the draft paragraph should facilitate a positive determination of the parties’ places of business by providing that they should be deemed to be located at the places indicated by them as their places of business. The Working Group took note of that suggestion and expressed its sympathy for the concerns it intended to address. The prevailing view, however, was that it was preferable to retain the formulation of the draft paragraph as a rebuttable presumption. It was felt that it would be undesirable to create the impression that the draft convention upheld an indication of a place of business by a party even where such an indication was inaccurate or intentionally false.

48. The Working Group proceeded to consider the conditions under which the presumption established by the draft paragraph might be rebutted. Pursuant to one view, which received expressions of strong support, the clause within square brackets in the draft paragraph was not needed and should be deleted with a view to enhancing legal certainty

in the interpretation of the draft paragraph. In particular the last phrase within square brackets (“and such indication is made solely to trigger or avoid the application of this Convention”) was said to be of questionable usefulness, as the parties were in any event free, under draft article 1, paragraph 3, to agree to the application of the draft convention, or to exclude its application, under draft article 4. Moreover, it was suggested that trading partners acting in good faith would normally be expected to provide accurate and truthful information concerning the location of their places of business. The legal consequences of false or inaccurate representations made by them were not primarily a matter of contract formation, but rather a matter of criminal or tort law. To the extent that those questions were dealt with in most legal systems, they would be governed by the applicable law outside the draft convention.

49. The countervailing view, which was also widely shared, was that it was important to include in the draft paragraph a provision allowing the parties or the court to disregard a representation made by one party when such representation was manifestly inaccurate or untruthful. It was said that such a provision was not intended to establish any form of criminal liability or liability in tort but merely to prevent situations where a party might benefit from making recklessly inaccurate or untruthful representations. The provision, it was further said, could not be regarded as giving rise to legal uncertainty, in view of the high standard required to rebut the presumption of paragraph 1. Views varied, however, as to whether the clause within square brackets should be retained in its entirety, as suggested by some, or limited only to the first phrase (“unless it is manifest and clear that the party does not have a place of business at such location”), as proposed by others. A third suggestion was that the two phrases should not be kept as cumulative conditions, in view of the great difficulty of demonstrating that it was both “manifest and clear” that a party did not have its place of business at a certain location and that its indication of a place of business had been made solely for the purposes of triggering or avoiding the application of the convention.

50. Having considered the various comments that had been made, the Working Group generally felt that it should consider further the provisions dealing with the location of the parties and that, for that purpose, the various elements currently contained in the draft paragraph could be tentatively retained. The Secretariat was requested to prepare a revised version that took into account the various views that had been expressed, including the deliberations of the Working Group on the remainder of the draft article (see paras. 51-59), as well as on article 14 (see paras. 60-65). In preparing such a revised version, the Secretariat should attempt to reformulate the draft paragraph as a general provision that offered an initial presumption of the parties’ location, based on their indication of their places of business, which should be followed by appropriate fall-back provisions in the absence of such an indication or in the event that the presumption could not be relied upon.

Paragraph 2

51. The view was expressed that the draft paragraph, which was based upon article 10, subparagraph (a), of the

United Nations Sales Convention, might not be appropriate in an instrument that was not restricted to sales contracts. It was pointed out, in that connection, that the cumulative reference to a place of business that had “the closest relationship to the contract and its performance” had given rise to uncertainty, since there might be situations where a given place of business of one of the parties was more closely connected to the contract, but another of that party’s places of business was more closely connected to the performance of the contract. Those situations were not rare in connection with contracts entered into by large multinational companies and might become even more frequent as a result of the current trend towards increased decentralization of business activities. It was therefore suggested that the draft paragraph might need to be reformulated.

52. That suggestion was objected to on the grounds that its adoption might lead to a departure from the text of the United Nations Sales Convention, as a result that should be generally avoided by the Working Group. Inconsistencies between the two instruments were said to be particularly undesirable in view of the risk of introducing a duality of regimes for sales transactions depending on the means used for their negotiation.

53. In response to those objections it was said that the Working Group should not generally exclude the possibility of using new criteria for determining a party’s place of business or for improving upon the criteria that had been used in the United Nations Sales Convention. It was suggested that other criteria, potentially more suited to the needs of electronic commerce, had been developed since the adoption of the United Nations Sales Convention. Those additional criteria might include elements such as the place of an entity’s organization or its place of incorporation.

54. The Working Group considered at length the different views that had been expressed and agreed that the matter required further study. It was also agreed that, while retaining the draft paragraph, the Working Group could explore using supplementary elements to the criteria used in the draft paragraph, possibly by expanding the definitions of “place of business” contained in draft article 5. It was noted that such an approach would not be inconsistent with the United Nations Sales Convention since the latter did not provide a definition of the expression “place of business”.

Paragraph 3

55. Apart from drafting comments and subject to the Working Group’s tentative conclusions with regard to the structure of the entire draft article 7, the draft paragraph was generally felt to be acceptable.

Paragraphs 4 and 5

56. The Working Group noted that, unlike the previous draft paragraphs, which offered positive indications of matters to be taken into account when determining a party’s place of business, the two draft paragraphs mentioned elements what would not, in and of themselves, provide a firm indication of a party’s place of business.

57. The Working Group considered a number of questions that were raised concerning the meaning of, and need for, the two draft paragraphs. In connection with paragraph 5, the view was expressed that the phrase within square brackets was not needed and should be deleted since most business entities could normally be expected to possess one or more of the elements of the sequence of fall-back solutions that a revised version of draft article 7 should offer to ascertain the location of a party’s “place of business”. The countervailing view was that it might be useful for the Working Group to study further the issues raised by the draft paragraph in the light of practical developments concerning the manner in which entities offering goods or services online organized their business. One situation that might need to be addressed in draft paragraph 4, possibly by combining it with paragraph 5, it was said, related to offers of goods or services by direct electronic mailing to a target audience through a web portal made available by a third party, such as a web host.

58. The view was expressed that draft paragraph 5 was not needed and should be deleted. In some countries, it was said, the assignment of domain names was only made after verification of the accuracy of the information provided by the applicant, including its location in the country to which the relevant domain name related. For those countries, it might be appropriate to rely, at least in part, on domain names for the purpose of article 7, contrary to what was suggested in the draft paragraph. For countries where such verification was not made, the rule might be seen as superfluous and might therefore be deleted. In practice, it was further said, there might be only few, if any, entities whose places of business would need to be arrived at on the basis of domain names alone.

59. Having considered the various views that had been expressed, the Working Group decided to retain, for further consideration, the elements mentioned in draft paragraphs 4 and 5, including the language in square brackets in draft paragraph 4. The Working Group agreed to consider, at a later stage, whether the two provisions might be usefully combined into one single paragraph.

Article 14. General information to be provided by the parties

60. The text of the draft article, as considered by the Working Group, read as follows:

“1. A party offering goods or services through an information system that is generally accessible to the public shall render the following information available to parties accessing such information system:

“(a) Its name and, where the party is registered in a trade or similar public register, the trade register in which the party is entered and its registration number, or equivalent means of identification in that register;

“(b) The geographic location and address at which the party has its place of business;

“(c) Details, including its electronic mail address, which allow the party to be contacted rapidly and communicated with in a direct and effective manner.

“2. A party offering goods or services through an information system that is generally accessible to the public shall ensure that the information required to be provided under paragraph 1 is easily, directly and permanently accessible to parties accessing the information system.”

61. The Working Group noted that the draft article was intended to enhance certainty and clarity in international transactions by ensuring that a party offering goods or services through open networks, such as the Internet, should offer at least information on its identity, legal status, location and address. It was pointed out that the draft article reflected the proposal, which had been positively received at the Working Group’s thirty-eighth session, that persons and companies making use of such open networks should at least disclose their places of business (see A/CN.9/484, para. 103).

62. There was general agreement within the Working Group that certainty in international transactions conducted by electronic means might benefit from international rules and standards that encouraged parties to disclose their location, among other elements. Views differed, however, as to whether the draft convention was the appropriate instrument for providing such a rule, as well as on the appropriateness of the draft article for that purpose.

63. Pursuant to one view, which was widely shared, obligations to disclose certain information would be more appropriately placed in international industry standards or guidelines, rather than in an international convention dealing with electronic contracting. Another possible source of rules of that nature might be domestic regulatory regimes governing the provision of online services, especially under consumer protection regulations. The inclusion of rules along the lines of the draft article was regarded as particularly problematic in the draft convention since the text did not provide for the consequences that might flow from failure by a party to comply with the disclosure requirements contemplated in the draft article. On the one hand, rendering commercial contracts invalid or unenforceable for failure to comply with the draft article was said to be an undesirable and unreasonably intrusive solution. On the other hand, providing for other types of sanctions, such as tort liability or administrative sanctions, was said to be clearly outside the scope of the draft convention.

64. The countervailing view, which also received strong support, was that the draft article was useful to help the parties determine whether a particular transaction would be regarded as domestic or international and to take measures necessary to protect their rights, in particular in the event of disputes or litigation. The draft article, it was said, could not be seen as excessively intrusive and did not impose an unreasonable burden on business entities, since the information contemplated therein was of a general nature and not concerned with a company’s internal affairs.

65. Having considered the various views that had been expressed, the Working Group felt that the substance of the draft article, possibly within square brackets, should be retained for further consideration by it at a later stage. In that connection, it was agreed that the addressees of the

disclosure obligations in the draft article should be redefined in accordance with the Working Group’s deliberations on draft article 7, paragraph 1 (see paras. 43-50). It was further agreed that some of the concerns that had been expressed in connection with the draft article might be addressed if the relationship between the draft article and draft article 7, paragraph 1, could be clarified in a revised version of the draft article. The Secretariat was requested to prepare such a revised draft taking into account the comments that had been made in the course of the Working Group’s deliberations.

Article 8. Time of contract formation

66. The text of the draft article, as considered by the Working Group, read as follows:

“1. A contract is concluded at the moment when the acceptance of an offer becomes effective in accordance with the provisions of this Convention.

“2. An offer becomes effective when it is received by the offeree.

“3. An acceptance of an offer becomes effective at the moment the indication of assent is received by the offeror.”

General remarks

67. It was explained, at the outset, that draft article 8 was intended to reflect the essence of the rules on contract formation contained, respectively, in articles 23, 15, paragraph 1, and 18, paragraph 2, of the United Nations Sales Convention. The verb “reach”, which was used in the United Nations Sales Convention, had been replaced with the verb “receive” in the draft article so as to align it with draft article 11, which was based on article 15 of the UNCITRAL Model Law on Electronic Commerce.

68. It was observed that the scope of the rules embodied in draft article 8 went beyond electronic contracting to cover the time when any form of a contractual offer or acceptance would become effective. Diverging views were expressed regarding the scope and nature of the legal issues linked to contract formation that should be dealt with in the draft instrument. One view was that the provision should be broadened beyond determining when an offer or an acceptance became “effective” to discuss such issues as the legal regime of withdrawal, revocation or modification of an offer or acceptance, the place of contract formation, issues of contracts concluded by conduct and, more generally, all the issues dealt with in articles 14-24 (Part II) of the United Nations Sales Convention. Strong support was expressed in favour of that view. It was pointed out that practitioners of international trade transactions would regard it as particularly desirable and timely to be able to rely on a set of uniform legal provisions regarding those issues upon which the various domestic laws in existence offered little harmony.

69. The opposing view was that draft article 8 should be deleted since it did not specifically address the issues of

electronic contracting to which the draft instrument should confine itself. Strong support was expressed in favour of the view that, even if the provisions contained in draft article 8 were redrafted so as to be limited in scope to electronic commerce transactions, they should still be deleted to avoid the creation of a dual regime where different rules would govern the time of formation of an electronic commerce contract within the draft instrument and the time of formation of other types of contract outside the purview of the draft instrument. As to the determination of the time of contract formation, it was stated that the issue was adequately dealt with by draft article 11. Also in favour of deletion of draft article 8, it was stated that no attempt should be made to provide a rule on the time of contract formation that deviated from the substance of the United Nations Sales Convention. In that context, it was pointed out that replacing the verb "reach" with the verb "receive" might lead to unforeseen consequences, for example regarding the compatibility with the draft instrument of domestic laws under which a contract would typically be formed when the offeror became aware of the acceptance of the offer (a theory known as contract formation through "information" of the offeror, as opposed to the mere "receipt" of the acceptance by the offeror). It was pointed out in response that the purpose of draft article 8 was not to deviate from the regime established under the United Nations Sales Convention but merely to provide a synthesis of its most essential provisions regarding contract formation.

70. The Working Group maintained its working assumption that it should limit itself to dealing with the use of data messages in the context of international commercial contracting. In view of the support expressed for the preparation of an instrument dealing broadly with the issues of contract formation, it was observed that the Commission at its forthcoming session might wish to discuss the desirability and feasibility of preparing such an instrument.

Paragraph 1

71. In the continuation of its deliberations, the Working Group focused on the individual paragraphs of draft article 8. Strong support was expressed in favour of retaining paragraph 1, which was described as an essential provision in that draft article and its only substantive addition to the text of the UNCITRAL Model Law on Electronic Commerce. Equally strong support was expressed in favour of deletion of the draft paragraph on the assumption that no interference should be made with the general law applicable outside the draft instrument regarding the time of contract formation. The prevailing view was that paragraph 1 should be replaced with a provision along the lines of draft article 10. As to the notion that a contract would be formed upon receipt of the acceptance, it was agreed that it could be reflected in the other paragraphs of draft article 8, for example in paragraph 3. At the close of the discussion, the view was reiterated that language drawn from draft article 10 was insufficient to provide the guidance and harmonization expected by practitioners as to how contracts were concluded.

Paragraphs 2 and 3

72. General agreement was expressed with respect to the substance of paragraphs 2 and 3. As a matter of drafting, it was widely felt that, since offer and acceptance were abstract notions and the purpose of paragraphs 2 and 3 was to solve the difficulty of determining a point in time at which the intent of the parties expressed by way of data messages would become effective as offer or acceptance, paragraphs 2 and 3 should refer to the specific medium or instrument through which the parties' intent would be manifested. Accordingly, paragraph 2 should be redrafted along the lines of: "An offer in the form of a data message becomes effective when the data message is received by the offeree." Paragraph 3 should read along the lines of: "When expressed in the form of a data message, an acceptance of an offer becomes effective at the moment the data message is received by the offeror."

73. The view was reiterated that, in order not to deviate or run the risk of being interpreted differently from the text of the United Nations Sales Convention, draft article 8 should reproduce the remainder of Part II of that Convention. The Working Group took note of that view.

Article 9. Invitations to make offers

74. The text of the draft article, as considered by the Working Group, read as follows:

"1. A proposal for concluding a contract which is not addressed to one or more specific persons, but is generally accessible to persons making use of information systems, such as the offer of goods and services through an Internet web site, is to be considered merely as an invitation to make offers, unless it indicates the intention of the offeror to be bound in case of acceptance.

"2. In determining the intent of a party to be bound in case of acceptance, due consideration is to be given to all relevant circumstances of the case. Unless otherwise indicated by the offeror, the offer of goods or services through automated computer systems allowing the contract to be concluded automatically and without human intervention is presumed to indicate the intention of the offeror to be bound in case of acceptance."

75. The Working Group noted that the draft article, which was inspired by article 14, paragraph 1, of the United Nations Sales Convention, was intended to clarify an issue that had raised a considerable amount of discussion since the advent of the Internet, namely the extent to which parties offering goods or services through open, generally accessible communication systems, such as an Internet web site, were bound by advertisements made on their web site.

Paragraph 1

76. There was general support within the Working Group for the policy underlying the draft paragraph. It was noted that, in a paper-based environment, advertisements in

newspapers, radio and television, catalogues, brochures, price lists or other means not addressed to one or more specific persons, but generally accessible to the public, were generally regarded as invitations to submit offers (according to some legal writers, even in those cases where they were directed to a specific group of customers), since in such cases the intention to be bound was considered to be lacking. By the same token, the mere display of goods in shop windows and on self-service shelves was usually regarded as an invitation to submit offers. That solution was the result of the application of article 14, paragraph 2, of the United Nations Sales Convention, which provided that a proposal other than one addressed to one or more specific persons was to be considered as merely an invitation to make offers, unless the contrary was clearly indicated by the person making the proposal.

77. The Working Group was of the view that, in keeping with the principle of media neutrality, the solution for online transactions should not be different from the solution used for equivalent situations in a paper-based environment. The Working Group was therefore agreed that, as a general rule, a company that advertised its goods or services on the Internet or through other open networks should be considered as merely inviting those who accessed the site to make offers. Thus, an offer of goods or services through the Internet would not *prima facie* constitute a binding offer.

78. Having essentially approved the substance of the draft paragraph, the Working Group considered proposals for clarifying further its scope of application. Consistent with its earlier decisions on focusing on issues particularly related to the use of data messages for electronic transactions, the Working Group agreed that the draft paragraph should be reformulated so as to avoid the impression that it contained a general rule on contract formation.

Paragraph 2

79. In response to a question it was noted that the first sentence of the draft paragraph reproduced some but not all of the elements of the rules on interpretation of statements and conduct of the parties that were contained in article 8 of the United Nations Sales Convention. It was suggested, in that connection, that, while there might be reasons for not reproducing the entirety of article 8 of the United Nations Sales Convention in the narrower context of the draft paragraph, it might be preferable to delete the first sentence of the draft paragraph so as to avoid uncertainty as to the relationship between the draft convention and the United Nations Sales Convention.

80. The Working Group noted that the second sentence of the draft paragraph established a presumption whereby a party offering goods or services through a web site that used interactive applications enabling negotiation and immediate processing of purchase orders for goods or services might be regarded as making a binding offer, unless it clearly indicated its intention not to be bound. That presumption was the object of both support and criticism within the Working Group.

81. Arguments in favour of the presumption underscored the belief that the draft provision helped enhance legal certainty in international transactions. It was stated that parties acting upon offers of goods or services made through the types of system contemplated in the draft paragraph might be led to assume that offers made through such systems were firm offers and that by placing an order they might be validly concluding a binding contract at that point in time. Those parties, it was said, should be able to rely on such a reasonable assumption in view of the potentially significant economic consequences of contract frustration, in particular in connection with purchase orders for securities, commodities or other items with highly fluctuating prices. A rule similar to the one contained in the draft paragraph, it was further said, might help enhance transparency in trading practices by encouraging business entities to state clearly whether or not they accepted to be bound by acceptance of offers of goods or services or whether they were only extending invitations to make offers.

82. The countervailing view was that the rules contained in the draft paragraph might give rise to various difficulties in its interpretation and application. A presumption of the type contemplated in the draft paragraph might have serious consequences for the offeror holding a limited stock of certain goods if it were to be liable to fulfil all purchase orders received from a potentially unlimited number of buyers. It was pointed out that, in order to avert that risk, entities offering goods or services through a web site that used interactive applications enabling negotiation and immediate processing of purchase orders for goods or services frequently indicated in their web sites that they were not bound by those offers. If that was already the case in practice, it would be questionable for the Working Group to reverse that situation in the draft provision. Furthermore, it was said that the party placing an order might have no means of ascertaining how the order would be processed and whether it was in fact dealing with “automated computer systems allowing the contract to be concluded automatically” or whether other actions, by human intervention or through the use of other equipment, might be required in order to effectively conclude a contract or process an order. The formulation in the draft paragraph was further criticized because the words “allowing the contract to be concluded automatically”, which appeared to assume that a valid contract had been concluded, were felt to be misleading in a context dealing with actions that might lead to contract formation.

83. The Working Group considered at length the various views that had been expressed and agreed that the matters raised by the draft paragraph required further consideration by the Working Group. In order to advance its future review of the matter, the Working Group requested the Secretariat to prepare a revised draft of paragraph 2 that contained two alternative options for the presumption in question: one confirming the binding character of the offers contemplated in that provision and another treating them as invitations to make offers.

84. The Secretariat was further requested to prepare another variant of the entire draft paragraph that should be drawn essentially from a combination of elements of

paragraph 1 and the second sentence of paragraph 2, in which the offer of goods or services through web sites using interactive applications would be presented as an illustration of situations involving only an invitation to make offers.

85. In reformulating the draft paragraph, the Secretariat was requested to ensure that the text was focused on issues of electronic contracting and avoid unnecessary repetition of language drawn from the United Nations Sales Convention.

Article 10. Use of data messages in contract formation

86. The text of the draft article, as considered by the Working Group, read as follows:

“1. Unless otherwise agreed by the parties, an offer and the acceptance of an offer may be expressed by means of data messages [or other actions communicated electronically in a manner that is intended to express the offer or acceptance, including, but not limited to, touching or clicking on a designated icon or place on a computer screen].

“2. Where data messages are used in the formation of a contract, that contract shall not be denied validity or enforceability on the sole ground that data messages were used for that purpose.”

87. The Working Group noted that, as a result of its deliberations on draft article 8, the rules contained in the draft article might need to be reformulated and, at least in part, combined with current draft article 8 (see paras. 66-73). Without prejudice to those deliberations, the Working Group proceeded to consider the substance of the draft article.

Paragraph 1

88. The Working Group noted that the rules contained in the draft article were based on article 11, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce. The phrase “or other actions communicated electronically”, and the reference, for illustrative purposes, to “touching or clicking on a designated icon or place on a computer screen”, it was said, were intended to clarify, rather than expand the scope of the rule contained in the Model Law.

89. In connection with the sentence in square brackets, the view was expressed that the illustrative reference to indication of assent by “touching or clicking on a designated icon or place on a computer screen” was not consistent with the principle of technological neutrality and that it carried the risk of being incomplete or becoming dated, as other means of indicating assent not expressly mentioned therein might already be in use or might possibly become widely used in the future. Thus, it was suggested that those words should be deleted from the draft paragraph. An alternative proposal, in that respect, was that the phrase in question be added to the definition of “data messages” in draft article 5,

if such illustration was deemed to be useful. The prevailing view within the Working Group, however, was that any of the actions mentioned in that phrase would in fact generate a data message and that, given the broad meaning of the latter expression in the draft convention, the proposed illustrative addition was not needed in the text of the draft convention. The same conclusion, it was said, might apply to the remainder of the sentence in square brackets.

Paragraph 2

90. A suggestion was made that the draft paragraph was excessively narrow in scope, since it applied only to data messages used in the context of contract formation. It was proposed that the draft paragraph be expanded so as to encompass other messages that might be used in the context of the performance or the termination of a contract. That proposal was objected to on the grounds that there might be situations where domestic law might require certain notices related to contract formation or termination to be made in writing. An example of such requirements might be notices of termination of loan agreement, which, pursuant to rules on debtor protection of some jurisdictions, were not admissible in any form other than a notice written on paper. An international convention such as the one under consideration, it was said, should not interfere with the operation of those rules of domestic law.

91. A proposal was made that the rule contained in the draft paragraph be qualified by a clause indicating that the draft paragraph was subject to draft article 13, which referred to requirements of written form imposed by the law. In response to that proposal it was pointed out that the draft paragraph contained a non-discrimination rule of paramount importance to removing legal obstacles to the use of data messages and that it was essential, in that respect, to reproduce faithfully the substance of the relevant portion of article 11 of the UNCITRAL Model Law on Electronic Commerce, without suggesting a subordination to possible requirements of written form.

92. Having considered both the proposed expansion and qualification to the draft paragraph, as well as the objections thereto, the Working Group agreed, for the time being, to retain the scope of the draft paragraph as currently formulated until it had fully considered the scope of application of the draft convention, in particular the exclusions under draft article 2 at its fortieth session (see para. 15).

Article 11. Time and place of dispatch and receipt of data messages

93. The text of the draft article, as considered by the Working Group, read as follows:

“1. Unless otherwise agreed by the parties, the dispatch of a data message occurs when it enters an information system outside the control of the originator or of the person who sent the data message on behalf of the originator.

“2. Unless otherwise agreed by the parties, if the addressee has designated an information system for the

purpose of receiving data messages, the data message is deemed to be received at the time when it enters the designated information system; if the data message is sent to an information system of the addressee that is not the designated information system, [the data message is deemed to be received] at the time when the data message is retrieved by the addressee. If the addressee has not designated an information system, receipt occurs when the data message enters an information system of the addressee.

“3. Paragraph 2 of this article applies notwithstanding that the place where the information system is located may be different from the place where the data message is deemed to be received under paragraph 5 of this article.

“4. Unless otherwise agreed by the parties, when the originator and the addressee use the same information system, both the dispatch and the receipt of a data message occur when the data message becomes capable of being retrieved and processed by the addressee.

“5. Unless otherwise agreed between the originator and the addressee, a data message is deemed to be dispatched at the place where the originator has its place of business, and is deemed to be received at the place where the addressee has its place of business, as determined in accordance with article 7.”

94. The deliberations of the Working Group were focused on draft paragraph 2, which was criticized for being overly complex and for containing an excessive level of detail. From a substantive point of view, it was suggested that a rule on receipt of data messages that focused on the moment when a data message entered a given information system was said to be excessively rigid and insufficient to ensure that the addressee had actual knowledge of the message. It was said that the fact that a message had entered the addressee's system or another system designated by the addressee might not always allow the conclusion that the addressee was capable of accessing the message. The rule contained in draft paragraph 2 should be rendered more flexible by adding the notion of accessibility of the data message to the elements mentioned in the draft paragraph.

95. One line of thought in that connection was that the rules set forth in the draft paragraph were substantially acceptable, but that the first and the last sentence of the draft paragraph needed further qualification by adding language such as “and the data message comes to the attention of the addressee”. Such an addition, it was said, might address situations where the message was not capable of being accessed by the addressee for reasons beyond the addressee's control, such as interruption or unavailability of access by the addressee to the information system.

96. Another line of thought was that it would be preferable to replace the entire paragraph 2, and possibly paragraphs 3-5 as well, with a shorter provision to the effect that a data message was deemed to be received if the message was capable of being retrieved and processed by the addressee.

97. While there was wide and strong support for the latter proposal, the Working Group also heard strong objections thereto. It was pointed out that the entire draft paragraph was based on article 15 of the UNCITRAL Model Law on Electronic Commerce and that care should be taken to avoid inconsistencies between the two texts. As currently formulated, the rules contained in the draft paragraph were felt to replicate, in an electronic environment, the tests used for dispatch and receipt of paper-based communications, namely, the moment when the communication left the sphere of control of the sender and the moment when it entered the sphere of control of the recipient. The notion of “entry” into an information system, which was used for both the definition of dispatch and that of receipt of a data message, referred to the moment when a data message became available for processing within an information system. The rules in the draft paragraph were said to be essentially intended to establish functional equivalence, but not to develop particular rules for electronic commerce. For that reason, it was said to be undesirable to craft the rules on the basis of the time when a message became intelligible or usable by the addressee. Those issues should remain outside the purview of the draft convention. Furthermore, it was said that paragraph 2 contained an important rule allowing the parties to designate a specific information system for receiving certain communications, for instance, where an offer expressly specified the address to which acceptance should be sent. Such a possibility was said to be of great practical importance, in particular for large corporations using various communications systems at different places.

98. The Working Group considered at length the differing views that were expressed. While a broadly held view was in favour of replacing draft paragraph 2 with a more general rule based on the notion of accessibility of a data message, the Working Group agreed that the matter required further consideration and decided that the current text of the draft paragraph should be kept in square brackets, as an alternative to a new paragraph to be prepared by the Secretariat. In preparing an alternative draft, the Secretariat was requested to include language that broadened the scope of the draft provisions so as to encompass other commercial communications beyond offers and acceptances.

Article 12. Automated transactions

99. The text of the draft article, as considered by the Working Group, read as follows:

“1. Unless otherwise agreed by the parties, a contract may be formed by the interaction of an automated computer system and a natural person or by the interaction of automated computer systems, even if no natural person reviewed each of the individual actions carried out by such systems or the resulting agreement.

“2. Unless otherwise [expressly] agreed by the parties, a party offering goods or services through an automated computer system shall make available to the parties that use the system technical means allowing the parties to identify and correct errors prior to the conclusion of a contract. The technical means to be made

available pursuant to this paragraph shall be appropriate, effective and accessible.

“[3. A contract concluded by a natural person that accesses an automated computer system of another person has no legal effect and is not enforceable if the natural person made a material error in a data message and:

“(a) The automated computer system did not provide the natural person with an opportunity to prevent or correct the error;

“(b) The natural person notifies the other person of the error as soon as practicable when the natural person learns of it and indicates that he or she made an error in the data message;

“(c) The natural person takes reasonable steps, including steps that conform to the other person’s instructions to return the goods or services received, if any, as a result of the error or, if instructed to do so, to destroy such goods or services; and

“(d) The natural person has not used or received any material benefit or value from the goods or services, if any, received from the other person.]”

General comments

100. Questions were raised as to the practical need for regulating automated transactions specifically. It was stated that the issues regulated in draft article 12 were already, or should be, answered in other draft articles. It was said that, in practice, it might be problematic to distinguish automated transactions from semi-automated and non-automated transactions.

101. The Working Group took note of those views and was mindful of the conceptual difficulties related to the notion of “automated computer system”, as used in the draft article, and of the need to avoid formulating rules on errors in an electronic environment that departed from the rules that applied in corresponding situations in a paper-based environment.

Paragraph 1

102. The Working Group noted that the draft paragraph developed further a principle formulated in general terms in article 13, paragraph 2 (b), of the UNCITRAL Model Law on Electronic Commerce. The draft paragraph, it was pointed out, was not intended to innovate on the current understanding of legal effects of automated transactions, as expressed by the Working Group (see A/CN.9/484, para. 106), that a contract resulting from the interaction of a computer with another computer or person was attributable to the person in whose name the contract was entered into.

103. Subject to replacing the words “natural person” with the word “person” and “automated computer system” with “automated information system”, the Working Group was of the view that the substance of the draft paragraph was generally acceptable.

Paragraphs 2 and 3

104. The Working Group held an extensive discussion on the need for and desirability of formulating specific rules to address mistakes and errors made by persons when dealing with automated computer systems.

105. There were expressions of strong support for including provisions dealing with errors in electronic transactions. There was a need for such a specific provision in the light of the relatively higher risk of human errors being made in online transactions made through automated information systems than in more traditional modes of contract negotiation. The need for specific provisions was even greater since errors made by the parties in those situations might become irreversible once acceptance was dispatched.

106. The countervailing view was that the provisions under consideration might interfere with well-established notions of contract law and were not appropriate in the context of the new instrument. It was said that the provisions along the lines of draft paragraph 2 and, even more so, draft paragraph 3, carried the risk of creating a duality of regimes on the legal consequences of mistake and error for electronic and non-electronic environments.

107. The prevailing view within the Working Group was that it would be useful to address the issue of errors and mistakes in electronic transactions. For purposes of clarity, such provisions should preferably appear in a separate article of the draft convention. The Working Group then proceeded to consider specific comments that were made in respect of paragraphs 2 and 3.

108. Various speakers expressed the view that draft paragraph 2 was of a regulatory or public law nature and that, as such, it was not appropriate for the draft convention to contain such a provision. Typically, an obligation for persons offering goods or services through automated information systems to offer means for correcting input errors could only be effective if sanctions of an administrative or regulatory nature were provided for non-compliance with such an obligation. As the draft paragraph did not, and by its very nature could not, provide such a system of sanctions, it would be preferable to delete the provision.

109. The countervailing view, which eventually prevailed, was that the draft paragraph was a useful provision to encourage best practices in electronic transactions and that the provision should be retained in the draft convention. Although provisions of that type might be found in consumer protection legislation, the prevailing view within the Working Group was that they could be appropriate in a business-to-business context as well. Furthermore, the draft paragraph could not be regarded as being overly prescriptive since it expressly recognized the parties’ freedom to deviate from its provisions. Some of the concerns that had been expressed, it was suggested, could be addressed by reformulating the draft paragraph to express more clearly the logical relationship between draft paragraphs 2 and 3, which established a sanction of a private law nature.

110. With regard to draft paragraph 3, it was suggested that such a provision might not be appropriate in the

context of commercial (i.e. non-consumer) transactions, since the right to repudiate a contract in case of material error might not always be provided under general contract law. Adopting a solution along the lines of the draft paragraph might interfere with well-established principles of domestic law. The use of automated information systems alone was not felt to be a sufficient reason to that end. Also, subparagraphs (c) and (d) were felt to go beyond matters of contract formation and depart from the consequences of avoidance of contracts under some legal systems. The prevailing view within the Working Group, however, was that a provision providing a harmonized solution for dealing with the consequences of errors in electronic transactions had great practical importance and was needed in the draft convention. The fact that the provision dealt with the validity of contracts was said to be consistent with draft article 3.

111. Nevertheless, the Working Group considered that the notion of “material error” in the draft paragraph needed to be clarified. Furthermore, the Working Group agreed that a revision of the draft paragraph to be prepared by the Secretariat could provide a second variant of draft paragraph 2 for which some of the substance of subparagraph (a) might be used. It was suggested that subparagraphs (c) and (d) could be combined under another paragraph, as a further alternative for consideration by the Working Group.

Article 13. Form requirements

112. The text of the draft article, as considered by the Working Group, read as follows:

“1. Nothing in this Convention requires a contract to be concluded in or evidenced by writing or subjects a contract to any other requirement as to form.

“2. Where the law requires that a contract to which this Convention applies should be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.

Variant A

“3. Where the law requires that a contract to which this Convention applies should be signed, that requirement is met in relation to a data message if:

“(a) A method is used to identify that person and to indicate that person’s approval of the information contained in the data message; and

“(b) That method is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.”

Variant B

“3. Where the law requires that a contract to which this Convention applies should be signed, or provides consequences for the absence of a signature, that

requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

“4. An electronic signature is considered to be reliable for the purposes of satisfying the requirements referred to in paragraph 3 if:

“(a) The signature creation data are, within the context in which they are used, linked to the signatory and to no other person;

“(b) The signature creation data were, at the time of signing, under the control of the signatory and of no other person;

“(c) Any alteration to the electronic signature, made after the time of signing, is detectable; and

“(d) Where the purpose of the legal requirement for a signature is to provide assurances as to the integrity of the information to which it relates, any alteration made to that information after the time of signing is detectable.

“5. Paragraph 4 does not limit the ability of any person:

“(a) To establish in any other way, for the purposes of satisfying the requirement referred to in paragraph 3, the reliability of an electronic signature;

“(b) To adduce evidence of the non-reliability of an electronic signature.”

113. It was observed that draft article 13 combined essential provisions on form requirements of the United Nations Sales Convention (art. 11) with provisions of articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce. Paragraph 1 restated the general principle of freedom of form contained in article 11 of the United Nations Sales Convention. Paragraph 2 set forth the criteria for the functional equivalence between data messages and paper documents, in the same manner as article 6 of the UNCITRAL Model Law on Electronic Commerce. Variant A stated the general criteria for the functional equivalence between handwritten signatures and electronic identification methods referred to in article 7 of the UNCITRAL Model Law on Electronic Commerce. Variant B was based on article 6, paragraph 3, of the UNCITRAL Model Law on Electronic Signatures. It was pointed out that, in contrast with the structure adopted in article 6, paragraph 3, of the UNCITRAL Model Law on Electronic Commerce, possible exclusions of certain fact situations from the scope of draft article 13 were not dealt with by way of a general provision in that draft article. Such possible situations where traditional form requirements might need to be maintained were intended to be dealt with under draft article 2. The view was expressed that a different approach should be taken, by way of a reproduction in the draft instrument of article 96 of the United Nations Sales Convention. It was generally felt, however, that creating a possibility for contracting States whose legislation required contracts to be concluded in or evidenced by writing to make a declaration to the effect of avoiding application of the more liberal rule

embodied in draft article 13 would be excessively complex. It was agreed that the matter might need to be further discussed in the context of draft article 2.

Paragraph 1

114. While the policy on which paragraph 1 was based met with wide approval, doubts were expressed as to the usefulness of expressly stating in the draft convention a rule that, in the view of a number of delegations, merely restated the obvious, duplicated certain provisions of draft articles 10 and 12 and provided little harmonizing effect. The view was expressed that paragraph 1 would serve a useful purpose if it were to be interpreted as confirming that it was up to domestic legislation to establish general form requirements regarding contract formation. Support was expressed in favour of that interpretation, which was said to confirm that it was unnecessary to resort to a declaration mechanism such as the one created by article 96 of the United Nations Sales Convention.

115. The prevailing view, however, was that paragraph 1 was useful and should be retained in square brackets, pending further consideration by the Working Group at a later stage. As a matter of drafting, doubts were also expressed regarding the merit of reproducing part of article 11 of the United Nations Sales Convention. It was pointed out that the reference to “writing” in that Convention was understandable since it had been drafted at a time when writing was the main form requirement likely to be imposed in contract-making. It was suggested that the draft instrument should instead adopt a formulation more in line with current contractual practices along the lines of “nothing in this Convention requires a contract to be concluded or evidenced [in a particular form] [by data messages or in any other form]”. After discussion, the Working Group agreed that the suggested wording should be reflected in a future redraft of paragraph 1.

Paragraph 2

116. The substance of paragraph 2 was found generally acceptable. Questions were raised regarding the exact meaning of the reference to “the law”, which might require a contract to be in writing, and also regarding the meaning of the words “in writing”. It was suggested that those issues might need to be discussed further in the context of draft article 5. The suggestion was noted by the Working Group.

117. The view was expressed that, while the result expected from paragraph 2 could also be reached through interpretation of existing domestic law, more serious difficulties might stem from writing requirements contained in multilateral instruments. It was observed that the matter might need to be discussed further in the context of item 5 of the agenda.

Paragraph 3

118. Support was expressed in favour of either variant A or B. In favour of variant B, it was pointed out that the

text was more detailed and more apt than variant A to provide legal certainty with respect to the use of electronic signatures. In support of variant A, it was stated that the text contained a more flexible provision than variant B, that it could more easily be made consistent with the stricter requirements that might exist in domestic legislation regarding the characteristics of an electronic signature and that it was more reflective of the principle of technology neutrality.

119. A widely shared view was that variant A should be retained, pending future discussion regarding the definition of “data message” in draft article 5. It was stated that the minimal harmonization that could be expected from variant A was sufficient to reduce the risk linked with the application of foreign electronic signature legislation. Another view was that neither of the variants was necessary if the main purpose of the draft instrument was to deal with contract formation. It was stated by its proponents that this view might be reconsidered if the Working Group decided that an important purpose of the draft instrument was to provide a version of the UNCITRAL Model Laws on Electronic Commerce and on Electronic Signatures in the form of a convention. Yet another view that gathered some support was that the two variants could be combined, with variant A applying as the smallest common denominator where States had already adopted electronic signature legislation and variant B applying where no such domestic legislation existed. It was pointed out in response that such a combination would result in undesirable duality of the legal regimes applicable. Furthermore, it was observed that combining the two variants would amount to adopting variant B, which reproduced and built upon the text of article 6 of the UNCITRAL Model Law on Electronic Commerce reproduced as variant A.

120. As a matter of drafting, it was pointed out that, should variant A be retained, words along the lines of “or provides consequences for the absence of a signature” should be inserted. With respect to both variants, it was pointed out that the reference to legal requirements with regard to “a contract” was too restrictive and should be extended to cover also pre- and post-contractual “communications”, “statements” or “manifestations of will” between the parties using data messages.

121. After discussion, the Working Group did not reach agreement regarding either of the variants. The Secretariat was requested to prepare a revised version of draft article 13, with possible alternative wordings, taking into account the various views and suggestions that had been expressed.

Article 15. Availability of contract terms

122. The text of the draft article, as considered by the Working Group, read as follows:

“A party offering goods or services through an information system that is generally accessible to the public shall make the data message or messages which contain the contract terms and general conditions available to the other party for a reasonable period of time in

a way that allows for their storage and reproduction. A data message is deemed not to be capable of being stored or reproduced if the originator inhibits the printing or storage of the data message or messages by the other party.”

123. The view was expressed that, for reasons expressed in the context of the discussion regarding draft articles 14 and 12, draft article 15 should be deleted. It was stated that it was pointless to establish regulatory provisions in the draft instrument, in particular if no sanction was created. In favour of deletion, it was also stated that draft article 15 would result in imposing rules that did not exist in the context of paper-based transactions, thus departing from the policy that the draft instrument should not create a duality of regimes governing paper-based contracts on the one hand and electronic transactions on the other. The widely prevailing view, however, was that the general policy embodied in the draft article should be retained, since it addressed specifically an element that was particularly important in the context of electronic contracts. It was agreed that further consideration might be needed in respect of the consequences of non-compliance with draft article 15. Possible consequences such as the nullity of the

contract or the non-incorporation of the general terms and conditions in the contract were mentioned.

124. With respect to the formulation of draft article 15, it was suggested that the words “for a reasonable period of time” should be deleted since the obligation to make the general conditions available to the public should not be limited in time. With respect to the last sentence, doubts were expressed as to whether such a “deeming” provision was sufficiently flexible to allow for the creation of “original” or “unique” electronic documents, which might sometimes be obtained through inhibition of the capacity of reproducing the electronic document. It was also suggested that further discussion might be necessary to determine whether the second sentence was needed in view of the requirement contained in the first sentence of the draft article, which would simply not be met in the situation considered under the second sentence.

125. After discussion, the Working Group requested the Secretariat to prepare a revised version of draft article 15, based on the above discussion, to be placed between square brackets for continuation of the discussion at a future session.

**B. Note by the Secretariat on legal aspects of electronic commerce:
legal barriers to the development of electronic commerce in
international instruments relating to international trade, working paper
submitted to the Working Group on Electronic Commerce
at its thirty-ninth session**

(A/CN.9/WG.IV/WP.94) [Original: English]

1. At its thirty-second session, in 1999, the United Nations Commission on International Trade Law (UNCITRAL) considered a recommendation that had been adopted on 15 March 1999 by the Centre for the Facilitation of Procedures and Practices for Administration, Commerce and Transport (now known as the Centre for Trade Facilitation and Electronic Business, CEFAC) of the Economic Commission for Europe.¹ That text recommended that UNCITRAL consider the actions necessary to ensure that references to “writing”, “signature” and “document” in conventions and agreements relating to international trade allowed for electronic equivalents. Support was expressed for the preparation of an omnibus protocol to amend multilateral treaty regimes to facilitate the increased use of electronic commerce.

2. Other items suggested for future work included electronic transactional and contract law; electronic transfer of rights in tangible goods; electronic transfer of intangible rights; rights in electronic data and software (possibly in cooperation with the World Intellectual Property

Organization); standard terms for electronic contracting (possibly in cooperation with the International Chamber of Commerce and the Internet Law and Policy Forum); applicable law and jurisdiction (possibly in cooperation with the Hague Conference on Private International Law); and online dispute settlement systems.²

3. The Commission took note of the above proposals. It was decided that, upon completing its current task, namely, the preparation of draft uniform rules on electronic signatures, the Working Group would be expected, in the context of its general advisory function regarding the issues of electronic commerce, to examine some or all of the above-mentioned items, as well as any additional items, with a view to making more specific proposals for future work by the Commission.³

4. The Working Group considered proposals for removing obstacles to electronic commerce in existing international conventions at its thirty-eighth session, in 2001, on

¹The text of the recommendation to UNCITRAL is contained in document TRADE/CEFACT/1999/CRP.7. Its adoption by CEFAC is stated in the report of CEFAC on the work of its fiftieth session (TRADE/CEFACT/1999/19, para. 60).

²*Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17), para. 251, and ibid., Fifty-third Session, Supplement No. 17 (A/53/17), para. 211.*

³*Ibid., Fifty-fourth Session, Supplement No. 17 (A/54/17), paras. 315-318.*

the basis of a note by the Secretariat (A/CN.9/WG.IV/WP.89). That note reproduced an analysis of the public international law issues that would be raised by the actions necessary to ensure that references to “writing”, “signature” and “document” in conventions and agreements relating to international trade allowed for electronic equivalents that had been prepared by Geneviève Burdeau, Professor at the University of Paris I—Panthéon Sorbonne, Associate of the International Law Institute and Secretary-General of the Hague Academy of International Law, at the request of the Secretariat.

5. The Working Group agreed to recommend to the Commission that it undertake work towards the preparation of an appropriate international instrument or instruments to remove those legal barriers to the use of electronic commerce which might result from international trade law instruments. The Working Group also agreed to recommend to the Commission that the Secretariat be requested to carry out a comprehensive survey of possible legal barriers to the development of electronic commerce in international instruments, including, but not limited to, those instruments already mentioned in the CEFACCT survey. Such a study should aim at identifying the nature and context of such possible barriers with a view to enabling the Working Group to formulate specific recommendations for an appropriate course of action. The study should be carried out by the Secretariat with the assistance of outside experts and in consultation with relevant international governmental and non-governmental organizations. The Commission endorsed that recommendation at its thirty-fourth session, in 2001.⁴

6. The purpose of the present note is to appraise the Working Group of the progress made by the Secretariat in carrying out the work entrusted to it by the Commission, following the recommendation of the Working Group. In anticipation of the endorsement by the Commission of the

recommendation that had been made by the Working Group at its thirty-eighth session, the Secretariat had immediately thereafter begun with a survey of possible legal barriers to the development of electronic commerce in international instruments. For that purpose, the Secretariat used as a starting point the instruments already mentioned in the CEFACCT survey. That list was then expanded to include other instruments relevant to trade law. At the current stage, the survey has been limited to instruments deposited with the Secretary-General. At a second stage, the survey might encompass international instruments deposited with other depositaries. The annex to the present note contains the results of the initial analysis of the instruments currently covered by the survey (33 international conventions altogether) and the preliminary conclusions as to the types of provision in each instrument that might create obstacles to electronic commerce.

7. The survey was limited to multilateral treaties registered with the Secretary-General of the United Nations that are listed under chapters X (International trade and development), XI (Transport and communications), XXI (Law of the sea), and XXII (Commercial arbitration) of the “Status of Multilateral Treaties deposited with the Secretary-General”.⁵ Conventions registered with national Governments or other organizations, such as the International Civil Aviation Organization, the International Institute for the Unification of Private Law (Unidroit) or the Hague Conference on Private International Law, have not been included in the survey at the present stage. The survey does not cover bilateral treaties, model laws or non-governmental texts.

8. The Working Group may wish to review the work carried out thus far by the Secretariat and consider, in particular, whether the methodology used by the Secretariat in the conduct of the survey is appropriate to this project, as envisaged by the Working Group.

⁴In view of the proximity of the dates of the Commission’s thirty-fourth session and the Working Group’s thirty-ninth session, the report of the Commission on the work of that session was not yet available at the time the present note was prepared.

⁵Available from untreaty.un.org

ANNEX

PRELIMINARY SURVEY OF POSSIBLE OBSTACLES TO ELECTRONIC COMMERCE IN INTERNATIONAL INSTRUMENTS RELATING TO INTERNATIONAL TRADE DEPOSITED WITH THE SECRETARY-GENERAL*

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*All references to the status of conventions and agreements are as at 5 February 2002.

**The number preceding the title of each instrument corresponds to the number under which the instrument appears in the respective chapter in the publication “Status of Multilateral Treaties Deposited with the Secretary-General”.

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I. INTERNATIONAL TRADE AND DEVELOPMENT

Comments

3. *Convention on Transit Trade of Land-locked States* (New York, 8 July 1965)

Status: Entered into force on 9 June 1967 (27 signatories; 37 parties).

Source: United Nations, *Treaty Series*, vol. 597, No. 8641, p. 3.

Comments

1. The purpose of the Convention is to invite the contracting parties to give full recognition to the needs of land-locked States in the matter of transit trade, instead of special taxes and charges, and to provide an opportunity to States with no sea coast to enjoy identical rights and treatment to those accorded coastal States.

2. Pursuant to article 5, the contracting States undertake to use simplified documentation and expeditious methods with regard to customs, transport and other administrative procedures relating to traffic in transit for the whole transit journey in their territory. Insofar as the Convention does not establish the form of such documentation, it does not seem to create obstacles to the development of electronic commerce. Whether and to what extent such "simplified documentation and expeditious methods with regard to customs" may involve electronic communications is a matter left for domestic law implementing the Convention.

Conclusions

3. The provisions of the Convention are of a trade policy nature. They are addressed to States and do not establish rules directly applicable to private law transactions. Furthermore, the extent to which electronic communications may be substituted for paper-based documents for the purposes of the Convention is dependent to a large extent upon the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form.

4. Given the close relationship between the Convention and other international instruments on customs and trade facilitation matters, the Working Group may wish to consider any issues related to electronic commerce that might arise under the Convention together with its consideration of those other instruments (see, in particular, paras. 52-82 below).

7. *Convention on the Limitation Period in the* *International Sale of Goods (New York, 14 June 1974)* *and Protocol thereto (Vienna, 11 April 1980)*

Status: Entered into force on 1 August 1988 (Convention: 12 signatories; 24 parties; Protocol: 17 parties).

Source: United Nations, *Treaty Series*, vol. 1511, No. 26119, p. 1.

5. The purpose of the Convention is to adopt uniform rules governing the limitation period in the international sale of goods.

6. The Convention contains various references to written form as well as to paper documents or other forms of communication, some of which might give rise to uncertainties in connection with electronic commerce. Those provisions may be grouped under essentially four categories, as indicated below.

(a) *Provisions that contemplate notices or* *declarations that may be exchanged by the parties*

7. Various provisions of the Convention attribute certain legal effects to notices that may be exchanged or declarations that may be made by the parties.

8. For example, article 12 provides that "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 the 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". Another example is article 14, paragraph 2, which provides that, for the purpose of establishing the time when a limitation period ceases to run upon commencement of arbitral proceedings, such proceedings are 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 that party has no such residence or place of business, then at that party's last known residence or place of business.

9. The Convention is silent as to whether such declarations or notices may be made by means of electronic communication. Neither does it specify when such declarations or notices are deemed to have been made or offer criteria that allow for such a determination in connection with electronic communications.

(b) *Provisions that expressly contemplate written notices* *or communications, including definitions of "writing"*

10. Various provisions in the Convention refer to communications that need to be made "in writing".

11. For example, article 18, paragraph 1, provides that, where legal proceedings have been commenced against one debtor, the limitation period prescribed in the 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. Paragraph 2 of the same article provides further that, where legal proceedings have been commenced by a sub-purchaser against the buyer, the limitation period prescribed in the 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.

12. Also, pursuant to article 20, 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 from the date of such acknowledgement. Further writing requirements are contained in article 22, which provides that the limitation period cannot be modified or affected by any declaration or agreement between the parties, except where the debtor, during the running of the limitation period, extends the period by a declaration in writing to the creditor.

13. The definition of “writing” in article 1, paragraph 3 (g), which includes “telegram and telex”, may not *prima facie* include electronic communications.

(c) *Provisions that refer to time and place of contract formation*

14. The provisions relating to the sphere of application of the Convention are built upon essentially two elements: the “internationality” of the contract and the parties’ location in the territories of different contracting States to the Convention at the time the contract is concluded (see arts. 2, subpara. (a), and 3, para. 1 (a)).

15. Those provisions may give rise to difficulties in electronic commerce, since most systems of contract law use the notions of dispatch and receipt of offer and acceptance for the purpose of determining the time of contract formation. It may be difficult to determine the place at which a message has been either dispatched or received. Transmission protocols of data messages between different information systems usually register the moment when a message is delivered from one information system to another or the moment when it is effectively received or read by the addressee. However, transmission protocols do not usually indicate the geographical location of the communication systems.

(d) *Provisions that refer to an existing undertaking or agreement between the parties*

16. Some provisions of the Convention refer to an underlying undertaking or agreement between the parties to which the Convention attaches certain consequences in connection with the limitation period.

17. Article 11 provides that if the seller has given an express undertaking relating to the goods that 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 claims 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.

18. As with the provisions contemplating notices or declarations (see paras. 7-9 above), the Convention is silent as to whether such undertaking may be made by means of electronic communication. Neither does it specify when such undertaking is deemed to have been made or offer criteria that allow for such a determination in connection with electronic communications.

19. Also, article 14 provides that, 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. This provision supposes the validity of the

arbitration agreement, but does not itself establish any requirements as to the form of such an agreement, which is implicitly left for the law applicable to the arbitration agreement.

Conclusions

20. The Working Group may wish to consider whether the types of issue related to electronic contracting raised under the Convention might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

10. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 11 April 1980)

Status: Entered into force on 1 January 1988 (18 signatories; 61 parties).

Source: United Nations, *Treaty Series*, vol. 1489, No. 25567, p. 3.

Comments

21. The purpose of the Convention is to adopt a set of uniform rules for the contracts for the sale of goods between parties whose places of business are in different States, in order to eliminate legal barriers and promote the development of international trade.

22. The issues of electronic contracting that might arise under the Convention were extensively analysed in an earlier note by the Secretariat (A/CN.9/WG.IV/WP.91) and considered by the Working Group at its thirty-eighth session (see A/CN.9/484, paras. 94-127). Some of those issues are also discussed in a more recent note by the Secretariat (A/CN.9/WG.IV/WP.95). For purposes of economy, the present note does not repeat those considerations, but adds only the following brief comments.

23. Generally, the issues of electronic contracting that might arise under the Convention fall largely under the same categories that have been identified above in respect of the Convention on the Limitation Period in the International Sale of Goods, with the additions indicated below.

(a) *Nature of goods covered by the Convention*

24. The Convention has been held to apply only to contracts for the international sale of “goods”, a term that has traditionally been understood to refer basically to movable tangible goods, thus excluding intangible assets, such as patent rights, trademarks, copyrights and a quota of a limited liability company, as well as know-how.

25. In its initial discussion on issues of electronic contracting, there was general agreement within the Working Group that existing international instruments, notably the United Nations Sales Convention, did not cover a variety of transactions currently made online and that it might be useful to develop harmonized rules to govern international transactions other than sales of movable tangible goods in the traditional sense (A/CN.9/484, para. 115). The Working Group was nevertheless reminded that, in practice, it was not always possible to draw a clear line between contracts for the sale of goods and contracts for the provision of services. Clear examples of the difficulty of distinguishing between goods and services could be found in transactions involving entertainment articles such as music or video records. The sale online of articles such as minidisks or videotapes would usually be regarded as a sale of goods, whereas

the offering of online broadcasts of movies, television shows or music concerts would seem to fall into the category of services. However, modern technology also offered the possibility of purchasing digitalized music or video files that could be downloaded directly from the seller's web site, without delivery of any tangible medium. The intent of the parties, it was suggested, had to be more closely examined in order to determine whether the transaction involved goods or services (A/CN.9/484, para. 117).

(b) *Definition of performance in electronic commerce*

26. Various provisions of the Convention refer to the obligations of seller and buyer in respect of delivery of goods. Article 60, for example, provides that the buyer's obligation to take delivery consists of: (a) doing all the acts that could reasonably be expected of him in order to enable the seller to make delivery; and (b) taking over the goods. The nature of such acts is well understood in connection with the delivery of tangible goods. However, to the extent that the Convention might be interpreted as covering the sale of products other than tangible movable goods (see previous comment under (a) above), questions might arise as to what acts constitute effective delivery of such goods.

Conclusions

27. In general, the issues raised by the Convention are issues of electronic contracting, as understood by the Working Group (see A/CN.9/WG.IV/WP.95, paras. 10-12). The Working Group may thus wish to consider whether those issues might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

12. *United Nations Convention on International Bills of Exchange and International Promissory Notes* (New York, 9 December 1988)

Status: Not yet in force (3 signatories; 3 parties).

Source: General Assembly resolution 43/165, annex.

Comments

28. The purpose of the Convention is to overcome the disparities and uncertainties that currently exist in international trade when international bills of exchange or international promissory notes are used as an instrument for international payment.

29. Bills of exchange and promissory notes are negotiable instruments under most legal systems. As such, the legal regime governing those instruments typically presupposes the existence of an instrument that, at least at some point, exists in tangible documentary form. In an earlier note, the Secretariat analysed various legal issues that arise in connection with developing an electronic equivalent to paper-based negotiable instruments (A/CN.9/WG.IV/WP.90). In order to avoid unnecessary repetition, the following paragraphs summarize some of the considerations made in that note.

30. Surmounting the issues of writing and signature in an electronic context does not solve the issue of negotiability, which has been said to be perhaps the most challenging aspect of implementing electronic data interchange in international trade practices. Rights represented by documents of title, such as bills of lading or warehouse receipts, are typically conditioned by the physical possession of an original paper document. Analyses of the legal basis for the negotiability of documents of title have indicated that

there is generally no statutory means in place by which commercial parties, through the exchange of electronic messages, can validly transfer legal rights in the same manner possible with paper documents.

31. That conclusion is also essentially valid for rights represented by negotiable instruments such as bills of exchange or promissory notes. Moreover, the legal regime of negotiable instruments is in essence based on the technique of a tangible original paper document, susceptible to immediate visual verification on the spot. In the present state of legislation, negotiability cannot be divorced from the physical possession of the original paper document.

32. Thus, it has been said that one challenge in developing law to accommodate electronically transmitted documents of title is to generate them in such a way that holders who claim due negotiation will feel assured that there is a document of title in existence, that it has no defects upon its face, that the signature, or some substitute therefor is genuine, that it is negotiable and that there is a means to take control of the electronic document equivalent in law to physical possession (A/CN.9/WG.IV/WP.90, para. 36).

33. The development of electronic equivalents to documents of title and negotiable instruments would therefore require the development of systems by which transactions could actually take place using electronic means of communication. That result could be achieved through a registry system, where transactions would be recorded and managed through a central authority, or through a technical device based on cryptography that ensures the singularity of the relevant data message. In the case of transactions that would have used transferable or quasi-negotiable documents to transfer rights that were intended to be exclusive, either the registry system or the technical device would need to provide a reasonable guarantee as to the singularity and the authenticity of the transmitted data.

Conclusions

34. In view of the particular nature of the issues raised by electronic substitutes for negotiable instruments, it appears that a comprehensive new legal framework might be required in order to allow for the international use of data messages in lieu of paper-based negotiable instruments. The Secretariat submits that developing such a comprehensive legal framework might go beyond the scope of the Working Group's efforts to remove obstacles to electronic commerce in existing instruments related to international trade. The Secretariat further submits that an analysis of the specific requirements for such a comprehensive legal framework might best be undertaken in the course of the Working Group's consideration of legal issues related to the transfer of rights, in particular, rights in tangible goods, by electronic means (see A/CN.9/484, paras. 87-93).^a

13. *United Nations Convention on the Liability of Operators of Transport Terminals in International Trade* (Vienna, 17 April 1991)

Status: Not yet in force (5 signatories; 2 parties).

Source: A/CONF.152/13.

Comments

35. The purpose of the Convention is to facilitate the movement of goods by establishing uniform rules concerning liability for

^aSee also *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr.3)*, para. 291.

loss of or damage to or delay in handing over such goods when they are in the charge of operators of transport terminals. These goods are not necessarily covered by the laws of carriage arising out of conventions applicable to the various modes of transport.

36. The Convention contains a number of provisions relating to communications between the private parties involved, which to a greater or lesser extent may give rise to doubts as to the acceptability of electronic communications for the purposes contemplated in it. The relevant provisions fall generally under the same categories that have been described above in connection with the Convention on the Limitation Period in the International Sale of Goods (see paras. 7-19 above).

37. Some of those provisions are already formulated in a manner intended to accommodate electronic means of communication. This is the case, for instance, of the definitions of "notice" ("a notice given in a form which provides a record of the information contained therein"); and "request" ("a request made in a form which provides a record of the information") contained in subparagraphs (e) and (f), respectively, of article 1. The Convention uses the notion of "notice" essentially in connection with communications of loss of or damage to goods handed over to an operator of a transport terminal (see, for instance, art. 11, paras. 1-3 and 5) and the notion of "request" in connection with the customer's demand for the issuance of an acknowledgement of receipt in respect of the goods (see, for instance, art. 4, para. 1) and requests for delivery of the goods (see, for instance, art. 5, paras. 3 and 4).

38. Potentially more problematic, however, seem to be the form requirements for the instrument whereby the operator of the transport terminal acknowledges receipt of the goods. Indeed, article 4, paragraph 1 (a) and (b), of the Convention, besides referring to "signature", uses for that purpose the term "document" in a context that appears to presuppose the use of a tangible medium. Those provisions read as follows:

"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."

39. It should be noted that the "document" envisaged by the Convention is not a document of title to the goods, but only evidence of custody of the goods by the operator of the transport terminal. The main issue that might be raised by the use of electronic communications for this purpose would thus relate to the evidentiary value of such communications, rather than to their effectiveness for the purpose of conferring title to the goods.

Conclusions

40. The Working Group may wish to consider whether the types of issue of electronic contracting raised under the Convention might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

15. United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 11 December 1995)

Status: Entered into force on 1 January 2000 (4 signatories; 6 parties).

Source: A/50/640 and Corr.1, annex.

Comments

41. The purpose of the Convention is to regulate and facilitate the use of independent guarantees and stand-by letters of credit given by a bank or other institution or person to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents.

42. The Convention contains a number of provisions relating to communications between the parties involved. The relevant provisions fall generally under the same categories that have been described above in connection with the provisions of the Convention on the Limitation Period in the International Sale of Goods (see paras. 7-19).

43. Examination of the relevant provisions allows the conclusion that the Convention already provides for the use of electronic communications, as pointed out in the CEFAC survey (see TRADE/CEFACT/1999/CRP.7, para. 2.22.3).

44. Indeed, article 6, subparagraph (g), defines "document" as a communication made "in a form that provides a complete record thereof", which is intended to include an electronic message. Article 7, paragraph 2, further provides that an "undertaking" covered by the Convention, which includes a guarantee or credit, may be issued in "any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by a procedure agreed upon by the guarantor/issuer and the beneficiary".

45. Also, article 11, paragraph 2, of the Convention expressly refers to the possibility of issuance of an undertaking "in non-paper form" and recognizes the right of the parties to agree on "a procedure functionally equivalent to the return of the document" in such a case.

Conclusions

46. The Working Group may wish to consider that the Convention does not create obstacles to the use of electronic means of communications as an alternative to the issuance and exchange of paper-based documents and that therefore no particular action with regard to the Convention is needed.

II. TRANSPORT AND COMMUNICATIONS INSTRUMENTS

A. Customs matters

General background note

47. In the context of its analysis of possible obstacles to electronic commerce under conventions that relate to customs matters, the Working Group may wish to note that international organizations and domestic customs authorities have been working for many years in the development of electronic systems for processing customs documentation and information.

48. As early as two decades ago, the Customs Cooperation Council (known as the World Customs Organization) adopted a "Recommendation concerning the transmission and authentication of customs information which is processed by computer", of 16 June 1981, inviting customs authorities to take steps to allow the use of electronic communications (see www.wcoomd.org/ie/En/Recommendations/authen_rece.htm). In particular, the World Customs Organization recommended the following:

(a) To allow, under conditions to be laid down by the customs authorities, declarants to use various electronic media (value-added networks, national postal, telegraph and telephone (PTT) agency, disc, tape, etc.) for the transmission of customs regulatory information to the customs authorities for automatic processing and to receive an automatic response to such information from the customs;

(b) To accept, under conditions to be laid down by the customs authorities, customs regulatory information from declarants and other government agencies, which is transmitted by use of electronic media, validated and authenticated by security technology, without the need to produce paper documentation with a hand-written signature;

(c) To accept, where legal recognition of electronically transmitted customs regulatory information is not resolved, that the customs should authorize declarants, under conditions to be laid down by the customs or other competent authorities, to produce customs regulatory information on plain paper;

(d) To accept, where electronic data interchange security and automated processing techniques are used but where, owing to legal constraints, the production of paper documentation and hand-written signatures are required, the periodic submission of paper documentation or their storage on the premises of the declarant, under conditions laid down by the customs administration.

49. In 1990, the World Customs Organization recommended that members of the Organization and all Member States of the United Nations or its specialized agencies and customs or economic unions apply the United Nations/Electronic Data Interchange for Administration, Commerce and Transport (EDIFACT) rules for the preparation of electronic messages to be interchanged between customs administrations and that other trade users make use of United Nations/EDIFACT (see "Recommendation of the Customs Cooperation Council concerning the use of the UN/EDIFACT rules for electronic data interchange", of 26 June 1990, available at www.wcoomd.org/ie/En/Recommendations/Recom2.html).

50. One significant practical international initiative is the Automated System for Customs Data (ASYCUDA), a computerized customs management system developed by the United Nations Conference for Trade and Development that covers most foreign trade procedures (see www.asycuda.org). The System handles manifests and customs declarations, accounting procedures, transit and suspense procedures. ASYCUDA generates trade data that can be used for statistical economic analysis and takes into account the international codes and standards developed by the International Organization for Standardization, the World Customs Organization and the United Nations. ASYCUDA can be configured to suit the national characteristics of individual customs regimes, national tariffs and customs legislation. ASYCUDA provides for electronic data interchange between traders and customs authorities using EDIFACT rules. ASYCUDA has been or is being installed in some 60 countries and it is expected that the number of user countries will grow to 100, making it the de facto world standard for customs.

51. At the national level, a survey conducted by the World Customs Organization indicates that automatization of at least some customs procedures has been one of the main components

of most national initiatives to modernize customs procedures (see www.wcoomd.org/hrds/surve_e.htm#INTRODUCTION).

5. *International Convention to Facilitate the Importation of Commercial Samples and Advertising Material (Geneva, 7 November 1952)*

Status: Entered into force on 20 November 1955 (6 signatories; 63 parties).

Source: United Nations, *Treaty Series*, vol. 221, No. 3010, p. 255.

Comments

52. The purpose of the Convention is to promote international trade through the exemption of import duties, customs duties and all other duties and taxes payable on or in connection with importation of commercial samples and advertising material of negligible value.

53. The Convention requires the contracting parties to exempt from import duties catalogues, price lists and trade notices relating to goods offered for sale or hire, or transport or commercial insurance services offered by a person established in the territory of another contracting party, when such documents are imported from the territory of any contracting party.

54. The references made in article IV of the Convention to the number of "documents or copies", or "consignments", including their maximum "gross weight", clearly suggest that the Convention applies primarily to materials printed on a tangible medium. Arguably, the Convention might be construed to apply to the importation of samples and advertising materials where such materials are stored in electronic form on a tangible medium (such as a diskette or a CD-ROM). However, it seems doubtful that the Convention could apply to the most common "electronic equivalents" of the importation of advertising materials, such as publicizing advertising materials or product catalogues internationally via the Internet, since in most instances the act of posting such information on a web site might take place entirely at one jurisdiction only, without any cross-border communication of data.

Conclusions

55. The provisions of the Convention are of a trade policy nature. They are addressed to States and do not establish rules directly relevant for private law transactions. The Working Group may therefore wish to consider that further study on issues related to electronic commerce under the Convention should be more appropriately carried out by other international organizations, such as the World Trade Organization or the World Customs Organization. The Working Group may further wish to request the Secretariat to follow any work that those organizations might undertake and report on their progress at a later stage.

9. *Customs Convention on Containers (Geneva, 18 May 1956)*

Status: Entered into force on 4 August 1959 (12 signatories; 43 parties).

Source: United Nations, *Treaty Series*, vol. 338, No. 4834, p. 103.

Comments

56. The purpose of the Convention is to develop and facilitate the use of containers in international trade. The Convention has

been terminated and replaced, in the relations between the parties thereto, by the 1972 Customs Convention on Containers (see below). However, since a number of the contracting parties to the 1956 Convention have not yet ratified or adhered to the 1972 Convention, the 1956 Convention remains in force. In its review of the 1956 Convention, the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

15. *Customs Convention on Containers, 1972* (Geneva, 1 December 1972)

Status: Entered into force on 6 December 1975 (15 signatories; 29 parties).

Source: United Nations, *Treaty Series*, vol. 988, No. 14449, p. 43.

Comments

57. The purpose of the Convention is to grant temporary admission to containers, whether loaded with goods or not, which should be re-exported within three months in order to facilitate international carriage by container.

58. The Convention contains a few requirements concerning documentation to be presented by importers or exporters of containers to customs authorities or records to be kept by them.

59. Article 8, for example, provides that the contracting parties may, under certain circumstances, "require the furnishing of a form of security and/or the production of customs documents on the importation or re-exportation of the container". Also, annex 2, paragraph 1, requires the contracting party to use, for checking movements of containers granted temporary admission, "the records kept by the owners or operators or their representatives". Annex 2, paragraph 2 (b), further requires the container operator to "undertake in writing", *inter alia*, to supply the competent customs authorities with certain information. Since the Convention does not contain definitions of terms such as "document", "undertaking" or "writing", questions may be raised as to whether those requirements might be met by information provided in the form of data messages.

Conclusions

60. The provisions of the Convention are of a trade policy nature. They are addressed to States and do not establish rules directly relevant for private law transactions. Furthermore, the extent to which electronic communications may be substituted for paper-based documents for the purposes of the Convention is dependent to a large extent on the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form.

61. The Working Group may therefore wish to consider that further study on issues related to electronic commerce under the Convention should be more appropriately carried out by other international organizations, such as the World Trade Organization or the World Customs Organization. The Working Group may further wish to request the Secretariat to follow any work that those organizations might undertake and report on their progress at a later stage.

13. *Customs Convention on the International Transport of Goods under Cover of TIR Carnets* (Geneva, 15 January 1959)

Status: Entered into force on 7 January 1960 (9 signatories; 37 parties).

Source: United Nations, *Treaty Series*, vol. 348, No. 4996, p. 13, vol. 481, p. 598.

Comments

62. The purpose of the TIR Convention is to regulate international transport of goods without intermediate reloading across one or more frontiers between a customs office of departure of one contracting party and a customs office of destination of another contracting party.

63. The Convention has been terminated and replaced, in the relations between the parties thereto, by the 1975 TIR Convention (see below). Since all but one of the contracting parties of the Convention have ratified or adhered to the new TIR Convention, the Secretariat's comments are limited to the 1975 TIR Convention.

16. *Customs Convention on the International Transport of Goods under Cover of TIR Carnets* (Geneva, 14 November 1975)

Status: Entered into force on 20 March 1978 (16 signatories; 64 parties).

Source: United Nations, *Treaty Series*, vol. 1079, No. 16510, p. 89.

Comments

64. The purpose of the TIR Convention is to facilitate the international carriage of goods by road vehicles by simplifying and harmonizing administrative formalities in the field of international transport, in particular at frontiers.

65. According to the *TIR Handbook*, a publication of the secretariat of the Economic Commission for Europe (ECE), which administers the TIR Convention, the essential principles and features of the transit system established by the TIR Convention are the following: (a) goods are required to travel in secure vehicles or containers; (b) throughout the journey, duties and taxes at risk should be covered by an internationally valid guarantee; (c) goods need to be accompanied by an internationally accepted document ("TIR carnet") taken into use in the country of departure and serving as a customs control document in the countries of departure, transit and destination; (d) customs control measures taken in the country of departure should be accepted by the countries of transit and destination; and (e) access to the TIR procedure, both for national associations issuing TIR carnets and for natural and legal persons utilizing TIR carnets requires authorization by competent national authorities (see www.unece.org/trans/new_tir/handbook/english/intro.htm).

66. As pointed out in the CEFAC survey, the TIR Convention revolves fundamentally around the issue and use of a paper-based document, the TIR carnet. Moreover, not only does the Convention not envisage the use of electronic data interchange but the present carnet is not aligned to the United Nations system (TRADE/CEFACT/1999/CRP.7, para. 2.23.3). Another difficulty in replacing the TIR system by electronic communications relates to the very function of the TIR carnet as acceptable proof to

domestic customs authorities of the existence of an international guarantee covering import duties and taxes in respect of the goods transported under the TIR system.

67. Furthermore, the TIR carnet fulfils other evidentiary functions, such as under various provisions of the Convention that require customs authorities of the contracting States to record certain information on the TIR carnet vouchers used in their country, on the corresponding counterfoils and on the vouchers remaining in the TIR carnet, such as particulars of the seals affixed and of the controls carried out on the load of a road vehicle, combination of vehicles or container in the course of the journey or at a customs office en route (see arts. 24, 34 and 35).

68. According to information published by the International Road Transport Union, the TIR system has operated smoothly for four decades since the TIR Convention was first implemented (see www.iru.org/TIR/TirSystem.E.htm). At the beginning of the 1990s, however, owing to the increase in trade volumes and the number of road hauliers performing TIR operations, the number of infringements of the TIR procedure also increased. A new means of controlling the system had to be found. Consequently the Administrative Committee for the TIR Convention adopted a recommendation on 20 October 1995 that provides for electronic confirmation of the discharge of a TIR operation in addition to the existing paper-based system. The goal of the SafeTIR system is to provide the status of the TIR carnet to the customs and the association issuing the TIR carnet with a confirmation, directly from the customs authorities, of the final or partial discharge of the TIR carnet, mainly to enable comparison of that confirmation against the paper-based discharge. The confirmation should reach the issuing association within one week.

69. Further efforts to adapt the TIR system to electronic means of communication are currently under way. At its ninety-ninth session, held in Geneva, from 23 to 26 October 2001, the ECE Working Party on Customs Questions affecting Transport decided to establish an Ad Hoc Expert Group on the Conceptual and Technical Aspects of the Computerization of the TIR Convention and an Ad Hoc Expert Group on the Legal Aspects of the Computerization of the TIR Convention.

70. The first session of the Ad Hoc Expert Group on the Conceptual and Technical Aspects of the Computerization of the TIR Convention was held in Geneva on 24 and 25 January 2002. At that session, the informal Ad Hoc Expert Group started its consideration of the conceptual and technical aspects of the computerization of the TIR procedures, including the financial and administrative implications of its introduction, at both the national and the international level. It is expected that the work of the Ad Hoc Expert Group will lead to the preparation of a draft set of electronic messages to allow for an interchange of electronic data, nationally, between contracting parties and with international organizations.

71. The report of the meeting of the Ad Hoc Expert Group had not yet been published at the time the present note was prepared, but will eventually be available from the web site of the ECE Transport Division (www.unece.org/trans/new_tir/home.html).

Conclusions

72. In view of the particular nature of the regime established by the TIR Convention, which requires the issuance of original documents capable of being read and processed by the customs and other authorities of the various contracting parties, the Working Group may wish to request the Secretariat to continue following the current efforts being undertaken under the auspices of ECE and report on their progress at a later stage.

14. *European Convention on Customs Treatment of Pallets used in International Transport* (Geneva, 9 December 1960)

Status: Entered into force on 12 June 1962 (8 signatories; 28 parties).

Source: United Nations, *Treaty Series*, vol. 429, No. 6200, p. 211.

Comments

73. The purpose of the Convention is to facilitate international carriage by containers, by granting admission without payment of import duties and taxes and free of import prohibitions or restrictions to pallets, under certain conditions, to encourage the use of pallets in international transportation and to reduce its cost. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

17. *International Convention on the Harmonization of Frontier Controls of Goods* (Geneva, 21 October 1982)

Status: Entered into force on 15 October 1985 (13 signatories; 41 parties).

Source: United Nations, *Treaty Series*, vol. 1409, No. 23538, p. 3.

Comments

74. The purpose of the Convention is to facilitate the international movement of goods by reducing the requirements for completing formalities as well as the number and duration of controls when being moved across one or more maritime, air or inland frontiers.

75. As pointed out in the CEFAC survey, the Convention itself is no barrier to the use of electronic communications (TRADE/CEFACT/1999/CRP.7, para. 2.24.3). Article 9, paragraph 1, of the Convention promotes the use of documents aligned on the United Nations layout key. Paragraph 2 of the same article requires contracting parties to accept documents produced by any appropriate technical process, provided that they comply with official regulations as to their form, authenticity and certification and that they are legible and understandable.

76. It should be noted, however, that the Convention does not override existing form requirements under domestic law or international agreements entered into by the contracting States. Thus, if individual laws require hard-copy documents, such requirements will remain applicable despite article 9, paragraph 2, of the Convention.

Conclusions

77. The provisions of the Convention are of a trade policy nature. They are addressed to States and do not establish rules directly relevant for private law transactions. Furthermore, the extent to which electronic communications may be substituted for paper-based documents for the purposes of the Convention is dependent to a large extent upon the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form.

78. The Working Group may therefore wish to consider that further study on issues related to electronic commerce under the Convention should be more appropriately carried out by other international organizations, such as the World Trade Organization

or the World Customs Organization. The Working Group may further wish to request the Secretariat to follow any work that those organizations might undertake and report on their progress at a later stage.

18. Convention on Customs Treatment of Pool Containers used in International Transport (Geneva, 21 January 1994)

Status: Entered into force on 17 January 1998 (7 signatories; 11 parties).

Source: ECE/TRANS/106.

Comments

79. The purpose of the Convention is to facilitate the use in common of containers by members of a pool, thus enhancing the efficient use of containers in international transport.

80. The Convention has a few provisions contemplating an agreement between the members of a container pool and written undertakings to be entered into by the parties that may generally give rise to the same types of issue as those raised under similar provisions in the Convention on the Limitation Period in the International Sale of Goods (see paras. 7-19 above). More specifically, article 5, paragraph 1 (b), requires the members of a pool, inter alia, to "(ii) keep records, for each type of container, showing the movement of containers so exchanged". It should be noted that article 5, paragraph 3 (b), makes the applicability of the facilities provided in article 4 (tax-free importation of containers, exemption from presentation of customs documents) subject to communication of the pool agreement to, and approval by, the competent customs authorities.

Conclusions

81. The provisions of the Convention are of a trade policy nature. They are addressed to States and do not establish rules directly relevant for private law transactions. Furthermore, the extent to which electronic communications may be substituted for paper-based documents for the purposes of the Convention is dependent to a large extent upon the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form.

82. The Working Group may therefore wish to consider that further study on issues related to electronic commerce under the Convention should be more appropriately carried out by other international organizations, such as the World Trade Organization or the World Customs Organization. The Working Group may further wish to request the Secretariat to follow any work that those organizations might undertake and report on their progress at a later stage.

B. Road traffic

1. Convention on Road Traffic (Geneva, 19 September 1949)

Status: Entered into force on 25 March 1952 (19 signatories; 91 parties).

Source: United Nations, *Treaty Series*, vol. 125, No. 1671, p. 3.

Comments

83. The purpose of the Convention is to harmonize the rules governing road traffic among contracting States, ensure their compliance in order to facilitate international road traffic and increase road safety. The provisions of the Convention deal essentially with road safety and traffic control issues and do not establish rules directly relevant for private law transactions. The Working Group may wish to consider that no action is required in respect of the Convention.

19. Convention on Road Traffic (Vienna, 8 November 1968)

Status: Entered into force on 21 May 1977 (36 signatories; 59 parties).

Source: United Nations, *Treaty Series*, vol. 1042, No. 15705, p. 17.

Comments

84. The purpose of the Convention is to facilitate international road traffic and to increase road safety through the adoption of uniform traffic rules. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce. The Working Group may wish to consider that no action is required in respect of the Convention.

8. General Agreement on Economic Regulations for International Road Transport and (a) Additional Protocol; and (b) Protocol of Signature (Geneva, 17 March 1954)

Status: Not yet in force (10 signatories; 4 parties).

Source: E/ECE/186 (E/ECE/TRANS/460).

Comments

85. The purpose of the General Agreement is to favour the development of the international carriage of passengers and goods by road by establishing a common regime for international road transport. In its review of the Agreement the Secretariat has not found any provisions that might be directly relevant to electronic commerce. The Working Group may wish to consider that no action is required in respect of the Agreement.

11. Convention on the Contract for the International Carriage of Goods by Road (Geneva, 19 May 1956) and Protocol thereto (Geneva, 5 July 1978)

Status: Entered into force on 2 July 1961 (Convention: 9 signatories; 44 parties; Protocol: 6 signatories; 30 parties).

Source: United Nations, *Treaty Series*, vol. 399, No. 5742, p. 189.

Comments

86. The purpose of the CMR Convention is to regulate and standardize the conditions surrounding the contract for international carriage of goods by road in vehicles when the place of taking over of the goods and the place designated for delivery are situated in two different countries, of which at least one is a contracting State. In its current form, the Convention contemplates some documentary requirements that might not be easily

replaced with electronic communications (see paras. 87-97) and, for that reason, consideration is being given to its revision (see paras. 98-103).

(a) *Possible obstacles to the use of electronic communications under the Convention*

87. The provisions of the Convention that have special relevance for the use of electronic communications may be generally grouped under two categories: (a) provisions concerning the instrument of the contract of carriage (consignment note); and (b) provisions that contemplate notices or declarations that may be exchanged by the parties.

(i) *Provisions concerning the instrument of the contract of carriage (consignment note)*

88. Article 4 of the Convention requires that contract of carriage "be confirmed by the making out of a consignment note" even though "the absence, irregularity or loss of the consignment note shall not affect the existence or the validity of the contract of carriage", which shall remain subject to the provisions of the Convention. The Convention does not define the consignment note, but the reference, in article 5, paragraph 1, to its issuance in three "original copies signed by the sender and by the carrier" clearly suggests that the Convention contemplates the issuance of the consignment note as a paper document. This is even more evident in the light of the last sentence of article 1, paragraph 1, which provides that "the first copy [of the consignment note] shall be handed to the sender, the second shall accompany the goods and the third shall be retained by the carrier".

89. As pointed out in the CEFAC survey, there are some potential problems if a paper document is not produced and automation is permitted only to the extent of allowing signatures to be printed or stamped and then only if the law of the country in which the note is produced so permits (art. 5, para. 1) (TRADE/CEFACT/1999/CRP.7, para. 2.10.3).

a. *The consignment note as proof of the contract of carriage*

90. In its most basic function, the consignment note is a document that proves the existence of the contract of carriage and its terms. Indeed, article 9, paragraph 1, provides that "the consignment note shall be prima facie evidence of the making of the contract of carriage, the conditions of the contract and the receipt of the goods by the carrier". This evidentiary function could arguably be fulfilled by data messages, provided that their functional equivalence to paper-based consignment notes is legally recognized. However, where no such general recognition exists, courts might find that the exchange of data messages is not equivalent to the making out of a "consignment note" under the Convention.

91. The consequences of such a finding for the parties may be significant. Under article 6 of the Convention, a consignment note is required, inter alia, to incorporate a statement that the Convention is applicable, to establish the applicable time limit for delivery and to make declarations of value or special interest in delivery. The absence of the statement on the applicability of the Convention can lead to unlimited liability for the carrier. The absence of the other matters referred to above may be fatal to any claim made by a claimant, in particular if it is not made against the contracting carrier but against a subcontractor or "successive CMR carrier". Finally, subcontractors or "successive carriers" only become obligated under the Convention if they have taken

over both the goods and a physical CMR note (art. 34). The CEFAC survey points out that some courts have been very strict in their interpretation of this provision so as to bar certain claims under CMR terms against a subcontractor who was not handed over the CMR note (art. 34).

b. *The consignment note and disposal of the goods*

92. Unlike other transport documents, such as the maritime bill of lading, the consignment note is not a document of title to the goods in transit. Nevertheless, possession of the consignment note has some significant consequences with regard to the right of disposal of the goods, as provided in article 12 of the Convention. For instance, while the sender has the right to dispose of the goods in transit (para. 1), such right ceases to exist, inter alia, "when the second copy of the consignment note is handed to the consignee", from which time onwards "the carrier shall obey the orders of the consignee".

93. Furthermore, pursuant to article 12, paragraph 5, in order to exercise that right, the sender or, as appropriate, the consignee must produce the first copy of the consignment note on which the new instructions to the carrier have been entered. The production of the consignment note has important consequences for the liability regime of the carrier, since paragraph 7 of the same article provides that "a carrier who has not carried out the instructions given under the conditions provided for in this article, or who has carried them out without requiring the first copy of the consignment note to be produced, shall be liable to the person entitled to make a claim for any loss or damage caused thereby".

94. Replacing paper-based consignment notes with data messages might conceivably be simpler than the development of purely electronic substitutes to documents of title. Nevertheless, an appropriate legal framework would seem to require more than simply recognizing the validity of data messages as substitutes for traditional consignment notes. Authentication methods and conditions for functional equivalence of data messages to "original" consignment notes would also need to be considered.

(ii) *Provisions that contemplate notices or declarations that may be exchanged by the parties*

95. Possible difficulties in the use of electronic communications may result from various provisions of the Convention that require certain notices to be given by the parties under specified circumstances. Article 20, paragraph 2, for example, allows the person entitled to receive compensation in case of failed delivery of the goods to "request in writing that he shall be notified immediately should the goods be recovered in the course of the year following the payment of compensation". In that case, the person "shall be given a written acknowledgement of such request".

96. Other writing requirements relate to reservations providing for compensation payment for delay in delivery of goods (art. 30, para. 3); notices of claims and their effect on the running of the limitation period; and the carrier's notice of rejection of claims (in both cases, art. 32, para. 2).

97. The possible obstacles to electronic commerce in those provisions are essentially of the same nature as in connection with similar provisions in the Convention on the Limitation Period in the International Sale of Goods (see paras. 5-20 above).

(b) *International initiatives to revise the Convention*

98. The CEFAC survey reports that the International Road Transport Union has carried out some detailed and authoritative

work exploring ways of remedying the difficulties outlined above. That work included the preparation of a discussion document entitled "Electronic transmission of information in the context of a contract for carriage of goods by road under the CMR Convention", of 2 February 1994, and a model communication agreement between commercial partners in the context of international carriage by road, of 8 February 1994. The CEFAC survey summarizes the conclusions of the studies done by the International Road Transport Union as follows: (a) the Union believes that virtually all problems posed by the Convention itself can be remedied by contractual clarification, but recognizes that electronic data interchange can only readily be used when all parties to the process of carriage by road are connected by electronic data interchange (still very rarely the case); and (b) a revision of the Convention itself would not be practical, although the Union believes that a protocol dealing solely with the problem of electronic transmission of commercial documents could readily be devised.

99. Those considerations seem to have found an echo within the ECE Working Party on Road Transport. At its ninety-second session, held in Geneva from 19 to 21 October 1998, the Working Party was informed that the ECE secretariat had contacted the Legal Rapporteurs Group of CEFAC regarding the integration of electronic data interchange into the Convention. The Legal Rapporteurs Group had recommended the drawing up of a protocol to the CMR Convention rather than a revision and suggested that the draft Model Law developed by UNCITRAL might provide some of the elements required in such a protocol. The Working Party agreed that developing a protocol to the Convention to incorporate electronic commerce issues was a complex issue that would require further analysis by experts on electronic data interchange, transport and private law and asked the Secretariat to contact Unidroit for its views on the matter (see TRANS/SC.1/R.363, paras. 41 and 42).

100. An initial memorandum entitled "Consideration of the development of a Protocol to [Convention on] the Contract for the International Carriage of Goods by Road (CMR)" was subsequently prepared by Jacques Putzeys, a member of the Governing Council of Unidroit, and submitted on 31 August 2000 for consideration by the Working Party. In that memorandum, Mr. Putzeys submitted the following provisional conclusions (TRANS/SC.1/2000/9, pp. 7 and 8):

(a) A first analysis leads to the conclusion that, if electronic data interchange and "electronic" consignment notes were to be accepted, no major legal difficulties would result from the linking of the means of proof to the CMR paper-based consignment note. This conclusion is based on a teleological interpretation of the CMR ("functional equivalence"), which, however, the case law of certain countries would admit with difficulty;

(b) The same conclusion may be reached in relation to the other modes of transmission, such as telecopy, telegram and telex. Certain national legislations have incorporated those instruments into their provisions on evidence;

(c) Legal security would consequently require the possibilities analysed above to be based, in legal terms, on a substantive uniform law;

(d) It is currently unanimously admitted that only an additional protocol would constitute an appropriate instrument. A protocol modifying the Convention would involve serious difficulties in consideration of the system of connecting factors of the CMR Convention (place of take-over or designated place for delivery). An additional protocol could moderate that criterion, for example, by not having it apply unless the parties to the contract of carriage had concluded a communication agreement;

(e) Following the example of existing conventions (the United Nations Convention on Contracts for the International Sale of Goods, the Convention for the Unification of Certain Rules for

International Carriage by Air (the Montreal Convention) and the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterway), the CMR protocol should be limited to what has been analysed and should not involve more than a provision permitting the functional equivalence of electronic data interchange (possibly also of other modes of transmission) to the paper-based consignment note;

(f) If the present situation of the road transport enterprises deriving from the CMR Convention is considered, it may be observed that in practice electronic data interchange is already used extensively. It is therefore urgent to fill the legal void.

101. The Working Party considered that memorandum at its ninety-fourth session, held in Geneva from 14 to 16 November 2000. The Working Party thanked Mr. Putzeys for his work and asked him if he would be in a position to prepare a draft text of the protocol. Mr. Putzeys offered to prepare an informal text of the protocol and to submit it to the Secretariat in early 2001. He cautioned that the proposal would only become formal after it had been adopted by the Governing Council of Unidroit, which would meet in September 2001, but that it could still be considered by the Working Party at its ninety-fifth session, in 2001 (TRANS/SC.1/367, paras. 51 and 52).

102. An initial draft protocol was subsequently prepared by Unidroit and submitted informally for the consideration of the Working Party on 1 August 2001, pending adoption by the Governing Council of Unidroit. The text of the draft protocol reads as follows:

"Draft EDI Protocol to the CMR

"[. . .]

"being parties to the Convention on the Contract for the International Carriage of Goods by Road (CMR), done at Geneva on 19 May 1956,

"[. . .]

"Article 1. For the purposes of the present Protocol 'Convention' means the Convention on the Contract for the International Carriage of Goods by Road (CMR).

"Article 2. At the end of article 5 of the Convention, the following paragraph is added:

'3. Unless otherwise agreed between the parties concerned, the consignment note may be made out by all other means of transmission of information, by electronic or similar means of communication, including, but not limited to, telegram, facsimile, telex, electronic mail or electronic data interchange (EDI),

'— [provided the information is accessible so as to be usable for subsequent reference.]

'— [The procedure used for the registration and treatment of data must be equivalent from the functional point of view, particularly so far as concerns the evidential value of the consignment note represented by those data.]

'— [If such other means are used, the carrier shall, if so requested by the consignor, deliver to the consignor a cargo receipt permitting identification of the consignment and access to the information contained in the record preserved by such other means.]'"

103. The Working Party considered the draft protocol at its ninety-fifth session, held in Geneva from 16 to 19 November 2001. The Working Party's deliberations on that

matter are summarized as follows in the report on the work of that session (TRANS/SC.1/369, paras. 44 and 45 (unofficial translation from the French)):

“44. The Working Party thanked Professor Putzeys for having prepared a draft protocol to the CMR Convention to allow the use of electronic data interchange (EDI) in lieu of paper-based consignment notes (TRANS/SC.1/ 2001/7). The draft text, which presents three possible variants to those already incorporated in existing conventions, received the official approval of the Governing Council of Unidroit at its meeting in September 2001 (TRANS/SC.1/2001/7/Add.1).

“45. As the draft caused varying reactions following questions raised by the German delegation, the Working Party felt that the topic needed to be considered further. The Working Party therefore requested the Secretariat to solicit in writing, by means of a questionnaire, the views of the contracting parties to the Convention with regard to the concrete action to be taken in respect of the draft protocol, in particular as regards the best solution to implement in the context of the CMR Convention. It also asked the Secretariat to prepare a summary of the replies. Professor Putzeys offered to assist the Secretariat in this task. At a third stage, an informal drafting group would be convened to prepare a draft protocol with a view to its adoption.”

Conclusion

104. In view of the nature of the transport documentation regime established by the CMR Convention, which may require particular solutions so as to allow for the use of data messages in connection with international road carriage, the Working Group may wish to request the Secretariat to continue monitoring the current efforts being undertaken under the auspices of ECE and report on their progress at a later stage.

12. Convention on the Taxation of Road Vehicles Engaged in International Goods Transport (Geneva, 14 December 1956)

Status: Entered into force on 29 August 1962 (5 signatories; 19 parties).

Source: United Nations, *Treaty Series*, vol. 436, No. 6292, p. 115.

Comments

105. The purpose of the Convention is to exempt from taxes and charges vehicles that are registered in the territory of one of the contracting parties and are temporarily imported in the course of international goods transport into the territory of another contracting party, under certain stipulated conditions. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

13. Convention on the Taxation of Road Vehicles Engaged in International Passenger Transport (Geneva, 14 December 1956)

Status: Entered into force on 29 August 1962 (6 signatories; 18 parties).

Source: United Nations, *Treaty Series*, vol. 436, No. 6293, p. 131.

Comments

106. The purpose of the Convention is to facilitate the taxation of road vehicles transporting persons and their baggage between countries for remuneration or other considerations. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

14. European Agreement concerning the International Carriage of Dangerous Goods by Road (Geneva, 30 September 1957) and (a) Protocol amending article 14, paragraph 3; and (b) Protocol amending article 1 (a), article 14, paragraph 1, and article 14, paragraph 3

Status: Entered into force on 29 January 1968 (Convention: 9 signatories; 38 parties; Protocol (a): 20 parties; Protocol (b): 24 parties).

Source: United Nations, *Treaty Series*, vol. 619, No. 8940, p. 77.

Comments

107. The purpose of the ADR Agreement is to increase the safety of international transport of dangerous goods by road, with the use of prohibitive or regulatory measures. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

22. Agreement on the International Carriage of Perishable Foodstuffs and on the Special Equipment to be used for such Carriage (Geneva, 1 September 1970)

Status: Entered into force on 21 November 1976 (7 signatories; 38 parties).

Source: United Nations, *Treaty Series*, vol. 1028, No. 15121, p. 121.

Comments

108. The purpose of the ATP Agreement is to improve the conditions of preservation of the quality of perishable foodstuffs during their carriage, in particular in international trade, by the use of special transport equipment and applicable temperatures during carriage. An earlier agreement on the same subject (the Agreement on Special Equipment for the Transport of Perishable Foodstuffs and on the Use of such Equipment for the International Transport of some of those Foodstuffs), concluded in Geneva on 15 January 1962 (E/ECE/456), has not entered into force.

109. The Agreement facilitates international trade in perishable goods by introducing common standards for the inspection, testing and approval of transport equipment. Once a certificate of inspection is issued by the competent authorities of a contracting party, in accordance with the standards set forth in the annex to the Agreement, the validity of such a certificate must be accepted by authorities of the other contracting parties.

Conclusions

110. Despite their significance for international trade, the substantive provisions of the Convention are essentially of a health and sanitary nature. They are addressed to States and do not establish rules directly relevant for private law transactions. Furthermore, the extent to which electronic communications may

be substituted for paper-based documents for the purposes of the Convention is dependent to a large extent upon the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form. The Working Group may thus wish to consider that no action is required in respect of the Convention.

21. *European Agreement concerning the Work of Crews of Vehicles Engaged in International Road Transport* (Geneva, 1 July 1970)

Status: Entered into force on 5 January 1976 (13 signatories; 41 parties).

Source: United Nations, *Treaty Series*, vol. 993, No. 14533, p. 143.

Comments

111. The purpose of the AETR Agreement is to increase the safety of road traffic by ensuring that crew members engaged in international road transport observe the conditions imposed with regard to daily rest periods, driving periods, manning and individual control books. An earlier agreement with the same title (E/ECE/457), which was concluded in Geneva on 19 January 1962, has not entered into force.

Conclusions

112. The provisions of the Agreement deal essentially with social matters and issues related to work safety and do not establish rules directly relevant for private law transactions. Furthermore, the extent to which electronic communications may be substituted for the records required in the Convention is dependent to a large extent upon the capability and readiness of public authorities in the contracting parties to the Convention to process such documents in electronic form. The Working Group may thus wish to consider that no action is required in respect of the Agreement.

23. *European Agreement supplementing the Convention on Road Traffic opened for Signature at Vienna on 8 November 1968* (Geneva, 1 May 1971)

Status: Entered into force on 7 June 1979 (12 signatories; 28 parties)

Source: United Nations, *Treaty Series*, vol. 1137, No. 17847, p. 369.

Comments

113. The purpose of the Agreement is to harmonize rules governing road traffic in Europe, ensure their compliance in order to facilitate international road traffic and increase road safety. In its review of the Agreement the Secretariat has not identified any provisions that might be of direct relevance for electronic commerce.

26. *Convention on the Contract for the International Carriage of Passengers and Luggage by Road* (Geneva, 1 March 1973) and Protocol thereto

Status: Entered into force on 2 April 1994 (2 signatories; 6 parties).

Source: United Nations, *Treaty Series*, vol. 1774, No. 30887, p. 109.

Comments

114. The purpose of the CVR Convention is to standardize the conditions for the contract for the international carriage of passengers and luggage by road. The provisions that may give rise to legal difficulties in connection with electronic communications are essentially those provisions which relate to transport documents.

115. The Convention contains a series of provisions dealing with transport documents. In respect of carriage of passengers, article 5 of the Convention requires the issuance by the carrier of "an individual or a collective ticket" even though the absence of such a ticket does not affect the existence or validity of the contract of carriage. In respect of luggage, article 8 requires the issuance of a "luggage registration voucher" by the carrier. None of those provisions expressly requires those documents to be printed on paper. However, the transferability of the passenger ticket (art. 7) and the requirement of presentation of the luggage registration voucher for delivery of luggage (art. 10, para. 1) seem to presuppose the issuance of those documents in tangible form.

116. In addition to those provisions, article 22, paragraph 3, contains two writing requirements in connection with the limitation period for actions under the Convention: the limitation period is suspended by a "written claim" until the date the carrier rejects the claim "by notification in writing" and returns any documents handed to him in support of the claim.

Conclusions

117. In view of the particular nature of the issues raised by electronic substitutes for transferable instruments, it appears that a comprehensive new legal framework might be required in order to allow for the international use of data messages in lieu of the paper-based transport documents envisaged by the Convention. The Secretariat submits that developing such a comprehensive legal framework might go beyond the scope of the Working Group's efforts to remove obstacles to electronic commerce in existing international trade-related instruments. The Secretariat further submits that an analysis of the specific requirements for such a comprehensive legal framework might best be undertaken in the course of the Working Group's consideration of legal issues related to the transfer of rights, in particular, rights in tangible goods, by electronic means (see A/CN.9/484, paras. 87-93).^a

118. As regards the writing requirements in the Convention, the Working Group may wish to consider whether they might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

C. Transport by rail

2. *International Convention to Facilitate the Crossing of Frontiers for Goods Carried by Rail* (Geneva, 10 January 1952)

Status: Entered into force on 1 April 1953 (7 signatories; 10 parties).

Source: United Nations, *Treaty Series*, vol. 163, No. 2139, p. 27 and vol. 328, p. 319.

^aSee also *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 291.

Comments

119. The purpose of the Convention is to ensure an effective and efficient examination at designated stations for goods carried by rail crossing frontiers. In its review of the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

D. Water transport

1. Convention relating to the Limitation of the Liability of Owners of Inland Navigation Vessels and Protocol thereto (Geneva, 1 March 1973)

Status: Not yet in force (Convention: 2 signatories; 1 party; Protocol: 1 party).

Source: ECE/TRANS/3.

Comments

120. The purpose of the CLN Convention is to enable owners and crew members of inland navigation vessels to limit their liability, either contractually or extra-contractually, by constituting a limitation fund in accordance with the provisions of the Convention. The Secretariat has reviewed the Convention and has not found any provisions that might be directly relevant to electronic commerce.

3. United Nations Convention on the Carriage of Goods by Sea (Hamburg, 31 March 1978)

Status: Entered into force on 1 November 1992 (28 signatories; 28 parties).

Source: United Nations, *Treaty Series*, vol. 1695, No. 29215, p. 3.

Comments

121. The purpose of the Convention is to establish uniform rules on rights and liabilities of the carrier and shipper relating to the carriage of goods by sea. Provisions that might pose obstacles to the use of electronic communications may be grouped under three basic categories: (a) provisions concerning the contract of carriage; (b) provisions that expressly contemplate written notices or communications, including definitions of "writing"; and (c) provisions that refer to an existing undertaking or agreement between the parties.

(a) Provisions concerning the contract of carriage

122. The Convention governs the rights and obligations of the parties to a contract of carriage. While the only instrument of contract of carriage expressly mentioned in the Convention is the bill of lading, the Convention also contemplates the possibility that a contract of carriage may be entered into by using a non-negotiable transport document.

(i) Provisions concerning the bill of lading

123. Bills of lading are regarded as documents of title under most legal systems. Rights in goods represented by documents of title are typically conditioned by the physical possession of an

original paper document (the bill of lading, warehouse receipt or other similar document). As such, the legal regime governing those instruments typically presupposes the existence of an instrument in tangible documentary form that is capable of being transferred by endorsement.

124. In an earlier note, the Secretariat analysed various legal issues that arise in connection with developing an electronic equivalent to paper-based documents of title and other negotiable instruments and pointed out the complexities involved in developing an electronic equivalent to paper-based bills of lading (A/CN.9/WG.IV/WP.90, in particular paras. 35-37, 75-78 and 95-106). After consideration of that note and of the various views that were expressed in connection with it, it was generally agreed within the Working Group that further study was needed in order for it to define in more precise terms the scope of future work in the area. The Working Group therefore agreed to recommend to the Commission that the Secretariat be requested to study further the issues related to transfer of rights, in particular rights in tangible goods, by electronic means and mechanisms for publicizing and keeping records of acts of transfer or creation of security interests in such goods. The study should examine the extent to which electronic systems for transferring rights in goods could affect the rights of third parties. The study should also consider the interface between electronic substitutes for documents of title and financial documentation used in international trade, by giving attention to efforts currently under way to replace paper-based documents, such as letters of credit and bank guarantees, with electronic messages (A/CN.9/484, para. 93). Those recommendations were endorsed by the Commission at its thirty-fourth session, in 2001.^b

(ii) Provisions concerning other instruments of the contract of carriage

125. Unlike the International Convention for the Unification of Certain Rules of Lading (the Hague Rules) of 1924, which apply only when a bill of lading is issued by the carrier, the Hamburg Rules govern the rights and obligations of the parties to a contract of carriage regardless of whether or not a bill of lading has been issued. This is becoming increasingly important as more and more goods are carried under non-negotiable transport documents, such as the sea waybill, rather than under bills of lading.

126. As noted in an earlier note prepared by the Secretariat, there is undoubtedly a trend towards an increased use of sea waybills as substitutes for traditional bills of lading. A sea waybill is a non-negotiable document that constitutes evidence of the contract of carriage and of the receipt of the goods by the carrier. It is not a document of title and it cannot be used to transfer ownership of the goods. A sea waybill need not be presented for taking delivery of the goods; the carrier tenders delivery to the named consignee who need only prove his identity (A/CN.9/WG.IV/WP.69, paras. 46-48).

127. There are no specific form requirements for instruments of contracts of carriage other than the bill of lading. Nevertheless, the reference, in article 18, to the issuance of a "document" other than a bill of lading to evidence the receipt of the goods to be carried suggests that the Convention contemplates the use of paper-based documents.

128. Given their non-negotiable nature, it is conceivably simpler to develop electronic equivalents to sea waybills than electronic alternatives to paper-based bills of lading. The issues to be considered in that connection are essentially the same as for the

^bIbid., paras. 292 and 293.

replacement of other contractual documents with electronic equivalents. Those issues include essentially issues dealt with in the UNCITRAL Model Law on Electronic Signatures, such as the following: recognition of the legal validity of electronic communications or records purporting to constitute a maritime transport document; legal recognition of electronic signatures and electronic equivalents to “original” paper documents. Nevertheless, much the same way as in the case of consignment notes for road transport (see paras. 92-94), an appropriate legal framework would seem to require more than simply recognizing the validity of data messages as substitutes for traditional sea waybills. Authentication methods and conditions for functional equivalence of data messages to “original” sea waybills would also need to be considered.

129. In that connection, the Working Group may wish to note that the Commission, at its thirty-fourth session, decided to establish a working group to consider various issues on maritime law.^c Those issues include questions such as the functioning of bills of lading and sea waybills, the relation of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provide financing to a party to the contract of carriage. In cooperation with the Comité Maritime International (CMI), the Secretariat has prepared a working paper containing drafts of possible solutions for a future legislative instrument, with alternatives and comments, which include provisions dealing with electronic equivalents to paper-based transport documents (A/CN.9/WG.III/WP.21 and Add.1). Working Group III (Transport Law) is expected to consider that working paper at its ninth session, to be held in New York from 15 to 26 April 2002.

(b) Provisions that expressly contemplate written notices or communications, including definitions of “writing”

130. Various provisions in the Convention refer to communications that need to be made “in writing”, which is defined in article 1, paragraph 8, as including “inter alia, telegram and telex”.

131. According to article 10, paragraph 3, any special agreement under which the carrier assumes obligations not imposed by this Convention or waives a right conferred by this Convention “affects the actual carrier only if agreed to by him expressly and in writing”. Article 19, paragraphs 1 and 2, require notice “in writing” of loss or damage to the goods not later than the working day after the day when the goods were handed over to the consignee, otherwise such handing over would constitute prima facie evidence of the delivery by the carrier of the goods as described in the document of transport. Paragraph 7 contains a similar provision in respect of notices of loss or damage that may be given by the carrier or actual carrier to the shipper.

(c) Provisions that refer to an existing undertaking or agreement between the parties.

132. A few provisions in the Convention refer to existing undertakings or agreements between the parties without specifying the form that they need to take. According to article 9, paragraph 1, the carrier is entitled to carry the goods on deck “only if such carriage is in accordance with an agreement with the shipper or with the usage of the particular trade or is required by statutory rules or regulations”. Pursuant to paragraph 2, in the absence of a statement to that effect in the bill of lading or other document evidencing the contract of carriage the carrier has the burden of proving that an agreement for carriage on deck has been entered into.

^cIbid., para. 345.

Conclusions

133. As regards the issues raised by electronic substitutes for bills of lading (see paras. 120 and 121) and other transport documents (see paras. 122-126), the Secretariat submits that the consideration of the particular issues involved might go beyond the scope of the Working Group’s efforts to remove obstacles to electronic commerce in existing international trade-related instruments. The Working Group may wish, at the present stage, to request that the Secretariat inform the Working Group on the progress of the work of Working Group III (Transport Law). The Working Group may wish also to consider formulating comments on that work at an appropriate stage.

134. As regards the other issues related to electronic commerce under the Convention (see paras. 127-129), the Working Group may wish to consider whether they might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

4. International Convention on Maritime Liens and Mortgages (Geneva, 6 May 1993)

Status: Not yet in force (11 signatories; 5 parties).

Source: A/CONF.162/7.

Comments

135. The purpose of the Convention is to improve the conditions for ship financing and the development of national merchant fleets and to achieve international uniformity in the field of maritime liens and mortgages. The provisions of relevance for the use of electronic communications may be grouped under essentially two categories: (a) provisions relating to the registration of maritime liens and mortgages; and (b) provisions that expressly contemplate written notices or communications.

(a) Provisions relating to the registration of maritime liens and mortgages

136. The Convention envisages the establishment by the contracting parties of a registration system for mortgages, *hypothèques* and registrable charges of the same nature to be effected in accordance with the law of the State in which the vessel is registered. Beyond acts related to the registration procedures, the Convention contains provisions on various related matters, such as priority of maritime liens and provisions governing the issuance of various certificates by the competent authorities.

137. An earlier note by the Secretariat points out that, in addition to general issues related to the fulfilment of legal “writing”, “signature” and “original” requirements, the establishment of electronic equivalents to paper-based registration systems raises a number of particular problems. They include the satisfaction of legal requirements for record-keeping, the adequacy of certification and authentication methods, the possible need for specific legislative authority to operate electronic registration systems, the allocation of liability for erroneous messages, communication failures and system breakdowns, the incorporation of general terms and conditions and the safeguarding of privacy (A/CN.9/WG.IV/WP.90, para. 31).

138. Possible legal obstacles arising out of legal requirements for record-keeping might be removed by means of legislation implementing the principles set forth in articles 8 and 10 of the

UNCITRAL Model Law on Electronic Commerce. The incorporation of terms and conditions is addressed in article 5 bis of the Model Law. However, the Model Law does not address other issues specifically relevant to the functioning of electronic registration systems (A/CN.9/WG.IV/WP.90, para. 32).

(b) Provisions that expressly contemplate written notices or communications

139. Article 11 of the Convention provides that, prior to a forced sale of a vessel in a State party, the competent authority in such State must ensure that notices are given to various authorities and persons. Although paragraph 3 of the same article requires such a notice to be "in writing", the same provision expressly recognizes that the notice may be "either given by registered mail, or given by any electronic or other appropriate means which provide confirmation of receipt".

Conclusions

140. In view of the particular nature of the issues raised by electronic registry systems, the Secretariat submits that a possible analysis of the specific requirements for the functioning of electronic registration systems under the Convention might best be undertaken in the course of the Working Group's consideration of legal issues related to the transfer of rights, in particular, rights in tangible goods, by electronic means (see A/CN.9/484, paras. 87-93).^a

E. Multimodal transport

1. United Nations Convention on International Multimodal Transport of Goods (Geneva, 24 May 1980)

Status: Not yet in force (6 signatories; 10 parties).

Source: TD/MT/CONF/16.

Comments

141. The purpose of the Convention is to enhance the development and effectiveness of international transport of goods by resolving legal uncertainties and to set levels of compensation for loss of or damage and delay to goods in transit.

142. Article 5, paragraph 1, of the Convention requires the multimodal transport operator to issue a multimodal transport document, which, at the option of the consignor, is in either negotiable or non-negotiable form. Paragraph 3 of that article provides that the signature on the document may be in handwriting, printed in facsimile, perforated, stamped, in symbols "or made by any other mechanical or electronic means, if not inconsistent with the law of the country where the multimodal transport document is issued". The document itself need not be printed on paper, as clearly stated in paragraph 4 of the same article. If the consignor so agrees, a non-negotiable multimodal transport document may be issued by making use of any mechanical "or other means preserving a record of the particulars stated in article 8 to be contained in the multimodal transport document". In such a

case the multimodal transport operator, after having taken the goods in charge, must deliver to the consignor "a readable document containing all the particulars so recorded, and such document shall for the purposes of the provisions of this Convention be deemed to be a multimodal transport document". While the Convention does not provide a definition of "document", it appears from the context of article 5 that the notion of "document" may be broader than the rather narrow definition of "writing" in article 1, paragraph 10, of the Convention, which means "inter alia, telegram or telex".

143. The form requirements for the multimodal transport document are intended to allow for the use of electronic means of communication. However, it seems doubtful that aligning form requirements with modern communication methods might be sufficient. Negotiable transport documents would seem to give rise, *mutatis mutandis*, to the same issues that arise in connection with maritime bills of lading, while the non-negotiable pose similar questions to those raised by equivalent maritime transport documents (see paras. 123-129).

144. In addition to questions immediately related to the types of transport document governed by the Convention, the Convention contains other provisions that might create obstacles to the use of electronic communications. Those provisions relate essentially to written notices or communications (in particular notices of loss of or damage to goods) and to an existing undertaking or agreement between the parties. The issues of electronic commerce raised by those provisions are very similar in nature to those raised by the corresponding provisions under the United Nations Convention on the Carriage of Goods by Sea (see paras. 130-132).

Conclusions

145. As regards the issues raised by electronic substitutes for multimodal transport documents (see paras. 142 and 143), the Secretariat submits that the consideration of the particular issues involved might go beyond the scope of the Working Group's efforts to remove obstacles to electronic commerce in existing international trade-related instruments. The Working Group may wish to request the Secretariat to consult the United Nations Conference on Trade and Development and inform the Working Group, at an appropriate stage, on any work that might be undertaken in connection with the matters discussed above.

146. As regards the other issues related to electronic commerce under the Convention (see para. 144), the Working Group may wish to consider whether they might not be addressed in the context of its deliberations on the development of an international instrument dealing with some issues of electronic contracting (see A/CN.9/WG.IV/WP.95).

2. European Agreement on Important International Combined Transport Lines and Related Installations and Protocol thereto (Geneva, 1 February 1991)

Status: Entered into force on 20 October 1993 (Convention: 19 signatories; 23 parties; Protocol: 15 signatories; 7 parties).

Source: United Nations, *Treaty Series*, vol. 1746, No. 30382, p. 3.

Comments

147. The purpose of the AGTC Convention is to facilitate the operation of combined transport services and infrastructures necessary for their efficient operation in Europe. In its review of

^aSee also *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 291.

the Convention the Secretariat has not found any provisions that might be directly relevant to electronic commerce.

III. COMMERCIAL ARBITRATION

1. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)

Status: Entered into force on 7 June 1959 (24 signatories; 128 parties).

Source: United Nations, *Treaty Series*, vol. 330, No. 4739, p. 3.

Comments

148. The purpose of the Convention is to establish uniform rules on the recognition and enforcement of foreign arbitral awards that would bring confidence in the efficacy of the arbitration process as a means of dispute resolution across state boundaries. Potentially problematic provisions belong essentially to the three categories indicated below.

(a) Provisions requiring written form of the arbitration agreement

149. Article II, paragraph 1, requires the contracting States to recognize “an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship”. The expression “agreement in writing” is defined in paragraph 2 of the same article so as to include “an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams”.

150. As indicated in an earlier study by the Secretariat, it is generally accepted that the expression in article II, paragraph 2, “contained in an exchange of letters or telegrams” should be interpreted broadly to include other means of communication, in particular telex (to which facsimile could nowadays be added). The same teleological interpretation could be extended to cover electronic commerce, a result that would be in line with the decision taken by the Commission when it adopted the UNCITRAL Model Law on Electronic Commerce in 1996 (see A/CN.9/460, para. 23). The problem arises from the combination of the question of form and the way the arbitration agreement comes about (i.e. its formation), expressed by the expression “exchange of letters or telegrams”, which lends itself to an overly literal interpretation in the sense of a mutual exchange of writings.

151. Pursuant to the mandate received from the Commission at its thirty-second session, in 1999, the Working Group on Arbitration is currently considering, among other topics on its agenda, proposals for clarifying the meaning of article II of the Convention. The current status of the Working Group’s deliberations is reflected in the report of the Working Group on the work of its thirty-third session (see A/CN.9/485, paras. 60-77) and the working paper prepared for the thirty-sixth session (A/CN.9/WG.II/WP.118).

(b) Provisions requiring the submission of “original” documents

152. Difficulties for the use of electronic communications may result, in particular, from the requirement, in article IV, paragraph 1, that, in order to obtain recognition and enforcement of an

arbitral award, the moving party must supply: “(a) the duly authenticated original award or a duly certified copy thereof”; and “(b) the original agreement referred to in article II or a duly certified copy thereof”. In view of the growing interest in online dispute settlement mechanisms, subparagraph (a) of this provision may be a source of legal uncertainty, in particular in States that have not enacted legislation implementing the Model Law on Electronic Commerce, in particular its article 8, or do not otherwise provide for the functional equivalence between data messages and paper-based originals.

(c) Provisions that contemplate notices or declarations that may be exchanged by the parties

153. Article V, paragraph 1 (b), provides that recognition and enforcement of an arbitral award may be refused if there is proof, inter alia, “that the party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or the arbitration proceedings or was otherwise unable to present his case”.

Conclusions

154. The Working Group may wish to take note of the work being undertaken by Working Group II (Arbitration) in connection with the written form of the arbitration agreement under article II of the Convention and related issues. The Working Group may wish to note that those issues will next be considered by Working Group II (Arbitration) at its thirty-sixth session, to be held in New York from 4 to 8 March 2002. The Working Group may also wish to request the Secretariat to inform the Working Group on the progress of that work with a view to formulating comments thereon at an appropriate stage.

2. European Convention on International Commercial Arbitration (Geneva, 21 April 1961)

Status: Entered into force on 7 January 1964 (16 signatories; 28 parties).

Source: United Nations, *Treaty Series*, vol. 484, No. 7041, p. 349.

Comments

155. The purpose of the Convention is to promote the recognition and enforcement of the arbitration process as a means of dispute resolution between physical and legal persons in European countries. Although the Convention does not specifically require that an arbitration agreement needs to be in writing or that an arbitral award needs to be contained in a printed document, the issues it raises are essentially the same as those raised by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (see paras. 148-154).

Conclusions

156. The Working Group may wish to take note of the work being undertaken by Working Group II (Arbitration) in connection with the written form of the arbitration agreement under article II of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and related issues. The Working Group may wish to note that those issues will next be considered by Working Group II (Arbitration) at its thirty-sixth session, to be held in New York from 4 to 8 March 2002. The Working Group may also wish to request that the Secretariat inform the Working Group on the progress of that work with a view to formulating comments thereon at an appropriate stage.

**C. Note by the Secretariat on legal aspects of electronic commerce;
electronic contracting: provisions for a draft convention, working paper
submitted to the Working Group on Electronic Commerce
at its thirty-ninth session**

(A/CN.9/WG.IV/WP.95) [Original: English]

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I. INTRODUCTION

1. At the thirty-second session of the United Nations Commission on International Trade Law (UNCITRAL), in 1999, various suggestions were made with respect to future work in the field of electronic commerce after completion of the model law on electronic signatures. It was recalled that, at the close of the thirty-second session of the Working Group, it had been proposed that the Working Group might wish to give preliminary consideration to undertaking the

preparation of an international convention based on relevant provisions of the UNCITRAL Model Law on Electronic Commerce and of the draft model law on electronic signatures (A/CN.9/446, para. 212).¹ The Commission was informed that interest had been expressed in a number of countries in the preparation of such an instrument.

¹Official Records of the General Assembly, Fifty-third Session, Supplement No. 17 (A/53/17), para. 209.

2. The attention of the Commission was drawn to a recommendation adopted on 15 March 1999 by the Centre for the Facilitation of Procedures and Practices for Administration, Commerce and Transport (CEFACT) of the Economic Commission for Europe.² That text recommended that UNCITRAL consider the actions necessary to ensure that references to “writing”, “signature” and “document” in conventions and agreements relating to international trade allowed for electronic equivalents. Support was expressed for the preparation of an omnibus protocol to amend multi-lateral treaty regimes to facilitate the increased use of electronic commerce.

3. Other items suggested for future work included electronic transactional and contract law; electronic transfer of rights in tangible goods; electronic transfer of intangible rights; rights in electronic data and software (possibly in cooperation with the World Intellectual Property Organization); standard terms for electronic contracting (possibly in cooperation with the International Chamber of Commerce and the Internet Law and Policy Forum); applicable law and jurisdiction (possibly in cooperation with the Hague Conference on Private International Law); and online dispute settlement systems.³

4. At its thirty-third session, in 2000, the Commission held a preliminary exchange of views regarding future work in the field of electronic commerce. The Commission focused its attention on three of the topics mentioned above. The first dealt with electronic contracting considered from the perspective of the United Nations Convention on Contracts for the International Sale of Goods (“the United Nations Sales Convention” or “the Convention”).⁴ The second topic was online dispute settlement. The third topic was dematerialization of documents of title, in particular in the transport industry.

5. The Commission welcomed the proposal to consider further the possibility of undertaking future work on those topics. While no decision as to the scope of future work could be made until further discussion had taken place in Working Group IV (Electronic Commerce), the Commission generally agreed that, upon completing its current task, namely, the preparation of the draft model law on electronic signatures, the Working Group would be expected to examine, at its first meeting in 2001, some or all of the above-mentioned topics, as well as any additional topic, with a view to making more specific proposals for future work by the Commission. It was agreed that work to be carried out by the Working Group could involve consideration of several topics in parallel as well as preliminary discussion of the contents of possible uniform rules on certain aspects of the above-mentioned topics.⁵

²The text of the recommendation to UNCITRAL is contained in document TRADE/CEFACT/1999/CRP.7. Its adoption by CEFACT is stated in the report of CEFACT on the work of its fiftieth session (TRADE/CEFACT/1999/19, para. 60).

³ *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17 (A/54/17)*, paras. 315-318.

⁴United Nations, *Treaty Series*, vol. 1489, No. 25567.

⁵*Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17)*, paras. 384-388.

6. The Working Group considered those proposals at its thirty-eighth session, in 2001, on the basis of a set of notes dealing with a possible convention to remove obstacles to electronic commerce in existing international conventions (A/CN.9/WG.IV/WP.89); dematerialization of documents of title (A/CN.9/WG.IV/WP.90); and electronic contracting (A/CN.9/WG.IV/WP.91).

7. The Working Group concluded its deliberations on future work by recommending to the Commission that work towards the preparation of an international instrument dealing with certain issues in electronic contracting be begun on a priority basis. At the same time, it was agreed to recommend to the Commission that the Secretariat be entrusted with the preparation of the necessary studies concerning three other topics considered by the Working Group, namely: (a) a comprehensive survey of possible legal barriers to the development of electronic commerce in international instruments, including, but not limited to, those instruments already mentioned in the CEFACT survey; (b) a further study of the issues related to transfer of rights, in particular, rights in tangible goods, by electronic means and mechanisms for publicizing and keeping a record of acts of transfer or the creation of security interests in such goods; and (c) a study discussing the UNCITRAL Model Law on International Commercial Arbitration, as well as the UNCITRAL Arbitration Rules, to assess their appropriateness for meeting the specific needs of online arbitration (A/CN.9/484, paras. 94-127). The Commission endorsed those recommendations at its thirty-fourth session, in 2001.⁶

8. The present note provides further information on the issues of electronic contracting, on which the Working Group held an extensive discussion at its thirty-eighth session (A/CN.9/484, paras. 94-127). Annex I to the note contains a preliminary draft of an international convention dealing with those issues. The form of a convention reflects a preliminary working assumption made by the Working Group, of which the Commission took note at its thirty-fourth session, in 2001,⁷ that the form of the instrument to be prepared could be that of a stand-alone convention dealing broadly with the issues of contract formation in electronic commerce (A/CN.9/484, para. 124). The form of an international convention would seem to be best suited to achieve the desired degree of legal certainty and predictability in international electronic commerce. Once the scope and the thrust of the uniform text has been considered, the Working Group would be in a better position to make a final decision on the form of the instrument. Annex II reproduces, for the information of the Working Group, domestic and regional legislative provisions on matters excluded from the scope of electronic commerce legislation. In preparing this note the Secretariat held consultations with outside experts and other organizations interested in this topic, including the International Chamber of Commerce and the Internet Law and Policy Forum. The Working Group may wish to use this note as a basis for its deliberations.

⁶*Ibid.*, *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, paras. 285-295.

⁷*Ibid.*, para. 294.

II. SPHERE OF APPLICATION OF AN INTERNATIONAL INSTRUMENT ON ELECTRONIC CONTRACTING

9. The sphere of application of an international instrument on electronic contracting can be determined by geographical factors as well as by the subject matters to be covered (substantive field of application). The following paragraphs discuss elements that the Working Group may wish to take into account when considering criteria for determining the sphere of application of the new instrument.

A. Substantive sphere of application

1. The notion of “electronic contracting”

10. Although frequently used in its deliberation, the expression “electronic contracting” has not been defined by the Working Group. Nevertheless, it appears from the deliberations of the Working Group that the expression has been used to refer to the formation of contracts by means of electronic communications, or “data messages” in the meaning of subparagraph (a) of article 2 of the UNCITRAL Model Law on Electronic Commerce. This understanding of the expression “electronic contracting” is also consistent with the meaning given to the expression in legal writings. Indeed, “electronic contracting” is regarded as “a method for forming agreements, not a subset based upon any specialized subject matter”.⁸

11. “Electronic contracts” are not believed to be “fundamentally different from paper-based contracts”.⁹ Nevertheless, electronic commerce does not fully reproduce contracting patterns used on contract formation through more traditional means. Thus, although an international harmonization effort to eliminate legal obstacles to the use of modern means of communication might not be primarily concerned with substantive law issues, some adaptation of traditional rules on contract formation may be needed to accommodate the needs of electronic commerce. If the Working Group confirms that this understanding of “electronic contracting” is correct, the new instrument would be concerned primarily with particular issues of contract formation raised by the use of data messages, but not with the material elements of offer and acceptance or the mutual rights and obligations of the parties under the contract. Substantive law issues arising under any given contract would continue to be governed by the applicable law. By the same token, the new instrument, even though dealing with the legal effect that data messages may have for the purpose of contract formation, would not otherwise deal with the validity of contracts. Matters such as the legal

capacity of the parties and requirements for the validity of contracts would not be governed by the new instrument.

12. These assumptions have been reflected in paragraph 1 of draft article 1 (in both variants) and in draft article 3 of the preliminary draft convention contained in annex I. The Working Group may wish to consider whether its understanding of the expression “electronic contracting” is adequately reflected in those draft provisions.

2. Types of contract to be covered

13. The Working Group held a preliminary discussion on the types of contract to be covered by the new instrument. One of the views was that, given the urgent need for the introduction of legal rules required to bring greater certainty and predictability to the international regime governing Internet-based and other electronic commerce transactions, the Working Group should initially focus its attention on issues raised by electronic contracting in the area of international sales of tangible goods (A/CN.9/484, para. 95). However, the discussion held by the Working Group does not appear to indicate that the new instrument should be solely concerned with the formation of sales contracts for tangible goods. Indeed, there was general agreement within the Working Group that it might be useful to develop harmonized rules to govern international transactions other than sales of movable tangible goods in the traditional sense (A/CN.9/484, para. 115).

14. On the basis of the above understanding of the initial conclusions of the Working Group, the preliminary draft convention is not limited to sales contracts, but covers any contract “concluded or evidenced by electronic means”. There are, however, two notable exceptions, as indicated below.

(a) Consumer contracts

15. The first limitation that results from the deliberations of the Working Group concerns consumer contracts. Although mindful of the practical difficulty of distinguishing certain consumer transactions from commercial transactions, the Working Group came to the preliminary conclusion that it should not focus its attention on consumer protection issues (A/CN.9/484, para. 122). When the Commission endorsed the Working Group’s recommendations, it was understood, *inter alia*, that the Working Group would not focus its work primarily on consumer transactions. That understanding is reflected in subparagraph (a) of draft article 2. The Working Group may wish to consider whether, as an alternative to an outright exclusion, the future instrument should follow the example of the UNCITRAL Model Law on Electronic Commerce, whereby an exclusion of consumer transactions is offered as an option for the enacting State.

16. One issue that may deserve further consideration by the Working Group concerns the manner in which an exclusion of consumer transactions should be formulated. At the thirty-eighth session of the Working Group it was suggested that the description of consumer transactions

⁸Donnie L. Kidd, Jr., and William H. Daughtrey, Jr., “Adapting contract law to accommodate electronic contracts”, *Rutgers Computer and Technology Law Journal*, vol. 26, p. 269, who write further that “an electronic contract is not a special type of contract, but a method of contracting. A special type of contract is identified by the subject matter of the contract rather than the manner in which the contract is formed”. (footnote 239).

⁹Shawn Pompian, “Is the statute of frauds ready for electronic contracting?”, *Virginia Law Review*, vol. 85, p. 1479.

contained in article 2, subparagraph (a), of the United Nations Sales Convention might need to be reconsidered with a view to better reflecting electronic commerce practice (A/CN.9/484, para. 122). However, as no alternative was then proposed to the criteria used in subparagraph (a) of article 2 of the United Nations Sales Convention, article 2, subparagraph (a) of the preliminary draft convention uses the same criteria as the Convention.

17. Another issue that the Working Group may wish to consider is whether under certain circumstances the consumer character of a transaction could be disregarded for the purpose of applying the new instrument. According to its article 2, subparagraph (a), the United Nations Sales Convention does not apply to sales 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”. According to legal literature, where the buyer does not inform the seller of such a purpose, the applicability of the Convention depends on the ability that the seller had to recognize that purpose. In order to determine whether that possibility exists, elements such as the number or nature of items bought should be taken into account. It should be noted, however, that, as indicated in the commentary on the draft Convention on Contracts for the International Sale of Goods, which was prepared by the Secretariat (A/CONF.97/5), article 2, subparagraph (a), of the United Nations Sales Convention was based on the assumption that consumer transactions were international transactions only in “relatively few cases”.¹⁰ Thus, the underlying assumption of article 2, subparagraph (a), of the United Nations Sales Convention is that consumer contracts would only exceptionally be covered by the Convention in cases where the consumer purpose of the transaction was not apparent.

18. The preliminary draft convention includes a provision along the lines of article 2, subparagraph (a), of the United Nations Sales Convention, without, however, the phrase “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”. The reason for such an exclusion is that it was felt at the Working Group’s preliminary discussion on the matter that the words “ought to have known” in article 2, subparagraph (a), of the Convention might be difficult to apply in practice to electronic transactions (A/CN.9/484, para. 120). Furthermore, with the ease of access afforded by open communication systems such as the Internet, the likelihood of consumers purchasing goods from sellers established abroad is greater than in a paper-based environment.

19. The Working Group may nevertheless wish to consider whether additional provisions might be needed in the preliminary draft convention so as to provide greater certainty as to whether a particular contract would fall under its scope of application, for instance, by requiring persons offering goods or services through open communication

systems to provide means for persons contracting with them to state the purpose of the contract.

(b) *Contracts relating to the grant of limited use of intellectual property rights*

20. The second exclusion is not related to the purpose of the transaction but to the nature of the contract. From the discussion held by the Working Group on licensing arrangements (A/CN.9/484, para. 116) and on transactions involving so-called “virtual goods” (A/CN.9/484, para. 117), it appears that the initial assumption of the Working Group was that the new instrument should not be concerned with contracts having the primary purpose of granting a limited right to use a certain product, under conditions laid down in the relevant agreement, which the Working Group referred to as “licensing contracts” (A/CN.9/484).

21. It should be noted, however, that, as it appears from the initial deliberations of the Working Group, the criterion for establishing such a limitation would not be the nature of the goods being traded (whether tangible goods or “virtual goods”), but rather the nature of the contract entered into by the parties and their intention (A/CN.9/484). Under such an approach, a contract where the buyer or “user” is free from restrictions as to the use of the product (be it a tangible or a “virtual good”) would normally be governed by the new instrument, even if such product incorporates patented or copyrighted work. In contrast, contracts where the agreement allows the producer or developer of the “virtual good” (or service) to exercise control over the product down through the licensing chain, the contract would remain outside the scope of the preliminary draft convention.

22. Thus, subparagraph (b) of draft article 2 excludes from the application of the preliminary draft convention “contracts relating to the grant of limited use of intellectual property rights”. The Working Group may wish to consider whether the draft provision adequately reflects the understanding of the Working Group.

(c) *Other exclusions*

23. The Working Group may wish to consider whether other types of contract should be excluded from the scope of application of the new instrument. With a view to facilitating the deliberations of the Working Group, annex II reproduces, for illustrative purposes, provisions of domestic or regional legislation that exclude certain matters from the scope of application of legislation adopted to facilitate the use of electronic commerce or, more generally, promote the use of electronic means of communication.

B. Geographical sphere of application

24. The sphere of application of the new instrument may either be limited to international contracts or cover any contract concluded or evidenced by data messages, regardless of the location of the parties. In the first case, the new instrument would need to establish criteria for determining when a contract is “international”. Furthermore, a choice

¹⁰Official Records of the United Nations Conference on Contracts for the International Sale of Goods: documents of the Conference and summary records of the plenary meetings and of the meetings of the Main Committee (United Nations publication, Sales No. E.81.IV.3), p. 16.

should be made as to whether the instrument would apply to any international contract or only to contracts that show connections to contracting States of the new instrument. These alternative approaches are discussed below.

1. “International contracts”

25. Most of the trade law instruments that have been prepared by the Commission apply only to “international” transactions. One notable exception, however, is the UNCITRAL Model Law on Electronic Commerce, which does not distinguish between domestic and international transactions, but offers the enacting State the option to limit the scope of application of the law to international transactions.

26. The international character of a contract may be defined in a variety of ways. The solutions adopted in both national and international legislation range from a reference to the place of business or habitual residence of the parties in different countries¹¹ to the adoption of more general criteria such as the contract having “significant connections with more than one State” or relating “to international commerce”.¹²

27. At the thirty-eighth session of the Working Group it was suggested that, in view of practical difficulties in establishing the places of business of the parties, in the absence of a clear indication by them, other criteria should be used for establishing the geographical sphere of application of the future instrument, such as the place of contract formation (A/CN.9/484, paras. 110 and 111). The Working Group agreed, however, that the place of conclusion of a contract, as traditionally understood in private international law, might not provide sufficient basis for a workable solution in an electronic environment (A/CN.9/484, para. 112).

28. Indeed, rules on contract formation often distinguish between “instantaneous” and “non-instantaneous” communications of offer and acceptance or between communications exchanged among parties present at the same place at the same time (*inter praesentes*) or communications exchanged at distance (*inter absentes*). Typically, unless the parties engage in “instantaneous” communication or are negotiating face-to-face, a contract is formed either when acceptance is dispatched to the offeror or when the offeror receives it. The place of contract formation can be relatively easily established once the places of dispatch or receipt are known.

29. In electronic commerce, however, it may be difficult to determine the place at which a message has been either dispatched or received. Transmission protocols of data message between different information systems usually

register the moment when a message is delivered from one information system to another or the moment when it is effectively received or read by the addressee. However, transmission protocols do not usually indicate the geographical location of the communication systems. It is not surprising, therefore, that article 15 of the UNCITRAL Model Law on Electronic Commerce refers to the notion of “place of business” when providing rules to determine the places of dispatch and receipt of data messages.

30. In the light of the practical difficulty of determining in advance the place of contract formation, this criterion has not been used to establish the sphere of application of the preliminary draft convention.

31. Other concepts proposed at the thirty-eighth session of the Working Group included the notion of “centre of gravity” of a contract (A/CN.9/484, para. 112). However, a review of selected international instruments shows that references to the place that “has the closest relationship to the contract and its performance” or to other similar notions in most cases are only subsidiary means for determining a party’s place of business, typically in case of plurality of places of business.¹³ Furthermore, it is doubtful that the “centre of gravity” of a contract will always be apparent to the parties at the time the contract is concluded.

32. For the above reasons, paragraph 1 of variant B of draft article 1 refers to the places of business of the parties, as this criterion has traditionally been used in international instruments prepared by the Commission and by other international organizations, such as the International Institute for the Unification of Private Law (Unidroit).¹⁴ Where a party has more than one place of business, paragraph 2 of draft article 7 refers to the place that has the closest relationship to the contract and its performance.

33. The preceding observations lead to the second question related to the geographical sphere of application of the new instrument, namely, whether it should generally apply to contracts between parties whose places of business are in different States or should become applicable only when both States are also States parties to the instrument. Such a requirement appears in article 1, paragraph 1 (a), of the United Nations Sales Convention, but not in other UNCITRAL instruments, such as the Convention on the Limitation Period in the International Sale of Goods (“the United Nations Limitation Convention”)¹⁵ (see subpara. (a) of article 2) or the UNCITRAL Model Law on International Commercial Arbitration (see paragraph 3 of article 1). In the interest of ensuring the widest possible application of the new instrument, draft article 1, variant B, does not limit the sphere of application to contracts between parties whose places of business are in contracting States.

¹¹E.g. United Nations Sales Convention, article 1, paragraph 1; Convention on the Limitation Period in the International Sale of Goods, article 2, subparagraph (a); and United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, article 1, subparagraph (a).

¹²UNCITRAL Model Law on Electronic Commerce, article 1, first footnote.

¹³E.g. United Nations Sales Convention, article 10, subparagraph (a); United Nations Limitation Convention, article 2, subparagraph (c); United Nations Guarantees Convention, article 4, paragraph 2 (a); Unidroit Convention on International Financial Leasing, article 3, paragraph 2; and Unidroit Convention on International Factoring, article 2, paragraph 2.

¹⁴Unidroit Leasing Convention, article 3, subparagraph 1 (a); and Unidroit Factoring Convention, article 2, paragraph 1 (a).

¹⁵United Nations, *Treaty Series*, vol. 1511, No. 26119.

2. *Sphere of application independent of the location of the parties*

34. Given the difficulties involved in determining the location of the parties, variant A of draft article 1 does not limit the sphere of application of the preliminary draft convention to “international” contracts. Under this variant, the draft convention would apply to any contract concluded or evidenced by data messages, regardless of whether or not the parties have their place of business in different States.

35. Such an approach might have the practical advantage of obviating the need for establishing where the parties have their places of business in order to determine whether the instrument applies in any given case. Furthermore, under this approach, parties who conclude contracts electronically in a contracting State might benefit from the favourable regime of the new instrument even when entering into purely domestic transactions. This option might be particularly attractive for parties located in States that do not have legislation in force supporting the use of data messages in contract formation.

36. Variant A of draft article 1 recognizes, however, that States may wish to preserve the duality of regimes for domestic and international contracts. Accordingly, draft paragraph 3 makes it possible for a State to make a declaration to the effect that it will apply the instrument only to international contracts.

III. GENERAL PROVISIONS: LOCATION OF THE PARTIES

37. The preliminary draft convention contains a number of general provisions, such as definitions and interpretation, which are customary in international instruments. From among the general provisions of the preliminary draft convention those dealing with the location of the parties may require particular attention.

A. General issues related to the location of the parties

38. One of the central concerns of the Working Group during its initial discussion of issues raised by electronic contracting was the need for enhancing legal certainty and predictability. In that context, it was proposed that, when considering a new international instrument on electronic contracting, the Working Group should envisage formulating rules that required the parties to a contract concluded electronically to clearly indicate where their relevant places of business were located (A/CN.9/484, para. 103). That proposition is reflected in draft article 14, paragraph 1 (*b*). The legal effect of such an indication is set forth in paragraph 1 of draft article 7, which establishes a presumption that a party’s place of business is the one indicated as such by it. The combined application of the two provisions might be beneficial to enhance legal certainty in electronic transactions by facilitating the determination by the parties, at the time a contract is concluded, of matters such as

whether or not the contract is international, whether or not it is covered by the new instrument and, possibly, which law governs the contract.

39. At its thirty-eighth session, the Working Group considered the question as to whether the parties should be allowed to freely select the regime governing their transactions by choosing the place they declared to be their place of business. Such a situation was seen as undesirable, to the extent that it would make it possible for the parties to transform purely domestic transactions into international ones, only for the purpose of avoiding the application of the law of a particular country (A/CN.9/484, para. 102). The Working Group may wish to consider whether specific provisions should be made to avoid situations where a party’s indication of a place of business would serve no other purpose than to circumvent the new instrument or trigger its applications in cases that would fall outside their scope (for example, in a purely domestic transaction, assuming that the new instrument would only apply to “international” contracts). A possible rule to that effect is proposed in the phrase within square brackets in article 7, paragraph 1, of the preliminary draft convention.

40. As regards the notion of “place of business” for the purposes of the new instrument, the preliminary draft convention follows the cautious approach taken by the Working Group at its thirty-eighth session, namely, that every effort should be made to avoid creating a situation where any given party would be considered as having its place of business in one country when contracting electronically and in another country when contracting by more traditional means (A/CN.9/484, para. 103). Therefore, both variants of the proposed definitions of “place of business” (draft article 5, subparagraph (*j*), variants A and B) are based on the assumption that legal entities would be physically located at a certain place.

B. Particular considerations on electronic commerce

41. If the relevant place of business has not been clearly indicated by the parties before or at the time of conclusion of the contract, the question arises as to whether there exist circumstances from which the location of the relevant place of business can be inferred.

42. If the new instrument is to apply the generally understood meaning of the notion of “place of business” under existing international instruments, such as the United Nations Sales Convention,¹⁶ elements such as the location of the equipment and technology supporting an information system or the places from which such system may be accessed should not be regarded as controlling. Otherwise, a person’s place of business for the purposes of the instrument might be different from the same person’s place of business for other purposes. Furthermore, location of equipment and technology may not be adequate factors, since they do not provide sufficient indication as to the

¹⁶As developed in legal literature, in the absence of a definition of “place of business” in the Convention.

ultimate parties to the contract. For example, a contract on behalf of the seller may be automatically concluded with the buyer by the computer of the information services provider that hosts the seller's web site.

43. Nevertheless, it is conceivable that a legal entity's activities might be entirely or predominantly carried out through the use of information systems, without a fixed "establishment" or without any connection to a physical location other than, for instance, the registration of its articles of incorporation at a given registry. For these so-called "virtual companies" it might not be reasonable to apply the same criteria traditionally used to determine a person's place of business. The language within square brackets in paragraph 4 of draft article 7 recognizes that possibility by providing that, for legal entities that do not have a place of business, the location of the equipment and technology supporting the information system or the places from which such a system may be accessed may be taken into account in order to establish where such a legal entity has its place of business.

44. In its preliminary exchange of views on this matter, the Working Group considered which elements, in an electronic environment, were suitable for inferring the place of business of the parties, in the absence of a clear indication by them to that effect. One solution proposed to the Working Group was to take into account the address from which the electronic messages were sent. It was suggested that, in the case of addresses linked to domain names connected to specific countries (such as addresses ending with ".at" for Austria, ".nz" for New Zealand, etc.), it could be argued that the place of business should be located in the corresponding country.

45. However, that proposition was criticized on the ground that an electronic mail (e-mail) address or a domain name could not automatically be regarded as the functional equivalent of the physical location of a party's place of business. It was said that it was common in certain branches of business for companies to offer goods or services through various regional web sites bearing domain names linked to countries where such companies did not have a "place of business" in the traditional sense of the term. Furthermore, goods being ordered from any such web site might be delivered from warehouses maintained for the purpose of supplying a particular region, which might be physically located in a State other than those linked to the domain names involved. It was pointed out, in that connection, that the system of assigning domain names for Internet sites had not been originally conceived in strictly geographical terms, which was evident from the use of domain names and e-mail addresses that did not show any link to a particular country, as in those cases where an address was a top-level domain such as ".com" or ".net", for example.

46. Paragraph 5 of draft article 7 reflects the preliminary agreement reached by the Working Group as to the limitations of regarding domain names and e-mail addresses alone as controlling factors for determining internationality in the Internet environment.

IV. FORMATION OF CONTRACTS

47. Issues related to contract formation may be divided into two broad categories: (a) general issues of contract formation as known under contract law; and (b) issues specific to contracting through electronic means or rendered particularly conspicuous by the use of modern means of communication. With regard to the first category, the central question is how traditional notions such as offer and acceptance, timing of communications and receipt and dispatch of offer and acceptance may be transposed to an electronic environment. The second category includes questions that, although not entirely new, go beyond the simple issue of functional equivalence. They include, for example, legal treatment of fully automated systems used in electronic commerce, as well as additional rights and obligations that parties using such systems might have, above and beyond what would normally be expected in a paper-based negotiating scenario.

A. General issues

48. As an initial working basis, the rules on contract formation in the preliminary draft convention contain provisions that follow the rules on the formation of contracts set forth in the United Nations Sales Convention. The advantage of the Convention's rules on formation consists in their having demonstrated their workable character in an international environment beyond the confines of sales law. This is evidenced, *inter alia*, by the fact that they have been used as models in the work of Unidroit that led to the "Principles of International Commercial Contracts".¹⁷

1. Offer and acceptance

49. Draft article 8 of the preliminary draft convention contains provisions intended to make it possible to determine the time of contract formation. They are based on similar provisions of the United Nations Sales Convention. However, the provisions in the preliminary draft convention do not deal with various other substantive issues dealt with in the United Nations Sales Convention, such as the substantive criteria that a declaration has to meet in order to be considered an offer or an acceptance. The reason for this limited approach is that the preliminary draft convention is not intended to deal specifically with sales contracts, nor is it supposed to reproduce or duplicate the entire regime of the United Nations Sales Convention or of other international treaties dealing with other types of contract. Thus, the preliminary draft convention contains only those rules on contract formation that may be regarded as strictly necessary in order to achieve greater legal certainty in electronic contracting.

50. Such rules include, firstly, basic rules to allow the parties to determine clearly when a contract is concluded. They are contained in article 8 of the preliminary draft convention. In the consultations conducted by the

¹⁷Compare articles 2.1 et seq. of the Unidroit Principles of International Commercial Contracts.

Secretariat it has been suggested that the usefulness of the future instrument might be limited if it were not to address, for all contracts subject to its sphere of application, the issue of the time of contract formation.

51. Another of those basic rules is concerned with a party's intention to be bound, which distinguishes an offer from an invitation to make an offer (see article 9 of the preliminary draft convention). Article 14, paragraph 1, of the United Nations Sales Convention provides that a proposal for concluding a contract that is addressed to one or more specific persons constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance. Whether the parties negotiate by e-mail, electronic data interchange (EDI) or through more traditional means, the nature and legal effect of their communications will be established by their intention.

52. Where a specific rule on electronic contracting may be needed is in connection with article 14, paragraph 2, of the United Nations Sales Convention, which provides that a proposal other than one addressed to one or more specific persons is to be considered merely as an invitation to make offers, unless the contrary is clearly indicated by the person making the proposal. In a paper-based environment, advertisements in newspapers, radio and television, catalogues, brochures or price lists are generally regarded as invitations to submit offers (according to some legal writers, even in those cases where they are directed to a specific group of customers), since in those cases the intention to be bound is considered to be lacking. By the same token, the mere display of goods in shop windows and on self-service shelves are usually regarded as invitations to submit offers.

53. The situation becomes more complex when the parties offer goods or services through a web site. The Internet makes it possible to address specific information to a virtually unlimited number of persons and current technology permits contracts to be concluded nearly instantly. The Working Group was aware of this situation and took the view that Internet transactions might not fit easily into the established distinctions between what might constitute an "offer" and what should be interpreted as an "invitation to treat" (A/CN.9/484, para. 125). If the principle of article 14, paragraph 2, of the United Nations Sales Convention is transposed to an electronic environment, a company that advertises its goods or services on the Internet or through other open networks should be considered to be merely inviting those who access the site to make offers. Thus, an offer of goods or services through the Internet would not *prima facie* constitute a binding offer. Paragraph 1 of draft article 9 of the preliminary draft convention reflects this general rule.

54. The difficulty that arises in this context relates to the possible intention of being bound by an offer. One possible criterion for distinguishing between a binding offer and an invitation to treat may be based on the nature of the applications used by the parties. Legal writings on electronic contracting have proposed a distinction between web sites offering goods or services through interactive applications and those which use non-interactive applications. If a web site only offers information about a company and its

products and any contact with potential customers lies outside the electronic medium, there would be little difference to a conventional advertisement. Interactive applications, however, may enable negotiation and immediate conclusion of a contract (in the case of virtual goods even immediate performance), so that they might be regarded as an offer "open for acceptance while stocks last", as opposed to an "invitation to treat".¹⁸ This proposition is reflected in paragraph 2 of draft article 9 of the preliminary draft convention.

2. Expression of consent

55. One of the fundamental objectives of the new instrument would be to clearly recognize that the parties to a contract may express their consent by means of electronic communications or other types of data message. For that purpose, draft article 10 reproduces a rule contained in article 11 of the UNCITRAL Model Law on Electronic Commerce that an offer and the acceptance of an offer may be expressed by means of data messages.

56. Some domestic laws based on the Model Law, such as the Uniform Electronic Commerce Act prepared by the Uniform Law Conference of Canada ("the Uniform Electronic Commerce Act of Canada") contain more detailed provisions on expression of consent in an electronic environment. Section 20, paragraph 1 (b), of the Uniform Electronic Commerce Act of Canada expressly refers to touching or clicking on an appropriately designated icon or place on a computer screen as a manner of manifesting consent. The Working Group may wish to consider whether such additional clarification would be required. In fact, it would appear that, to the extent that the new instrument might build upon the concept of "data message", following the example of the UNCITRAL Model Law on Electronic Commerce, the additional clarification might not be necessary.

57. Article 2 of the UNCITRAL Model Law on Electronic Commerce defines "data message" as "information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy". Unless the word "information" is given a restrictive interpretation, the result of any of the actions listed in section 20, paragraph 1 (b), of the Uniform Electronic Commerce Act of Canada would in most cases be the sending of information in the form of data messages. For example, when a person clicks on an "I agree" button shown on a computer screen, information is sent to the other computer indicating that the relevant button was activated at the other end of the communication chain. Such information should be regarded as a "data message" within the meaning of this term in article 2, subparagraph (a), of the Model Law.

58. It should also be noted that, when first considering this matter, the Working Group was of the view that the

¹⁸Christoph Glatt, "Comparative issues in the formation of electronic contracts", *International Journal of Law and Information Technology*, vol. 6, p. 50.

expression of consent through clicking would require particular attention. A note of caution was struck, however, as to the need to maintain a technology-neutral approach to the issues of online contract formation. The rules to be developed should be sufficiently general to stand the test of—at least some—technological change (A/CN.9/484, para. 126).

3. *Receipt and dispatch*

59. With respect to the issues of receipt and dispatch in the formation of contracts, it was generally agreed during the Working Group's preliminary discussions that any future legal instrument should preserve a degree of flexibility to endorse the use of electronic commerce techniques both in a situation where electronic communication was instantaneous and in a situation where electronic messaging was more akin to the use of traditional mail (A/CN.9/484, para. 127).

60. According to the United Nations Sales Convention, both the offer and the acceptance (at least in most cases) become effective upon their "receipt", as defined in article 24, according to which "for the purposes of this Part of the Convention, an offer, declaration of acceptance [. . .] 'reaches' the addressee when it is made orally to him or delivered by any other means to him personally, to his place of business or mailing address".

61. With respect to traditional forms of communication, such as oral or paper-based communications, the above-mentioned provision does not seem to cause any problems. A question arises, however, as to whether article 24 can be applied to electronic forms of communication without creating problems. It appears that the issue is only one of defining the "receipt" of the electronic message. The UNCITRAL Model Law on Electronic Commerce deals in its article 15 with issues related to time and place of receipt and dispatch of a data message. Those provisions seem to be sufficiently flexible to cover both situations where electronic communication appears to be instantaneous and those where electronic messaging mirrors traditional mail.

62. It appears, therefore, that the United Nations Sales Convention, in particular its article 24, contains rules that, when supplemented by provisions along the lines of article 15 of the UNCITRAL Model Law on Electronic Commerce, can serve as a general model also in an electronic environment. Thus, draft article 11 of the preliminary draft convention reflects essentially the provisions of article 15 of the Model Law. The Working Group may wish to consider whether the rule proposed therein should be made more specific so as to be useful in electronic contracting practice.

4. *Possible additional issues*

63. Despite the success of the rules of the United Nations Sales Convention on offer and acceptance, which is due to their ability to transcend the traditional differences in the approaches taken by civil and common law, questions may

be asked as to whether they deal exhaustively with all the issues relating to contract formation and, consequently, whether they can be resorted to when drafting general rules on electronic contracting. The question to be considered by the Working Group is, therefore, the extent to which there are additional issues that need to be addressed in the new instrument.

64. The rules set forth in the United Nations Sales Convention were drafted mainly with a view to dealing with cases where a contract was formed through offer and acceptance. The fact that those cases do not cover all the ways by which an agreement can be reached becomes evident in view of the possible complexity of transactions that include a great deal of communication between the parties and that do not necessarily fit within the traditional analysis of offer and acceptance. According to one school of thought, agreements reached without an offer and an acceptance being clearly discernible do not fall within the scope of the Convention and should, therefore, be dealt with by resorting to the applicable domestic law. Under such an approach, it might be impossible to use the body of the Convention's rules on formation of the sales contract as a model for an exhaustive body of rules on the formation of electronic contracts.

65. However, according to the majority of commentators, the United Nations Sales Convention covers the agreements reached without resorting to the traditional "offer-acceptance" scheme. The fact that the Convention does not expressly refer to them is not due to their being excluded from its scope, but rather to the fact that the drafters did not consider it necessary to address them specifically and to tackle the additional difficulties they might have encountered in trying to devise appropriate wording for those types of agreement. Thus, like any other matter that is governed by (albeit not expressly settled in) the Convention, the issue of whether there is an agreement even without a clear offer and acceptance, has to be settled in conformity with the general principles on which it is based under paragraph 1 of article 7. Those principles include the principle of the consensual nature of the contract as well as the principle that the existence of the contract depends on whether it is possible to discern the minimum contents required for the conclusion of the contract (such as the elements defined in article 14 of the Convention for the sales contract).

66. Irrespective of which of the two above-mentioned approaches is taken with regard to the United Nations Sales Convention, the Working Group may wish to consider whether specific rules are required in the context of electronic contracting to clarify the legal regime applicable to agreements reached in ways other than a discrete offer and acceptance.

67. In addition to questions related to how consent could be expressed, it was suggested at the Working Group's thirty-eighth session that the following issues, among others, needed to be considered: (a) the acceptance and binding effect of contract terms displayed on a video screen but not necessarily expected by a party; and (b) the incorporation by reference of contractual clauses accessible through a "hypertext link" (for an explanation of such links, see

para. 46-5 of the Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce, as amended by article 5 bis).

68. Neither of these issues are dealt with in the UNCITRAL Model Law on Electronic Commerce. Article 5 bis of the Model Law contains a general provision intended to uphold the legal effect of information incorporated by reference. However, the Model Law does not deal in detail with matters of contract law. Furthermore, neither the Model Law nor the United Nations Sales Convention expressly provide a solution for the well-known problem of “battle of forms”.¹⁹ “Battle of forms” or unexpected contractual terms may be a serious problem in the context of electronic transactions, in particular where fully automated systems are used and no means are provided for reconciling conflicting contractual terms.

69. However, the consultations conducted by the Secretariat have indicated that attempting to address issues such as battle of forms or unexpected contractual terms might well exceed the scope of the new instrument and should best be left for the applicable law. The Working Group may wish to consider whether the new instrument should include rules on these matters.

B. Special issues

70. Special questions posed by electronic commerce include the use of fully automated communication systems, the treatment of mistake or error, the information to be provided by the parties and the means for obtaining a record of the contract.

1. Automated computer systems

71. Automated computer systems, sometimes called “electronic agents”, are being used increasingly in electronic commerce. While the UNCITRAL Model Law generally accommodates the use of fully automated systems, it does not deal specifically with those systems beyond the general rule on attribution in article 13, paragraph 2 (b). When considering this matter at its thirty-eighth session, the Working Group was of the view that, while the expression “electronic agent” had been used for purposes of convenience, the analogy between an automated system and a sales agent was not appropriate. Thus, general principles of agency law (for example, principles involving limitation of liability as a result of the faulty behaviour of the agent) could not be used in connection with the operation of such systems. The Working Group reiterated its earlier understanding that, as a general principle, the person (whether a natural person or a legal entity) on whose behalf a computer was programmed should ultimately be responsible for any message generated by the machine (A/CN.9/484, para. 107). As a general rule, the employer of a tool is responsible for the results obtained by

the use of that tool since the tool has no independent volition of its own. However, an “electronic agent”, by definition, is capable, within the parameters of its programming, of initiating, responding or interacting with other parties or their electronic agents once it has been activated by a party, without further attention of that party.

72. Although the use of automated systems, for example, for issuing purchase orders or processing purchase applications seems to be compatible with the United Nations Sales Convention, which allows the parties to create their own rules (art. 9), it might be useful for the new instrument to make it clear that the actions of automated systems programmed and used by people will bind the user of the system, regardless of whether human review of a particular transaction has occurred.

73. An advantage of such a provision may be to facilitate the development of automatization for contracting purposes. At present, the attribution of actions of an automated computer system to a person or legal entity is based on the paradigm that an electronic agent is capable of performing only within the technical strictures of its preset programming. However, at least in theory it is conceivable that future generations of automated computer systems may be created with the ability to act autonomously and not just automatically. That is, through developments in artificial intelligence, computers may be able to learn through experience, modify the instructions in their own programs and even devise new instructions.²⁰

2. Treatment of mistake and error

74. Closely related to the use of automated computer systems is the question of treatment of mistakes and errors in electronic commerce. Since the UNCITRAL Model Law on Electronic Commerce is not concerned with substantive issues that arise in contract formation, it does not deal with the consequences of mistake and error in electronic contracting.

75. However, recent uniform legislation enacting the Model Law, such as the Uniform Electronic Commerce Act of Canada and the Uniform Electronic Transactions Act, which was prepared by the National Conference of Commissioners on Uniform State Laws of the United States of America (“the United States Uniform Electronic Transactions Act”) contain provisions dealing with errors made by natural persons when dealing with an automated computer system of another person. The relevant provision in the Uniform Electronic Commerce Act of Canada (sect. 22) and in the United States Uniform Electronic Transactions Act (sect. 10) set forth the conditions under which a natural person is not bound by a contract in the event that the person made a material error.

76. The Working Group may wish to consider whether it would be desirable for the new instrument to deal with mistakes and errors made by natural persons when dealing

¹⁹Both issues are, however, addressed in the Unidroit Principles on International Commercial Contracts (see art. 2.1 et seq.).

²⁰Allen and Widdison, “Can computers make contracts?”, *Harvard Journal of Law and Technology*, vol. 9, No. 25 (Winter 1996).

with automated computer systems. In particular, the Working Group may wish to consider whether provisions of this type would be appropriate in a business-to-business context. The rationale for provisions such as those contained in the Uniform Electronic Commerce Act of Canada and in the United States Uniform Electronic Transactions Act seems to be the relatively higher risk of human errors being made in transactions involving a natural person, on the one hand, and an automated computer system, on the other, as compared with transactions that involve only natural persons. Errors made by the natural person in such a situation might become irreversible once acceptance is dispatched. It should also be noted that international texts, such as the UNIDROIT Principles of International Commercial Contracts, deal with the consequences of errors for the validity of the contract, albeit restrictively (see arts. 3.5 and 3.6). However, it could be argued that a provision of this type would interfere with well-established notions of contract law and might not be appropriate in the context of the new instrument. For these reasons, the relevant provision in the preliminary draft convention (para. 3 of art. 12) appears within square brackets.

77. A slightly different approach might be to envisage only an obligation for persons offering goods or services through automated computer systems to offer means for correcting errors, without dealing with the consequences of errors for the validity of the contract. Such an obligation, which is provided in article 11, paragraph 2, of the Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ("Directive 2000/31/EC of the European Union"), is also contained in paragraph 2 of draft article 12.

78. Another issue that the Working Group may wish to consider is whether the new instrument should deal with errors made by the automated system itself. At its initial discussion of this issue, the Working Group was of the view that errors made by any such system should ultimately be attributable to the persons on whose behalf they operated. Nevertheless, the Working Group recognized that there might be circumstances that justified a mitigation of that principle, such as when an automated system generated erroneous messages in a manner that could not have reasonably been anticipated by the person on whose behalf the system was operated. It was suggested that elements to be taken into account when considering possible limitations for the responsibility of the party on whose behalf the system was operated included the extent to which the party had control over the software or other technical aspects used in programming such automated system. It was also suggested that the Working Group should consider, in that context, whether and to what extent an automated system provided an opportunity for the parties contracting through such a system to rectify errors made during the contracting process (A/CN.9/484, paras. 107 and 108).

79. However, in its review of domestic and regional legislation on electronic commerce, the Secretariat has not found any precedents of legislative provisions dealing with the consequences of errors made by the automated system

itself. Thus, the preliminary draft convention, at this stage, does not include a provision on this issue. The Working Group may wish to consider whether such a provision would be needed.

3. System requirements

80. Another special issue raised by electronic contracting that was mentioned during the discussions in the Working Group relates to the ability of the receiving party to print the general conditions of a contract and the mechanisms offered for record retention (A/CN.9/484, para. 126).

81. Except for purely oral transactions, most contracts negotiated through traditional means would result in some tangible record of the transaction to which the parties can refer in case of doubt or dispute. In electronic contracting, such record, which may exist as a data message, may be only temporarily retained or may be available only to the party through whose information system the contract was concluded. Thus, some recent legislation on electronic commerce, such as Directive 2000/31/EC of the European Union (art. 10, para. 1), requires that a person offering goods or services through information systems accessible to the public should provide means for storage or printing of the contract terms. This obligation is combined with the person's obligation to disclose some minimum information when negotiating electronically.

82. No similar obligations exist under the United Nations Sales Convention or most international instruments dealing with commercial contracts. The Working Group may therefore wish to consider, as a matter of principle, whether it would be appropriate to create specific obligations for parties conducting business electronically that may not exist when they contract through more traditional means.

83. The rationale for creating such specific obligations seems to be the interest of enhancing legal certainty, transparency and predictability in international transactions concluded by electronic means. The use of the Internet in international trade has become a reality and is expected to increase. It has made it possible for parties in different countries having little or even no prior knowledge or information about one another to enter into contracts nearly instantaneously. Thus, it may not be unreasonable to require certain information to be provided or technical means to be offered in order to make available contract terms in a way that allows for their storage and reproduction, in the absence of a prior agreement between the parties, such as a trading partner agreement or other type of agreement. This is the approach taken by some recent domestic and regional legislation on electronic commerce, such as Directive 2000/31/EC of the European Union.

84. The Working Group may wish to note that special obligations of this type seem to have been developed to address consumer protection concerns. Nevertheless, it appears that they could be adapted to a business-to-business context.

V. FORM REQUIREMENTS

85. Although the United Nations Sales Convention does not generally deal with issues of validity, as indicated in subparagraph (a) of article 4, it deals expressly with the formal validity of contracts for the international sale of goods. Indeed, article 11 establishes that:

“A contract for the international sale of goods need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses.”

Thus, article 11 establishes the principle that the formation and the evidence of a contract subject to the Convention is free of any form requirement,²¹ and, therefore, can be concluded orally, in writing²² or in any other way.

86. The preliminary draft convention follows the general principle of freedom of form enshrined in the United Nations Sales Convention and extends it to all contracts falling within its sphere of application. However, it is recognized that form requirements may exist under the applicable law as writing or signature requirements, for example when a State party to the United Nations Sales Convention has made a reservation under article 96 of the Convention, which provides:

“A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration in accordance with article 12 that any provision of article 11, article 29, or Part II of this Convention, that allows a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form other than in writing, does not apply where any party has his place of business in that State.”

87. Despite the wide acceptance that the UNCITRAL Model Law on Electronic Commerce has found and the increasing number of States that have based their legislation on electronic commerce on it, an international instrument on electronic contracting could not be based on the

assumption that the principles of the Model Law have already achieved universal application. It seems, therefore, necessary for the new instrument to establish the conditions under which form requirements may be met by equivalent electronic methods.

A. Writing and signature requirements

88. The preliminary draft convention reproduces the criteria contained in article 6 of the UNCITRAL Model Law on Electronic Commerce for the legal recognition of data messages as “writings”.

89. As regards signature requirements, the Working Group may wish to consider whether the new instrument should limit itself to a general provision on the recognition of electronic signatures or whether it should spell out the conditions for the legal recognition of electronic signatures in a greater level of detail. Under the first option, the Working Group might wish to introduce in the new instrument a provision along the lines of article 7, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce. That option is reflected in variant A of paragraph 3 of draft article 13. Under the second option, the Working Group might wish to use more detailed language along the lines of article 6, paragraph 3, of the UNCITRAL Model Law on Electronic Signatures. That option is reflected in variant B of paragraph 3 of draft article 13. It should be noted that these options are not mutually exclusive, since article 7, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce was the basis for the more detailed rules in article 6, paragraph 3, of the UNCITRAL Model Law on Electronic Signatures.

B. Other requirements

90. Articles 8 and 9 of the UNCITRAL Model Law on Electronic Commerce deal with other legal requirements that may create obstacles to electronic commerce, namely, requirements relating to the production of “original” documents or to the retention of documents and records.

91. The preliminary draft convention does not contain provisions dealing with those matters, as they do not appear to be of immediate relevance in the context of contract formation. The Working Group may wish to consider whether the new instrument should incorporate any of those or even other provisions of the Model Law.

²¹See Oberster Gerichtshof, 6 February 1996, *Österreichische Zeitschrift für Rechtsvergleichung* 248 (1996) = CLOUT case n. 176.

²²For this statement, see, for instance, Oberlandesgericht München, 8 March 1995, CLOUT case n. 134.

ANNEX I

**PRELIMINARY DRAFT CONVENTION¹ ON
[INTERNATIONAL] CONTRACTS CONCLUDED OR
EVIDENCED BY DATA MESSAGES**

Chapter I. Sphere of application**Article 1. Scope of application***Variant A²*

1. This Convention applies to contracts concluded or evidenced by means of data messages.

2. Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

[3. A State may declare that it will apply this Convention only to contracts concluded between parties having their places of business in different States or [when the rules of private international law lead to the application of the law of a Contracting State or] when the parties have agreed that it applies.]³

[4. Where a State makes a declaration pursuant to paragraph 3 the fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.]

Variant B⁴

1. This Convention applies to international contracts concluded or evidenced by means of data messages.

2. For the purposes of this Convention a contract is considered international if, at the time of the conclusion of the contract, the parties have their places of business in different States.

3. This Convention also applies [when the rules of private international law lead to the application of the law of a Contracting State or]⁵ when the parties have agreed that it applies.

¹The draft instrument has been prepared in the form of a convention in accordance with the working assumption agreed to at the thirty-eighth session of the Working Group (A/CN.9/484, para. 124) and without prejudice to a final decision by the Working Group as to the nature of the instrument.

²Variant A departs from the traditional definition of scope of application of international trade law instruments, such as the United Nations Convention on Contracts for the International Sale of Goods, inasmuch as paragraph 1 does not limit the scope of the Convention to "international" contracts. The preliminary draft convention would apply whenever the forum is in a Contracting State, without the need for investigating further the location of the parties (see above, paras. 25-35).

³Draft paragraphs 3 and 4 appear within square brackets, as possible additions, in the event that States might wish to preserve the duality of systems for domestic and international contracts. Such an approach was also used in article 1 of the UNCITRAL Model Law on Electronic Commerce.

⁴Variant B reflects essentially the scope of application of the United Nations Sales Convention, as set out in its article 1.

⁵The phrase "when the rules of private international law lead to the application of the law of a Contracting State" in paragraph 3 of variant A and in paragraph 3 of variant B reproduces a rule that is contained in the provisions on the sphere of application of other United Nations Commission on International Trade Law (UNCITRAL) instruments. That phrase appears within square brackets since it might cause an expansion of the scope of application of the draft convention beyond what was initially contemplated by the Working Group.

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

5. [Neither] The nationality of the parties [nor the civil or commercial character of the parties or of the contract] is [not] to be taken into consideration in determining the application of this Convention.

Article 2. Exclusions

This Convention does not apply to the following contracts:

(a) Contracts concluded for personal, family or household purposes;⁶

(b) Contracts granting limited use of intellectual property rights;⁷

(c) [Other exclusions, such as real estate transactions, to be added by the Working Group.]⁸

Article 3. Matters not governed by this Convention

This Convention governs only the formation of contracts concluded or evidenced by data messages. In particular, except as otherwise expressly provided in this Convention, it is not concerned with:

(a) The validity of the contract or of any of its provisions or of any usage;⁹

(b) The rights and obligations of the parties arising out of the contract or of any of its provisions or of any usage;¹⁰

(c) The effect which the contract may have on the ownership of rights created or transferred by the contract.¹¹

⁶This provision follows an exclusion contained in article 2, subparagraph (a), of the United Nations Sales Convention and in most instruments prepared by UNCITRAL. It reflects the initial understanding of the Working Group that the future instrument should not focus on consumer transactions (see above, paras. 15-19).

⁷This exclusion reflects the initial understanding of the Working Group that licensing contracts should be distinguished from other commercial transactions (see above, paras. 20-22). The Working Group may wish to consider whether the wording of the draft paragraph adequately reflects the notion of "licensing contract" as understood by the Working Group.

⁸This draft article might contain additional exclusions, as may be decided by the Working Group. With a view to facilitating the consideration of this issue by the Working Group, annex II reproduces, for illustrative purposes and without the intention of being exhaustive, exclusions typically found in domestic laws on electronic commerce.

⁹Draft subparagraphs (a) and (c) are derived from article 3 of the United Nations Sales Convention.

¹⁰This provision has been included so as to make it clear that the preliminary draft convention is not concerned with substantive issues arising out of the contract, which, for all other purposes, remains subject to its governing law (see above, paras. 10-12).

¹¹Draft subparagraph (c) was based, mutatis mutandis, on article 4, subparagraph (b), of the United Nations Sales Convention.

Article 4. Party autonomy

The parties may exclude the application of this Convention or derogate from or vary the effect of any of its provisions.¹²

Chapter II. General provisions**Article 5. Definitions¹³**

For the purposes of this Convention:

(a) “Data message” means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy;

(b) “Electronic data interchange (EDI)” means the electronic transfer from computer to computer of information using an agreed standard to structure the information;

(c) “Originator” of a data message means a person by whom, or on whose behalf, the data message purports to have been sent or generated prior to storage, if any, but it does not include a person acting as an intermediary with respect to that data message;

(d) “Addressee” of a data message means a person who is intended by the originator to receive the data message, but does not include a person acting as an intermediary with respect to that data message;

(e) “Automated computer system” means a computer program or an electronic or other automated means used to initiate an action or respond to data messages or performances in whole or in part, without review or intervention by a natural person at each time an action is initiated or a response is generated by the system;¹⁴

(f) “Information system” means a system for generating, sending, receiving, storing or otherwise processing data messages;

(g) “Offeror” means a natural person or legal entity that offers goods or services;¹⁵

(h) “Offeree” means a natural person or legal entity that receives or retrieves an offer of goods or services;

Variant A:¹⁶

[(i) “Signature” includes any method used for identifying the originator of a message and indicating that the information contained in the message is attributable to the originator;]

Variant B:¹⁷

[(i) “Electronic signature” means data in electronic form in, affixed to, or logically associated with, a data message, which may be used to identify the person holding the signature creation data in relation to the data message and indicate that person’s approval of the information contained in the data message;

Variant A:¹⁸

[(j) “Place of business” means any place of operations where a person carries out a non-transitory activity with human means and goods or services;]

Variant B:¹⁹

[(j) “Place of business” means the place where a party pursues an economic activity through a stable establishment for an indefinite period;]

(k) “Person” and “party” include natural persons and legal entities;²⁰

¹²Draft article 4 reflects the general principle of party autonomy, as recognized in several UNCITRAL instruments. The Working Group may wish to consider, however, whether some limitation to this principle might be appropriate or desirable in the context of the preliminary draft convention, in particular in the light of provisions such as draft articles 12, paragraph 2, and 14.

¹³The definitions contained in draft subparagraphs (a)-(d) and (f) are derived from article 2 of the UNCITRAL Model Law on Electronic Commerce.

¹⁴This definition is based on the definition of “electronic agent” contained in section 2 (6) of the United States Uniform Electronic Transactions Act; a similar definition is also used in section 19 of the Uniform Electronic Commerce Act of Canada. This definition was included in view of the provisions of draft article 12.

¹⁵The proposed definitions of “offeror” and “offeree” (draft subparagraphs (g) and (h), respectively) have been included in view of the fact that those expressions are used in draft articles 8 and 9, in a context in which they might not easily be replaced with the words “originator” or “addressee”.

¹⁶Variant A is proposed in the event that the Working Group would wish to include in the preliminary draft convention only a general provision on the recognition of electronic signatures, along the lines of article 7 of the UNCITRAL Model Law on Electronic Commerce. Following the example of recent uniform legislation enacting the Model Law in Canada (Uniform Electronic Commerce Act) and the United States (Uniform Electronic Transactions Act), the definition of electronic signature in variant A includes the notion of “attribution”, which is also used, although in a different context, in article 13 of the UNCITRAL Model Law (see also draft art. 13, para. 3, variant A).

¹⁷Variant B reproduces the definition of electronic signature contained in article 2, subparagraph (a), of the UNCITRAL Model Law on Electronic Signatures (see A/CN.9/493). The Working Group may wish to use this definition in the event that it feels it necessary to include more specific requirements for the recognition of electronic signatures, along the lines of article 6, paragraph 3, of the UNCITRAL Model Law on Electronic Signatures (see draft art. 13, para. 3, variant B).

¹⁸The proposed definition of “place of business”, in variant A of draft subparagraph (j), reflects the essential elements of the notions of “place of business”, as understood in international commercial practice, and “establishment”, as used in article 2, subparagraph (f), of the UNCITRAL Model Law on Cross-Border Insolvency. The proposed definition appears within square brackets in view of the fact that, although having repeatedly used the concept of “place of business” in its various instruments, the Commission has thus far not defined the concept. Nevertheless, the Working Group may wish to consider the desirability of providing a uniform definition of “place of business” for the purpose of enhancing legal certainty and promoting uniformity in the application of the convention. The proposed definition might also be regarded as a necessary complement to draft article 7, in particular its paragraph 1.

¹⁹Variant B of draft subparagraph (j) contains an alternative definition of place of business, which follows the understanding given to this expression within the European Union (see para. 19 of the preamble to Directive 2000/31/EC of the European Union).

²⁰This definition is offered to make it clear that when using the words “person” or “party” without further qualification, the preliminary draft convention is referring to both natural persons and legal entities. The Working Group may wish to note that, during the preparation of the UNCITRAL Model Law on Electronic Commerce, it was felt that such a definition did not belong in the text of the instrument, but in its guide to enactment.

[(1) *Other definitions that the Working Group may wish to add.*]²¹

Article 6. Interpretation²²

1. 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 trade.

2. 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.

Article 7. Location of the parties

1. For the purposes of this Convention, a party is presumed to have its place of business at the geographic location indicated by it in accordance with article 14 [, unless it is manifest and clear that the party does not have a place of business at such location and that such indication is made solely to trigger or avoid the application of this Convention].²³

2. If a party has more than one place of business, the place of business for the purposes of this Convention is that which has the closest relationship to the relevant contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract.²⁴

3. If a natural person does not have a place of business, reference is to be made to the person's habitual residence.

4. The location of the equipment and technology supporting an information system used by a legal entity for the conclusion of a contract, or the place from which such information system may be accessed by other persons, in and of themselves, do not

constitute a place of business [, unless such legal entity does not have a place of business].²⁵

5. The sole fact that a person makes use of a domain name or electronic mail address connected to a specific country does not create a presumption that its place of business is located in such country.²⁶

Chapter III. Formation of contracts

Article 8. Time of contract formation²⁷

1. A contract is concluded at the moment when the acceptance of an offer becomes effective in accordance with the provisions of this Convention.

2. An offer becomes effective when it is received by the offeree.

3. An acceptance of an offer becomes effective at the moment the indication of assent is received by the offeror.

Article 9. Invitations to make offers

1. A proposal for concluding a contract which is not addressed to one or more specific persons, but is generally accessible to persons making use of information systems, such as the offer of goods and services through an Internet web site, is to be considered merely as an invitation to make offers, unless it indicates the intention of the offeror to be bound in case of acceptance.²⁸

2. In determining the intent of a party to be bound in case of acceptance, due consideration is to be given to all relevant circumstances of the case. Unless otherwise indicated by the

²¹The Working Group may wish to consider the need for or desirability of including definitions for other terms used in the preliminary draft convention, such as "signatory" (if variant B of draft art. 13 is adopted), "Internet", "web site" and "domain name".

²²This draft article mirrors article 7 of the United Nations Sales Convention and similar provisions in other UNCITRAL instruments.

²³Draft article 7 is one of the central provisions in the preliminary draft convention and one which may be essential, if the sphere of application of the preliminary draft convention is defined along the lines of variant A of draft article 1. Draft paragraph 1 builds upon a proposal that was made at the thirty-eighth session of the Working Group, to the effect that the parties in electronic transactions should have the duty to disclose their places of business (A/CN.9/484, para. 103). That duty is reflected in draft article 14, paragraph 1 (b). In line with the spirit of the Working Group's consideration of this matter at its thirty-eighth session (A/CN.9/484, paras. 96-104), draft paragraph 1 is not intended to create a new concept of "place of business". If the Working Group considers that specific provisions should be made to prevent fraud (see para. 39 above), it may wish to add language along the lines suggested in the phrase within square brackets. It should be noted that the phrase within square brackets is intended to prevent fraud, but not to limit the parties' ability to agree on the applicability of the Convention under draft article 1 (para. 3 in variant A and para. 2 in variant B) or otherwise interfere with the parties' right to choose the applicable law.

²⁴Draft paragraphs 2 and 3 reflect traditional rules applied to determine a party's place of business (see, for instance, United Nations Sales Convention, art. 10).

²⁵This draft paragraph proposes a rule specifically concerned with issues raised by the use of electronic means of communication in contract formation. The draft paragraph is intended to reflect an opinion shared by many delegations participating in the thirty-eighth session of the Working Group that, when dealing with the location of the parties, the Working Group should take care to avoid devising rules that would result in any given party being considered as having its place of business in one country when contracting electronically and in another country when contracting by more traditional means (A/CN.9/484, para. 103). The draft paragraph follows the solution proposed in paragraph 19 of the preamble to Directive 2000/31/EC of the European Union. The phrase within square brackets is intended to deal only with so-called "virtual companies" and not with natural persons, who are covered by the rule contained in draft paragraph 3.

²⁶This draft paragraph takes into account the fact that the current system for assignment of domain names was not originally conceived in geographical terms and that, therefore, the apparent connection between a domain name and a country does not, in and of itself, suffice to conclude that there is a genuine and permanent link between the domain name user and the country (see paras. 44-46 above).

²⁷Each paragraph of this draft article reflects the essence of the rules on contract formation contained, respectively, in articles 23, 15, paragraph 1, and 18, paragraph 2, of the United Nations Sales Convention. The verb "reach", which is used in the United Nations Sales Convention, has been replaced with the verb "receive" in the draft article so as to align it with draft article 11, which is based on article 15 of the UNCITRAL Model Law on Electronic Commerce.

²⁸This provision, which is based on article 14, paragraph 1, of the United Nations Sales Convention, is intended to clarify an issue that has raised considerable amount of discussion since the advent of the Internet. The proposed results from an analogy between offers made by electronic means and offers made through more traditional means (see paras. 52-54)

offeror, the offer of goods or services through automated computer systems allowing the contract to be concluded automatically and without human intervention is presumed to indicate the intention of the offeror to be bound in case of acceptance.²⁹

Article 10. Use of data messages in contract formation³⁰

1. Unless otherwise agreed by the parties, an offer and the acceptance of an offer may be expressed by means of data messages [or other actions communicated electronically in a manner that is intended to express the offer or acceptance, including, but not limited to, touching or clicking on a designated icon or place on a computer screen].

2. Where data messages are used in the formation of a contract, that contract shall not be denied validity or enforceability on the sole ground that data messages were used for that purpose.

Article 11. Time and place of dispatch and receipt of data messages³¹

1. Unless otherwise agreed by the parties, the dispatch of a data message occurs when it enters an information system outside the control of the originator or of the person who sent the data message on behalf of the originator.

2. Unless otherwise agreed by the parties, if the addressee has designated an information system for the purpose of receiving data messages, the data message is deemed to be received at the time when it enters the designated information system; if the data message is sent to an information system of the addressee that is not the designated information system, at the time when the data message is retrieved by the addressee. If the addressee has not designated an information system, receipt occurs when the data message enters an information system of the addressee.³²

²⁹Paragraph 2 offers criteria for determining a party's intention to be bound in case of acceptance. The first sentence is based on the general rule on interpretation of a party's consent, which is contained in paragraph 3 of article 8 of the United Nations Sales Convention. The rule proposed in the second sentence of this paragraph is similar to the rule proposed in legal writings for the functioning of automatic vending machines (see para. 54).

³⁰The rules contained in this draft article are based on article 11, paragraph 1, of the UNCITRAL Model Law on Electronic Commerce. The phrase "or other actions communicated electronically" and the reference, for illustrative purposes, to "touching or clicking on a designated icon or place on a computer screen", which are derived from section 20, paragraph 1 (b), of the Uniform Electronic Commerce Act of Canada, are intended to clarify rather than expand the scope of the rule contained in the Model Law. They appear within square brackets, however, in case the Working Group finds that such additional clarification is not needed.

³¹Except for draft paragraph 4, the rules contained in this draft article are based on article 15 of the UNCITRAL Model Law on Electronic Commerce, with some adjustments to harmonize the style of the individual provisions with the style used elsewhere in the draft convention, which follows more closely the style of the United Nations Sales Convention.

³²Draft paragraph 2 does not add further requirements to those set forth in article 15, paragraph 2, of the Model Law, unlike some domestic legislative texts based on the Model Law that generally require that a message should be "in a form capable of being retrieved and processed by [the addressee's] system" (United States Uniform Electronic Transactions Act, sect. 15 (b) (1) (2)) or "capable of being retrieved and processed by the addressee" (Uniform Electronic Commerce Act of Canada, sect. 23 (2)) and not only when both parties use the same system.

3. Paragraph 2 of this article applies notwithstanding that the place where the information system is located may be different from the place where the data message is deemed to be received under paragraph 5 of this article.

4. Unless otherwise agreed by the parties, when the originator and the addressee use the same information system, both the dispatch and the receipt of a data message occur when the data message becomes capable of being retrieved and processed by the addressee.³³

5. Unless otherwise agreed between the originator and the addressee, a data message is deemed to be dispatched at the place where the originator has its place of business, and is deemed to be received at the place where the addressee has its place of business, as determined in accordance with article 7.

Article 12. Automated transactions

1. Unless otherwise agreed by the parties, a contract may be formed by the interaction of an automated computer system and a natural person or by the interaction of automated computer systems, even if no natural person reviewed each of the individual actions carried out by such systems or the resulting agreement.³⁴

2. Unless otherwise [expressly] agreed by the parties, a party offering goods or services through an automated computer system shall make available to the parties that use the system technical means allowing the parties to identify and correct errors prior to the conclusion of a contract. The technical means to be made available pursuant to this paragraph shall be appropriate, effective and accessible.³⁵

[3. A contract concluded by a natural person that accesses an automated computer system of another person has no legal

³³This draft paragraph deals with cases where both the originator and the addressee use the same communication system. In such a case, the criterion used in draft paragraph 1 cannot be used, since the message remains in a system that cannot be said to be "outside the control of the originator". The rule proposed in the draft paragraph provides for simultaneous dispatch and receipt of a data message "when it becomes capable of being retrieved and processed by the addressee". This situation was not contemplated by article 15, paragraph 1, of the Model Law. It is submitted, however, that the proposed rule, which is based on section 23 (2) (a) of the Uniform Electronic Commerce Act of Canada, does not conflict with the rules contained in article 15 of the Model Law.

³⁴This draft provision develops further a principle formulated in general terms in article 13, paragraph 2 (b), of the UNCITRAL Model Law on Electronic Commerce. The draft paragraph does not innovate on the current understanding of legal effects of automated transactions, as expressed by the Working Group (A/CN.9/484, para. 106) that a contract resulting from the interaction of a computer with another computer or person is attributable to the person in whose name the contract is entered into.

³⁵This draft paragraph deals with the issue of errors in automated transactions (see paras. 74-79 above). The rule contained in the draft paragraph, which is based on article 11, paragraph 2, of Directive 2000/31/EC of the European Union, creates an obligation, for persons offering goods or services through automated computer systems, to offer means for correcting input errors. The Working Group may wish to consider whether the possibility of derogation by agreement needs to be expressly made or can result from tacit agreement, for instance, when a party proceeds to place an order through the seller's automated computer system even though it is apparent to such a party that the system does not provide an opportunity to correct input errors.

effect and is not enforceable if the natural person made a material error in a data message and³⁶

(a) The automated computer system did not provide the natural person with an opportunity to prevent or correct the error;

(b) The natural person notifies the other person of the error as soon as practicable when the natural person learns of it and indicates that he or she made an error in the data message;

(c) The natural person takes reasonable steps, including steps that conform to the other person's instructions to return the goods or services received, if any, as a result of the error or, if instructed to do so, to destroy such goods or services; and

(d) The natural person has not used or received any material benefit or value from the goods or services, if any, received from the other person.]

Article 13. Form requirements³⁷

1. Nothing in this Convention requires a contract to be concluded in or evidenced by writing or subjects a contract to any other requirement as to form.³⁸

2. Where the law requires that a contract to which this Convention applies should be in writing, that requirement is met by a data message if the information contained therein is accessible so as to be usable for subsequent reference.³⁹

Variant A⁴⁰

3. Where the law requires that a contract to which this Convention applies should be signed, that requirement is met in relation to a data message if:

(a) A method is used to identify that person and to indicate that person's approval of the information contained in the data message; and

(b) That method is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

³⁶Draft paragraph 3 deals with the legal effects of errors made by a natural person communicating with an automated computer system. The draft provision, which is based on section 22 of the Uniform Electronic Commerce Act of Canada, appears in square brackets because in the consultations held by the Secretariat it has been suggested that a provision of this type might not be appropriate in the context of commercial (i.e. non-consumer) transactions, since the right to repudiate a contract in case of material error may not always be provided under general contract law.

³⁷This draft article combines essential provisions on form requirements of the United Nations Sales Convention (art. 11) with provisions of articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce.

³⁸This provision restates the general principle of freedom of form contained in article 11 of the United Nations Sales Convention.

³⁹This provision sets forth the criteria for the functional equivalence between data messages and paper documents, in the same manner as article 6 of the UNCITRAL Model Law on Electronic Commerce.

⁴⁰Variant A sets forth the general criteria for the functional equivalence between handwritten signatures and electronic identification methods referred to in article 7 of the UNCITRAL Model Law on Electronic Commerce.

Variant B⁴¹

3. Where the law requires that a contract to which this Convention applies should be signed, or provides consequences for the absence of a signature, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

4. An electronic signature is considered to be reliable for the purposes of satisfying the requirements referred to in paragraph 3 if:

(a) The signature creation data are, within the context in which they are used, linked to the signatory and to no other person;

(b) The signature creation data were, at the time of signing, under the control of the signatory and of no other person;

(c) Any alteration to the electronic signature, made after the time of signing, is detectable; and

(d) Where the purpose of the legal requirement for a signature is to provide assurances as to the integrity of the information to which it relates, any alteration made to that information after the time of signing is detectable.

5. Paragraph 4 does not limit the ability of any person:

(a) To establish in any other way, for the purposes of satisfying the requirement referred to in paragraph 3, the reliability of an electronic signature;

(b) To adduce evidence of the non-reliability of an electronic signature.

Article 14. General information to be provided by the parties⁴²

1. A party offering goods or services through an information system that is generally accessible to the public shall render the following information available to parties accessing such information system:

(a) Its name and, where the party is registered in a trade or similar public register, the trade register in which the party is entered and its registration number, or equivalent means of identification in that register;

(b) The geographic location and address at which the party has its place of business;

(c) Details, including its electronic mail address, which allow the party to be contacted rapidly and communicated with in a direct and effective manner.

2. A party offering goods or services through an information system that is generally accessible to the public shall ensure that the information required to be provided under paragraph 1 is easily, directly and permanently accessible to parties accessing the information system.

⁴¹Variant B is based on article 6, paragraph 3, of the draft UNCITRAL Model Law on Electronic Signatures.

⁴²This draft article is intended to enhance certainty and clarity in international transactions by ensuring that a party offering goods or services through open networks, such as the Internet, should offer at least information on its identity, legal status, location and address. It reflects the proposal, which was received positively at the Working Group's thirty-eighth session, that persons and companies making use of such open networks should at least disclose their places of business (A/CN.9/484, para. 103). The draft provision is based on article 5, paragraph 1, of Directive 2000/31/EC of the European Union.

Article 15. Availability of contract terms⁴³

A party offering goods or services through an information system that is generally accessible to the public shall make the

⁴³This draft article deals with a particular problem of electronic contracting: the availability of a record of the contract. The draft article, which is based on article 10, paragraph 3, of Directive 2000/31/EC of the European Union, requires a party offering goods or services through open information systems to ensure that its contracting partners would be able, for a reasonable amount of time, to print or store the data messages containing the contract terms.

data message or messages which contain the contract terms and general conditions available to the other party for a reasonable period of time in a way that allows for their storage and reproduction. A data message is deemed not to be capable of being stored or reproduced if the originator inhibits the printing or storage of the data message or messages by the other party.

[Other provisions that the Working Group may wish to include.]

ANNEX II

**COMMON EXCLUSIONS FROM THE SPHERE OF APPLICATION OF DOMESTIC
OR REGIONAL LAWS THAT RECOGNIZE THE LEGAL EFFECT
OF ELECTRONIC MESSAGES AND SIGNATURES**

Bermuda

Electronic Transactions Act, 1999

“Exclusions

“6 (1) Part II (legal requirements respecting electronic records) and Part III (communication of electronic records) do not apply to any rule of law requiring writing or signatures for the following matters—

“(a) the creation, execution or revocation of a will or testamentary instrument;

“(b) the conveyance of real property or the transfer of any interest in real property.

“(2) The Minister may by regulations provide that this Act, or such provisions thereof as may be specified in the regulations, does not apply to any class of transactions, persons, matters or things specified in the regulations.”

Canada

Uniform Electronic Commerce Act

“(2) The [appropriate authority] may, by [statutory instrument], specify provisions of or requirements under [enacting jurisdiction] law in respect of which this Act does not apply.

“(3) This Act does not apply in respect of

“(a) wills and their codicils;

“(b) trusts created by wills or by codicils to wills;

“(c) powers of attorney, to the extent that they are in respect of the financial affairs or personal care of an individual;

“(d) documents that create or transfer interests in land and that require registration to be effective against third parties.

“(4) Except for Part 3, this Act does not apply in respect of negotiable instruments, including negotiable documents of title.

“(5) Nothing in this Act limits the operation of any provision of [enacting jurisdiction] law that expressly authorizes, prohibits or regulates the use of electronic documents.”

Hong Kong Special Administrative Region of China

Ordinance No. 1 of 2000 (Electronic Commerce Ordinance)

“Schedule 1

“Matters excluded from application of sections 5, 6, 7, 8 and 17 of this ordinance under section 3 of this ordinance

“1. The creation, execution, variation, revocation, revival or rectification of a will, codicil or any other testamentary document.

“2. The creation, execution, variation or revocation of a trust (other than resulting, implied or constructive trusts).

“3. The creation, execution, variation or revocation of a power of attorney.

“4. The making, execution or making and execution of any instrument which is required to be stamped or endorsed under the Stamp Duty Ordinance (Cap. 117) other than a contract note to which an agreement under section 5A of that Ordinance relates.

“5. Government conditions of grant and Government leases.

“6. Any deed, conveyance or other document or instrument in writing, judgments, and *lis pendens* referred to in the Land Registration Ordinance (Cap. 128) by which any parcels of ground tenements or premises in Hong Kong may be affected.

“7. Any assignment, mortgage or legal charge within the meaning of the Conveyancing and Property Ordinance (Cap. 219) or any other contract relating to or effecting the disposition of immovable property or an interest in immovable property.

“8. A document effecting a floating charge referred to in section 2A of the Land Registration Ordinance (Cap. 128).

“9. Oaths and affidavits.

“10. Statutory declarations.

“11. Judgments (in addition to those referred to in section 6) or orders of court.

“12. A warrant issued by a court or a magistrate.

“13. Negotiable instruments.”

Ireland

Electronic Commerce Act, 2000

“10.—(1) Sections 12 to 23 are without prejudice to—

“(a) the law governing the creation, execution, amendment, variation or revocation of—

- (i) a will, codicil or any other testamentary instrument to which the Succession Act, 1965, applies,
- (ii) a trust, or
- (iii) an enduring power of attorney,

“(b) the law governing the manner in which an interest in real property (including a leasehold interest in such property) may be created, acquired, disposed of or registered, other than contracts (whether or not under seal) for the creation, acquisition or disposal of such interests,

“(c) the law governing the making of an affidavit or a statutory or sworn declaration, or requiring or permitting the use of one for any purpose, or

“(d) the rules, practices or procedures of a court or tribunal, except to the extent that regulations under section 3 may from time to time prescribe.

“ . . .

“11.—Nothing in this Act shall prejudice the operation of—

“(a) any law relating to the imposition, collection or recovery of taxation or other Government imposts, including fees, fines and penalties,

“(b) the Companies Act, 1990 (Uncertificated Securities) Regulations, 1996 (S.I. No. 68 of 1996) or any regulations made in substitution for those regulations,

“(c) the Criminal Evidence Act, 1992, or

“(d) the Consumer Credit Act, 1995, or any regulations made thereunder and the European Communities (Unfair Terms in Consumer Contracts) Regulations, 1995 (No. 27 of 1995).”

Slovenia

Electronic Commerce and Electronic Signature Act

“Article 13

“(1) Where the law or any other regulation requires information to be in writing, that requirement is met by an electronic message, if the information contained therein is accessible so as to be usable for subsequent reference.

“(2) The provisions of the previous paragraph do not apply to:

“1. contracts regulating property and other rights and other rights on immovable things;

“2. contracts regulating testaments;

“3. contracts regulating property relationships between spouses;

“4. contracts of disposal of property belonging to persons who have been dispossessed of legal capacity;

“5. contracts of tradition and division of property inter vivos;

“6. contracts of life-subsistence and agreements of waiver of heirship prior to inheritance;

“7. contracts of donations and contracts of donations mortis causa;

“8. contracts of sale with the retention of ownership;

“9. other legal acts, which shall be, according to legal provisions, made in a form of a notarial note.”

United States of America

Uniform Electronic Transactions Act

“Section 3. Scope^a

“(a) Except as otherwise provided in subsection (b), this [Act] applies to electronic records and electronic signatures relating to a transaction.

“(b) This [Act] does not apply to a transaction to the extent it is governed by:

“(1) a law governing the creation and execution of wills, codicils, or testamentary trusts;

“(2) [The Uniform Commercial Code other than Sections 1-107 and 1-206, Article 2, and Article 2A];^b

^aThe official commentary to the Uniform Electronic Transactions Act states that the Act “is inherently limited by the fact that it only applies to transactions related to business, commercial (including consumer) and governmental matters”. Thus, “transactions with no relation to business, commercial or governmental transactions would not be subject to [the] Act.” Unilaterally generated electronic records and signatures that are not part of a transaction are also not covered by the Act.

^bParagraph (2) excludes all of the Uniform Commercial Code other than its sections 1-107 (waiver or renunciation of claim or right after breach) and 1-206 (writing requirement for contracts for sale of personal property) and articles 2 and 2A (sales and leases). The excluded provisions of the Uniform Commercial Code deal with negotiable instruments (art. 3), bank deposits (art. 4) and funds transfers (art. 4A); letters of credit (art. 5), bulk transfers and bulk sales (art. 6); warehouse receipts, bills of lading and other documents of title (art. 7); investment securities (art. 8); secured transactions, sales of accounts and chattel paper (art. 9). The official commentary to the Uniform Electronic Transactions Act indicates that “the check collection and electronic fund transfer systems governed by articles 3, 4 and 4A involve systems and relationships involving numerous parties beyond the parties to the underlying contract” and that “the impact of validating electronic media in such systems involves considerations beyond the scope of this Act”. Articles 5, 8 and 9 of the Uniform Commercial Code, in turn, were not excluded because the subject matter was not appropriate for being governed by the Uniform Electronic Transactions Act, but “because the revision process relating to those Articles included significant consideration of electronic practices”.

“(3) [the Uniform Computer Information Transactions Act];^c
and

“(4) [other laws, if any, identified by State].”^d

^cThe Uniform Computer Information Transactions Act deals specifically with transactions involving computer information.

^dThe official commentary indicates that additional exclusions under subparagraph (b) (4) should be limited to laws that govern electronic records and signatures which may be used in transactions as defined in section 2 (16) (i.e. “an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs”). The official commentary discusses at length the need for and the appropriateness of generally excluding the following matters from the scope of the Act: trusts (other than testamentary trusts); powers of attorney; real estate transactions between the parties (as opposed to their effect on third parties); and matters governed by consumer protection statutes. The commentary indicates that the Drafting Committee of the Electronic Transactions Act determined that exclusion of these additional areas was not warranted, in part in view of the enabling nature of the Act and the fact that section 8 (b) (3) specifically preserves the applicability of requirements provisions such as “laws requiring information to be presented in particular fonts, formats or in similar fashion, as well as laws requiring conspicuous displays of information”.

European Union

Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the internal market

“Article 9

“Treatment of contracts

“1. Member States shall ensure that their legal system allows contracts to be concluded by electronic means. Member States shall in particular ensure that the legal requirements applicable to the contractual process neither create obstacles for the use of electronic contracts nor result in such contracts being deprived of legal effectiveness and validity on account of their having been made by electronic means.

“2. Member States may lay down that paragraph 1 shall not apply to all or certain contracts falling into one of the following categories:

“(a) contracts that create or transfer rights in real estate, except for rental rights;

“(b) contracts requiring by law the involvement of courts, public authorities or professions exercising public authority;

“(c) contracts of suretyship granted and on collateral securities furnished by persons acting for purposes outside their trade, business or profession;

“(d) contracts governed by family law or by the law of succession.”

D. Note by the Secretariat on legal aspects of electronic commerce; electronic contracting: provisions for a draft convention—comments by the International Chamber of Commerce, working paper submitted to the Working Group on Electronic Commerce at its thirty-ninth session

(A/CN.9/WG.IV/WP.96) [Original: English]

Following the issuance of document A/CN.9/WG.IV/WP.95, the Secretariat received comments on that document by an ad hoc expert group established by the International Chamber of Commerce. The text of those comments is reproduced in the annex to the present note.

ANNEX

REPORT OF THE AD HOC EXPERT GROUP OF THE INTERNATIONAL CHAMBER OF COMMERCE ON THE DRAFT UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW CONVENTION ON ELECTRONIC CONTRACTING*

Executive Summary

The ad hoc expert group of the International Chamber of Commerce (ICC) welcomes the note by the Secretariat (A/CN.9/WG.IV/WP.95) and the desire of the Working Group on

Electronic Commerce to create increased legal certainty for online contracting. ICC has received a number of responses to a questionnaire it sent out to companies, giving them the opportunity to express their opinions in the field of electronic commerce and electronic contracting; the questionnaire is reproduced in the annex to the present report, together with the responses received to it at the time this report was finalized. The views of the ICC ad hoc expert group expressed in this report have been influenced by the responses received, which generally favour harmonization as a means for reducing legal uncertainty in online contracting. The expert group will continue to update the annex as further responses are received and will be happy to make the results available to the UNCITRAL secretariat and the Working Group.

*Members of the expert group have included Mark Bohannon, Charles Debattista, David Fares, Christina Hultmark Ramberg, Christopher Kuner, Anna Nordén, Heather Shaw and Aleksandar Stojanoski. The views expressed herein are the personal opinions of the members of the expert group, and not necessarily those of the organizations they represent.

The expert group believes it is important that the principles of freedom of contract and party autonomy should be very strongly anchored in the convention, in order to avoid misunderstandings and to ensure that business has confidence in it. The expert group also suggests that the Working Group carefully consider whether the convention should apply only to electronic contracts, or to commercial contracts in general, and to keep in mind that there may be a number of problems in regulating electronic contracts separately from all commercial contracts. The expert group also believes that it would be important to clarify the interaction between any convention on electronic contracting and the United Nations Convention on Contracts for the International Sale of Goods (hereinafter "the United Nations Sales Convention").

The expert group agrees that it is appropriate for the convention to address also contracts outside the sphere of the sale of goods. However, the question of whether the convention should also cover transactions in intellectual property (such as licensing transactions) should be studied further. The expert group found no consensus on whether transactions in intellectual property should be included in the potential work. As a matter of pragmatism, the expert group recommends that the UNCITRAL negotiations on a convention exclude consumer contracts, by use of the same definition as in the United Nations Sales Convention.

With regard to whether the convention should cover domestic or international transactions, the expert group finds that the concept described in the note by the Secretariat, whereby the enacting States may choose not to make the convention applicable to domestic transactions, but where the default position of the convention is that it is applicable also to domestic transactions, is worthy of further consideration. The expert group favours the adoption of legal rules that would make it easier to ascertain the location of the parties, as long as certain dangers inherent in such rules are avoided.

In terms of substantive legal issues concerning the formation of contracts, the expert group finds it particularly important to achieve harmonization in the areas of conclusion of contracts, incorporation of terms, mistake and input errors.

I. INTRODUCTION

1. The ICC ad hoc expert group welcomes the note by the Secretariat entitled "Electronic contracting: provisions for a draft convention" (A/CN.9/WG.IV/WP.95) hereafter referred to as "the Secretariat's note", available on the Internet at www.uncitral.org and the Working Group's desire to create increased legal certainty for online contracting. At the UNCITRAL Commission meeting in July 2001, ICC was asked to produce a report presenting the views of business on the need for a convention on electronic contracting. In order to gain a thorough understanding of those views, ICC sent out a questionnaire giving companies the opportunity to express their opinions in the field of electronic commerce in general and electronic contracting in particular. The questionnaire was sent out to a wide variety of companies in various business and geographical sectors around the world; the questionnaire is reproduced in the appendix at the end of this report, together with the responses received to it at the time this report was finalized, which generally favour harmonization as a means for reducing legal uncertainty in online contracting. The views of the expert group expressed in this report have been influenced by the responses received. The expert group will continue to update the appendix as further responses are received and will be happy to make the results available to the UNCITRAL secretariat and Working Group.

2. This report is drafted based on the assumption that there is a need for a convention (or other international instrument) dealing

with the issues of contracting. It will not further discuss the need for a convention, but will focus on the scope of such a convention as well as on the substantive issues a convention should deal with.

3. The objective of this report is not to be a response to the Secretariat's note, but rather to highlight the main issues. At the same time, since most issues of relevance to business have been identified as important areas also by the Secretariat, the expert group will use the Secretariat's note as a reference so as to avoid reiterating the legal background.

4. This report poses several questions to the Working Group. It is our belief that the Working Group should discuss and consider these questions prior to embarking on its work, so as to define appropriately the scope of the project. The expert group will, at the same time, continue its outreach to the broader business community to develop further its views on these questions. ICC is keenly aware of the commercial significance of the UNCITRAL project, and therefore hopes to continue actively to participate in this work and to provide more detailed comments on the project as it develops into a draft. In so doing, ICC will be able to draw on its wide international base of practical business experience.

II. SPHERE OF APPLICATION

A. Party autonomy and freedom of contract

5. As a preliminary comment, the expert group would like to stress that, in its view, it is important for the principles of freedom of contract and party autonomy to be very strongly anchored in the convention, whatever form it may take. This should be non-controversial, since the United Nations Sales Convention already recognizes these principles and there is no suggestion in the Secretariat's note that the situation should be different in the new convention. However, for avoidance of misunderstanding and to ensure that business has confidence in the convention, the expert group favours a strong affirmation in it that its rules are default rules that parties may derogate from. The expert group also believes that it would be important to clarify the interaction between any convention on electronic contracting and the United Nations Sales Convention.

B. Special regulation for e-contracts

(See the Secretariat's note, paras. 10-12)

6. The aim of UNCITRAL's work on an international instrument dealing with certain issues of electronic contracting is to eliminate legal barriers to international transactions that exist owing to the international disharmony of law. The first question to ask is whether these barriers are particular for electronic contracting, or whether they exist for all international commercial contracting.

7. Many of the responses to the questionnaire have expressed the view that contracts concluded by electronic communication should preferably not be regulated differently from contracts concluded by other means of communication. This is a point of fundamental importance and the expert group suggests that the Working Group carefully consider whether the convention should apply only to electronic contracts or to commercial contracts in general. In particular, the expert group would like to point out that there are a number of problems in regulating electronic contracts separately from all commercial contracts as follows:

(a) The expert group would like to question the definition as suggested in paragraphs 10 and 11 of the Secretariat's note and

in article 1 of the preliminary draft convention attached as annex I to the Secretariat's note, which refers to "contracts concluded or evidenced by means of data messages". In fact, many contracts are concluded by a mixture of oral conversations, telefaxes, paper contracts, e-mails and web communication. Thus, the term "contracts concluded or evidenced by means of data messages" proposed in the Secretariat's note could create practical problems in determining to what extent the convention is applicable;

(b) The practical problems encountered in relation to electronic contracts are in many cases not specific to the electronic environment, but arise in all international dealings, whether electronic or not. While it is true that some adaptation of traditional contracting rules may be needed to accommodate issues that arise with particular frequency in electronic commerce (such as the definition of "sent and received"), this does not mean that some of these issues may not be just as troublesome in the context of "traditional" contracting. Thus, there is reason to consider having the convention address the applicable legal issues in a media-neutral way.

C. Should the convention be applicable to goods only?

(See the Secretariat's note, paras. 13, 14 and 20-22)

8. The expert group agrees with paragraphs 13 and 14 of the Secretariat's note that it is appropriate for the convention to address also contracts outside the sphere of the sale of goods. It is particularly important that the convention also cover transactions in services.

9. Paragraphs 20-22 of the Secretariat's note suggest that the convention should also include transactions in intellectual property, such as licensing transactions. The expert group would like to point out that transactions in intellectual property may give rise to different issues than those that arise in relation to the sale of goods and services. The expert group could not reach consensus on this question, reflecting these substantive and procedural concerns, and believes that it should be studied more carefully by the Working Group.

D. Should the convention be applicable to consumers?

(See the Secretariat's note, paras. 15-19)

10. As reflected in the responses to the questionnaire, the expert group sees a need for guidance with respect to consumer contracts concluded by electronic means. However, as a matter of pragmatism, the expert group recommends that the UNCITRAL negotiations on a convention exclude consumer contracts, for various reasons. First of all, many States see consumer rights as a matter of *ordre public*, so that it could be very difficult to reach agreement on any substantive rules. Having the convention applicable to consumer transactions would also be likely to make the deliberations so controversial that there is a substantial risk that no consensus would be reached. Another concern is that it would not be feasible to allow sufficient room for the principle of freedom of contract if consumer transactions were to be included.

11. As to the means of excluding consumer transactions, the expert group would like to recommend that the convention use the same definition as in the United Nations Sales Convention, as suggested in the Secretariat's note (para. 16). By so doing, it would be possible to benefit from the experience and case law related to the United Nations Sales Convention. It is possible to arrive at a wide variety of definitions of a "consumer transaction". The optimal solution would be if all instruments (national or international) use the same definition, but this will not be the case

within the foreseeable future. The expert group therefore recommends that UNCITRAL use the same definition in all UNCITRAL conventions.

12. The United Nations Sales Convention, article 2 (a), ("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") may create problems in the electronic setting, since the other party's capacity of being a consumer or businessman may be hidden (see the Secretariat's note, paras. 18 and 19). This problem should be discussed further. The expert group recommends that the wordings in the United Nations Sales Convention, article 2 (a), referring to the seller's knowledge be included in the new convention.

E. Should the convention be applicable to international contracts only?

(See the Secretariat's note, paras. 25-36)

13. It is preferable that the same rules apply irrespective of whether a transaction is domestic or international. By having the same rules for domestic and international transactions, a business may use the same interface for all its operations and customers thus become used to this interface in all their dealings. However, the expert group acknowledges that such a wide scope of application will create difficulties in reaching consensus in the Working Group. Many States are likely to be less willing to accept and ratify a convention that interferes with their law for domestic transactions. The expert group thus finds that the concept described in the Secretariat's note (para. 36 and draft article 1, variant A), whereby the enacting States may choose not to make the convention applicable to domestic transactions but where the default position of the convention is that it is applicable also to domestic transactions, is a potentially useful approach, but that further consideration of this issue is needed before a decision is taken.

14. The definition of international transactions should be the same as in the United Nations Sales Convention, which will make it possible to benefit from case law that has developed for the United Nations Sales Convention. Moreover, it would generally be good if the conventions were to have the same scope of application in this respect.

F. Location of the parties

(See the Secretariat's note, paras. 37-46)

15. The expert group shares the view expressed in the Secretariat's note that considerable legal uncertainty is presently caused by the difficulty of determining where a party to an online transaction is located; while this danger has always existed, the global reach of electronic commerce has made it more difficult than ever to determine location. This uncertainty can have important legal consequences, since the location of the parties is important for issues such as jurisdiction, applicable law and enforcement. The responses to the questionnaire support this view as well.

16. The Secretariat's note makes a number of suggestions on how to deal with this uncertainty, including (a) requiring the parties to a contract concluded electronically to indicate clearly where their relevant places of business are located; (b) establishing a presumption that a party's place of business is the one indicated as such by it; and (c) determining circumstances from which the location of the relevant place of business can be inferred. The expert group finds much to support in these

suggestions since they could lead to increased legal certainty, but would like to point out a few potential problems:

(a) The consequences of a party failing to comply with one of these provisions would have to be considered and well defined. For instance, the expert group believes it is important to avoid the situation foreseen in the European Union e-commerce directive (which is referred to in the Secretariat's note as the inspiration for some of these provisions) whereby the parties are obliged to fulfil certain informational obligations, but it is not clear what the consequences are if they fail to do so (i.e. whether they can be sanctioned, whether the contract is void or voidable, etc.), since this situation itself creates considerable legal uncertainty;

(b) As the Secretariat's note points out, it could be advisable to adopt provisions to avoid situations where a party's indication of a place of business would serve no purpose other than to circumvent the new instrument or trigger its application in cases that would fall outside its scope. However, the expert group would like to point out the difficulty of drafting such provisions and the danger of including provisions that are overly complex and limit the parties from legitimately indicating their places of business;

(c) The expert group would also like to warn of the danger of overly simplistic rules based on indications that may seem to be conclusive, but in fact may have little or no connection with a party's true place of business (e.g. when a party uses a country-level domain name); the expert group is encouraged by the fact that the Secretariat's note seems to recognize this danger.

III. SUBSTANTIVE ISSUES ON FORMATION OF CONTRACTS

17. The majority of responses received to the questionnaire recognize that disharmony in law regarding formation of contracts is an obstacle to electronic commerce.

A. Conclusion of contracts

(See the Secretariat's note, paras. 49-54 and 63-66)

18. As described in paragraphs 64-67 of the Secretariat's note, the concept of offer and acceptance, although very well established in many jurisdictions, causes problems from both practical and theoretical points of view. The expert group would like to recommend that the wording of the International Institute for the Unification of Private Law (Unidroit) Principles of International Commercial Contracts, article 2.1 ("A contract may be concluded either by the acceptance of an offer or by the conduct of the parties that is sufficient to show agreement") be considered in relation to formation of contract, in order to ascertain and inform the parties that a contract may be concluded also by other means than the offer and acceptance model.

19. The expert group believes that it is important to specify to what extent electronic offers are binding offers or only invitations to treat. In the questionnaire, business has expressed concerns about the present uncertainty in this respect.

B. Dispatched and received

(See the Secretariat's note, paras. 59-62)

20. The expert group would find it useful to include in the convention rules on when a message is "received" and "dispatched".

C. Automated transactions

(See the Secretariat's note, paras. 71-73)

21. The expert group would like to question the practical need for regulating automated transactions specifically. The issues regulated in draft article 12 are already, or should be, answered in other draft articles. The rule on formation follows from draft article 8 (at least if the wording is amended as proposed above). Errors should be dealt with separately and for all types of electronic mistake, whether in an automated situation or not (see below).

22. Further, the expert group is afraid that it will be problematic to distinguish automated transactions from semi-automated transactions and non-automated transactions, which is another reason for not regulating automated transactions specifically.

D. Form requirements

(See the Secretariat's note, paras. 85-89)

23. The expert group agrees that the convention need not address the issue of form requirements (paras. 85-87 of the Secretariat's note). The expert group sees no need to include articles on signature and writing requirements in the convention, since the convention—like the United Nations Sales Convention—ought to be based on the general rule that no form requirement is needed (paras. 88-89 of the Secretariat's note) and—like the United Nations Sales Convention—allow for reservations from the convention with respect to form requirements.

E. Incorporation of terms

(See the Secretariat's note, paras. 67-69)

24. The results from the questionnaire demonstrate that incorporation of terms is an area where business currently sees problems caused by disharmony of national laws. However, incorporation of terms by reference is an oft-debated problem not only in the electronic environment. The decisive question is how much attention needs to be brought to the incorporation for it to be legally valid. This problem remains the same in the electronic environment.

25. The expert group suggests that UNCITRAL should try to solve the general problem of incorporation of standard terms with a particular focus on standard terms in the electronic setting. This could be addressed in the convention in a general manner. Guidance can be found in the Unidroit Principles, articles 2.20, 2.21 and 2.22.

26. The expert group acknowledges the difficulties in solving the battle of forms problems. However, an attempt at solving the problem is included in the United Nations Sales Convention, article 19, which could be repeated and possibly also improved upon in a new convention.

F. Input errors and mistake

(See the Secretariat's note, paras. 74-79)

27. The results from the questionnaire show that business is also unsettled by inconsistencies in national law on errors and mistakes. The expert group would prefer that input errors and mistakes be dealt with in a separate article in the convention.

28. The convention must clearly indicate that the parties may by their agreement vary the convention's default rule on mistake, i.e. the convention's rule on mistake should not be mandatory. Although it is clear that the convention itself should generally not

be mandatory, the expert group finds it useful to point this out specifically with respect to electronic mistakes, since some national legislation in this area is mandatory.

APPENDIX

QUESTIONNAIRE AND RESPONSES

QUESTIONNAIRE

ICC distributed the following "Questionnaire regarding electronic contracting practices"* to companies worldwide in September 2001.

Background

Disharmony between different legal systems creates huge costs for anyone wanting to pursue trade outside their own jurisdiction. In order to avoid the problem of determining the applicable law to electronic contracts the United Nations Commission for International Trade Law (UNCITRAL) is considering the development of legal rules for electronic contracting. While businesses would remain free to agree on their own contracting practices, the UNCITRAL project could result in the development of basic default rules for electronic contracting which could be of fundamental importance for cross-border electronic commerce.

ICC wants to ensure that this important project reflects business realities and is preparing a report to be submitted to UNCITRAL in November giving an overview of existing electronic contracting practices and analysing which legal issues would be appropriate for UNCITRAL to deal with. To this end, ICC is approaching companies to learn more about their electronic contracting practices and to solicit the views of business as to what the proper scope of the UNCITRAL work should be. ICC would very much appreciate it if you would take a few minutes to consider the following questions:

Your own practice and experience

Does your company have any experience with electronic contracting?

(a) *If yes:*

(i) Have you been required by suppliers/customers/partners to use electronic means for contracting?

(ii) Have you encountered any problems (legal or practical)?

(b) *If no*, what are the reasons for this (no opportunity/need, infrastructure or security problems, legal uncertainty, etc.)?

Particular examples

The scope of the UNCITRAL project is as yet unclear, but ICC has identified a few issues that create obstacles for electronic contracting and that may be candidates for consideration by UNCITRAL. Keeping in mind that these are only examples, ICC would be interested in your views on the following issues.

A. Contract formation

At present the rules on formation of contract are different in different countries. The rules on what types of message are legally binding differ. For instance, a message on a web site could be an automatically binding "offer" according to one national law, but not according to another. This disharmony creates a significant problem in the international setting, owing to the difficulty of determining applicable law and the lack of international uniformity concerning the binding nature of messages.

1. Do you think it is a problem that the extent to which you are bound by electronic messages differs in different countries?

2. Would it be helpful if the rules on formation of electronic contracts were to be harmonized?

*Note that the order of numbering in the Questionnaire is not sequential.

B. Incorporation of terms in the contract

Another area of disharmony is to what extent terms are binding when a contract is entered into online. Take, for instance, the rules as to whether a reference through a hyperlink to another web site containing legal terms make those terms part of the contract. Some jurisdictions require an active approval (a clicking on the link or in an “OK” box for example), whereas other jurisdictions do not impose such requirements.

3. Do you think it is a problem that the law in relation to incorporation of terms differs in different countries?
4. Would it be helpful if the rules on incorporation of terms in electronic contracts were to be harmonized?

C. Mistake/error

Owing to the speed and automation that characterize the use of electronic communications, mistakes are easily made (e.g. instead of ordering shares worth \$1,000, you may find yourself bound to order 1,000 shares), whether by the result of human error or owing to automated choices made by computers. There is currently uncertainty as to how responsibility for mistakes should be divided, since the traditional rule (which puts most of the burden on the mistaken party) may not be suitable for the electronic environment. Different jurisdictions currently adopt different positions with respect to mistakes in electronic communication.

5. Do you think it is a problem that the law in relation to mistake differs in different countries?
6. Would it be helpful if the rules on mistake in electronic communication were to be harmonized?

D. Evidence

Even in the off-line paper world, counterparties frequently find it difficult to identify the terms of their contracts precisely: correspondence may go to and fro, it may or may not mature into an integral “contractual document”, or alternatively there may be more than one “document” which looks “contractual” because each of the counterparties use their own standard terms. The opportunities for such uncertainty are multiplied in the online world, where legal certainty depends not only on the applicable law of contract but also on the law of evidence and on the admissibility of electronic messages as proof of contractual intent.

8. Have you come across any problems owing to international disharmony within the area of law of evidence regarding proving:
 - (a) That a contract is concluded, or
 - (b) The terms upon which you have contracted?
9. Would it be helpful if the rules on evidence in relation to electronic transactions were to be harmonized?

Future regulation

10. Do you believe that the issues listed under A-D above are problems in practice?
11. Are there other issues that UNCITRAL should be addressing?
12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)?
13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)?
14. What are the most urgent issues that you would like Governments and international organizations to address in electronic commerce in general and electronic contracting in particular?

RESPONSES

We have received responses so far from 12 companies representing a wide variety of business sectors and geographical regions. The following is a summary of them, including quotations (*italicized*) from the responses:

No.	Country	Summary of Questions/Responses
1.	Czech Republic, industrial company	<p>1. Does your company have any experience with electronic contracting? <i>"Yes."</i></p> <p>2-9. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p>12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"It will be useful. The rules should be valid in all countries."</i></p> <p>13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"Only one regulatory framework should be valid."</i></p>
2.	Denmark, industrial company	<p>1. Does your company have any experience with electronic contracting? <i>"We have since the middle of the 1980s been promoting the use of electronic contracting towards our (external) customers, as well as internally between business units . . . Regarding the legal aspects, the greatest uncertainty has been the issues concerning the question of invoicing across borders."</i></p> <p>2-9. Regarding the examples of legal obstacles identified in the questionnaire, the company says as follows: <i>"The international disharmony in the areas of contract formation, incorporation of terms in the contract, mistake/error and evidence, have not yet been issues that have caused problems in relations towards our customers. However, it is an area which deserves more attention, due to the evolution and expected increased use of electronic data interchange (EDI) or electronic contracting, in the near future. The present situation with discrepancy between the different laws in different countries is a latent risk, which undermines commercial relations across borders and continents, causing companies to use an excessive amount of time and money in their attempt to foresee their legal position. Harmonization or creation of further default rules would therefore be very welcome as a practical tool in relation to cross border business."</i></p> <p>10-14. Regarding future work, the company says as follows: <i>"In our opinion it is a good idea to promote an internationally harmonized regulatory framework for electronic contracting, if and to the extent it reflects business' need for simple and transparent regulation regarding the division of rights and obligations among the contracting parties. The development of such a harmonized regulatory framework, should preferably be based on rules which apply irrespective of what medium is used, i.e. it should apply for both online and offline contracting, in order to secure the global spreading out and usage thereof."</i></p>
3.	Denmark, another industrial company	<p>1. Have you been required by suppliers/customers/partners to use electronic means for contracting? <i>"Yes."</i> Have you encountered any problems (legal or practical)? <i>"Not yet."</i></p> <p>2-9. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p>11. Are there other issues that UNCITRAL should be addressing? <i>"E-business in general, intellectual rights conflicts vs. domain rights."</i></p>

No.	Country	Summary of Questions/Responses
	Denmark another industrial company (continued)	<p>12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? "Yes."</p> <p>13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"The rules should be the same."</i></p>
4.	France, large bank	<p>Company notes the importance of territorial identification: <i>"A website may be implemented in one country while the company it serves—whose goods and services it sells—is in another country. The buyer needs to know where he is buying so as to be sure which laws apply. In a similar way, the seller may need to know where the buyer is buying from, on top of where the goods are to be shipped."</i></p>
5.	Germany, large mail order company	<p>Company sees little need for harmonization work, since most of the questions have already been solved by the European Union e-commerce directive and national law.</p>
6.	Germany, another large mail order company	<p>1. Does your company have experience with electronic contracting? <i>"We use electronic means with our customers because this necessity is required by the mail-order market. As far as suppliers are concerned we decided—after a test period—not to use electronic means because the technical requirements for that were too high and the security of data transmission was not guaranteed."</i></p> <p>2. Do you think it is a problem that the extent to which you are bound by electronic messages differs in different countries? <i>"No, because we and our subsidiaries operate in our individual domestic markets only."</i></p> <p>3. Would it be helpful if the rules on formation of electronic contracts were to be harmonized? <i>"This would be helpful. However, since at the time the European Union enacted the directive on electronic commerce it was not able to harmonize these rules, I doubt that this will happen in future."</i></p> <p>4-9. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p>12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"I don't think this would be useful. Similar to the United Nations Sales Convention the framework would not be jus cogens. The more powerful party of the contract would exclude those rules that he doesn't want."</i></p> <p>14. What are the most urgent issues that you would like Governments and international organizations to address in electronic commerce in general, and electronic contracting in particular? <i>"A real problem is the question of which law is applicable in cross-border business, e.g. competition law, data protection law, trade law. But I doubt that this problem can be solved in the near future."</i></p>
7.	Iceland, bank consortium	<p>1. Does your company have experience with electronic contracting? Have you encountered any problems? <i>"The legal problems are lack of predictability and trust due to complex IT-law issues (contract formation, non-repudiation, archiving, validation, evidence) and the fact that there is no case law. The use of electronic communications for important transactions is mostly restricted to closed user groups, whose members agreed previously on the technology used and the appended legal consequences."</i></p>

No.	Country	Summary of Questions/Responses
	Iceland, bank consortium (continued)	<p>2. Do you think it is a problem that the extent to which you are bound by electronic messages differs in different countries? <i>"Yes, I think it is a general problem in international contract law. It is for example a big issue for both consumers and suppliers to know if something is an offer or an invitation to make an offer. There are valid reasons for both but the parties have to know which one applies."</i></p> <p>3. Would it be helpful if the rules on formation of electronic contracts were to be harmonized? <i>"It would be helpful for clarification, but contract formation is a big legal issue for most countries and tradition is a very strong factor there. It is also not helpful to have special rules for electronic contract that vary from formation of contracts in the paper world. Another thing is that all formal requirements for contract formation can make simple things complex and should be avoided. Intention should be the main issue."</i></p> <p>4. Do you think it is a problem that the law in relation to incorporation of terms differs in different countries? <i>"Yes, I think it is a problem, especially for consumers. In the Nordic countries for example, consumer protection is very strong and incorporation by reference has to be done in a very clear and informed way."</i></p> <p>5. Would it be helpful if the rules on incorporation of terms in electronic contracts were to be harmonized? <i>"Yes, I think so, but again contract law is a delicate national issue."</i></p> <p>6. Do you think it is a problem that the law in relation to mistake differs in different countries? <i>"Yes."</i></p> <p>7. Would it be helpful if the rules on mistake in electronic communication were to be harmonized? <i>"I think that the traditional rules should be sufficient in almost all cases (intention, culpa, good faith)."</i></p> <p>8. Have you come across any problems owing to international disharmony within the area of the law of evidence? <i>"It has to be very clear when a contract is concluded. The main issue has to be the intention to be bound by the contract and not some formal requirements."</i></p> <p>9. Would it be helpful if the rules on evidence in relation to electronic transactions were to be harmonized? <i>"I do not think that it is practically doable to harmonize rules on evidence even though it would be helpful. It is also my opinion that general rules should apply here."</i></p> <p>10. Do you believe that the issues listed under A-D above are problems in practice? <i>"Yes, I believe that the issues that are listed constitute problems not only to electronic contracting but contracting in general. These issues are not new but the ability to conclude contracts electronically makes them more practical."</i></p> <p>12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"Yes it would be useful."</i></p> <p>13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e., for both online and offline contracting)? <i>"It is very preferable to have the same rules irrespective of the medium used."</i></p>
8.	Japan, multinational	<p>1. Have you been required by suppliers/customers/partners to use electronic means for contracting? <i>"Yes."</i> Have you encountered any problems (legal or practical)? <i>"Not so far. There have been few cases and little experience in electronic contracting."</i></p>

No.	Country	Summary of Questions/Responses
Japan, multinational (continued)		2. Do you think it is a problem that the extent to which you are bound by electronic messages differs in different countries? <i>"That is definitely a big problem which could hamper electronic commerce eventually."</i>
		3. Would it be helpful if the rules on formation of electronic contracts were to be harmonized? <i>"Yes, it would, however it would be more important how harmonization was done."</i>
		4. Do you think it is a problem that the law in relation to incorporation of terms differs in different countries? <i>"It might be a problem. But this issue would occur also in the case of non-electronic contracts. In case of non-electronic contracts, the parties normally take steps in the contract process to prevent it from happening."</i>
		5. Would it be helpful if the rules on incorporation of terms in electronic contracts were to be harmonized? <i>"It is hard to say yes or no."</i>
		6. Do you think it is a problem that the law in relation to mistake differs in different countries? <i>"Yes, it is a big problem."</i>
		7. Would it be helpful if the rules on mistake in electronic communication were to be harmonized? <i>"It is hard to say yes or no. If there is an article to prevent this risk from happening in the contract, there would not be such a need for international harmonization in this area. This is supposed to be an issue which should be dealt with between the parties to the contract."</i>
		8. Have you come across any problems owing to international disharmony within the area of law of evidence regarding proving that a contract is concluded, or the terms upon which you have contracted? <i>"No."</i>
		9. Would it be helpful if the rules on evidence in relation to electronic transactions were to be harmonized? <i>"I do not know"</i> .
		10. Do you believe that the issues listed under A-D above are problems in practice? <i>"For some issues, yes, but not for all the issues."</i>
		11. Are there other issues that UNCITRAL should be addressing? <i>"No."</i>
		12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"As a guideline or framework, yes. But if the convention was adopted, it would be totally up to each individual nation whether or not to ratify it. So, considerations of sovereignty would be important."</i>
		13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"It is hard to say which is better. We need to research more practical cases before making a decision on this issue."</i>
		14. What are the most urgent issues that you would like Governments and international organizations to address in electronic commerce in general, and electronic contracting in particular? <i>"Certificate authority liability and institutional and harmonized document formats to prevent problems entailed by electronic signatures."</i>

No.	Country	Summary of Questions/Responses
9.	Sweden, multinational	<p data-bbox="671 282 1278 521">1. Does your company have any experience with electronic contracting? <i>"Yes. The reason for not using e-contracting apart from EDI is not legal uncertainty. It's rather that no e-sales contracts are ever entered into, since all commerce is done via a password-protected e-commerce platform where you have a paper contract to start with. All international contracts are entered into locally by affiliates, which means no problems with disharmony of law. Cross-border contracts are so large that they are handled face-to-face."</i></p> <p data-bbox="671 533 1278 633">7. Would it be helpful if the rules on mistake in electronic communication were to be harmonized? <i>"The issue of mistake is a problem. Needs to be solved on national level as well as globally."</i></p>
10.	Thailand, commercial company	<p data-bbox="671 656 1278 757">1. Does your company have experience with electronic contracting? <i>"No, we have no experience to use electronic contracting owing to legal uncertainty and have no opportunity to use it yet."</i></p> <p data-bbox="671 768 1278 819">2-9. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p data-bbox="671 831 1278 931">12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"Yes, it will be very helpful."</i></p> <p data-bbox="671 943 1278 1126">13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"We see that there are some requirements that the rules for online electronic contracting and the rules for off-line electronic contracting are separated."</i></p>
11.	United States of America, large bank	<p data-bbox="671 1149 1278 1200">1. Have you encountered any problems (legal or practical)? <i>"No, too early in the game for potential issues to emerge."</i></p> <p data-bbox="671 1211 1278 1263">2-3. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p data-bbox="671 1274 1278 1514">4. Do you think it is a problem that the law in relation to incorporation of terms differs in different countries? <i>"Yes, big problem. Primarily in the context in which an electronic signature is used with the contract (the essence of the electronic contract value proposition is tied to electronic signatures). Example: does an electronic signature signify acknowledgement, informal general agreement or absolute legal confirmation of content? A global means for setting the context within language and cultural permutations is needed."</i></p> <p data-bbox="671 1525 1278 1576">5-9. Company finds problems in all these areas and would welcome harmonization work in them.</p> <p data-bbox="671 1588 1278 1715">10. Do you believe that the issues listed under A-D above are problems in practice? <i>"Not at the moment, but they are problems in getting traction for electronic contract/signatures generally. Practice will not commence until some of the foundation issues are resolved."</i></p> <p data-bbox="671 1727 1278 1827">12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"Yes."</i></p> <p data-bbox="671 1839 1278 2074">13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"Actually, resolving issues arising in the course of online contracting will likely also benefit latent issues in the offline world. I suggest working towards good online rules and then checking them for how well they will work with existing offline practice."</i></p>

No.	Country	Summary of Questions/Responses
	United States of America, large bank (continued)	14. What are the most urgent issues that you would like Governments and international organizations to address in electronic commerce in general and electronic contracting in particular? “1. Certificate authority liability. 2. Structured document formats and syntax to resolve context confusion in applying electronic signatures.”
12.	United States of America, multinational	<p>General comments: “We welcome both the UNCITRAL initiative considering the development of legal rules for electronic contracting and the ICC initiative to make sure that such an important project reflects business realities and practices. Before answering the questionnaire, we highlight a few key issues that are worth considering:</p> <p>— The divergence of national rules on electronic contracting may call for harmonization. We would recommend, however, that attention is also given to the mutual recognition of national rules in those areas where the divergences are not significant. In choosing the appropriate method of harmonization, it would further be useful to reflect upon the usefulness of codes of conduct.</p> <p>— To the extent that new or modified rules are needed to address the unique aspects of electronic transactions, such rules should be international because of the inherently global nature of electronic commerce. International and regional (i.e. Communication from the Commission to the Council and the European Parliament on European Contract Law, 2001/C 255/01) efforts of promoting increased certainty should be undertaken jointly, otherwise they could leave questions unanswered to entities doing business both within and outside a specific region.</p> <p>— In any transaction, whether between two businesses, between a business and a consumer, or between a business and a public entity, the validity of forming contractual relationships electronically must be legally ensured. In an increasingly global marketplace, all parties to an electronic transaction must feel assured that the legal framework that governs traditional commercial transactions is also applicable to contractual obligations acquired using electronic means.</p> <p>— Many jurisdictions have not yet adequately addressed questions such as how to contract via an online network, what constitutes a signature in the online environment and whether and to what extent online contracts are enforceable. This situation creates uncertainty and raises the spectre of non compliance and breach of obligations.”</p> <p>1. Have you been required by suppliers/customers/partners to use electronic means for contracting? “Yes, mainly by customers.” Have you encountered any problems (legal or practical)? “From a general perspective, there is an overall sense of legal uncertainty. More specifically, the most common problems are related to multiple jurisdictions (including access from sanctioned countries); personal data protection (effectiveness of online consent, opt-in, etc.); and effectiveness of click/shrink wrap method in connection with certain country specific provisions (i.e. express acceptance of clauses in standard contracts under art. 1341 of the Italian Civil Code).”</p> <p>2. Do you think it is a problem that the extent to which you are bound by electronic messages differs in different countries? “Yes.”</p> <p>3. Would it be helpful if the rules on formation of electronic contracts were to be harmonized? “Definitely yes.”</p> <p>4. Do you think it is a problem that the law in relation to incorporation of terms differs in different countries? “Yes.”</p>

No.	Country	Summary of Questions/Responses
	United States of America, multinational (continued)	<p>5. Would it be helpful if the rules on incorporation of terms in electronic contracts were to be harmonized? <i>"Yes, very helpful."</i></p> <p>6. Do you think it is a problem that the law in relation to mistake differs in different countries? <i>"We believe that there may be a need to investigate to what extent the "type" of mistake is different in an online compared to the offline environment and, if so, whether any technical or regulatory initiatives are needed in this regard."</i></p> <p>7. Would it be helpful if the rules on mistake in electronic communication were to be harmonized? <i>"Yes."</i></p> <p>8. Have you come across any problems owing to international disharmony within the area of law of evidence regarding proving (a) that a contract is concluded, or (b) the terms upon which you have contracted? <i>"Yes, mainly (b)."</i></p> <p>9. Would it be helpful if the rules on evidence in relation to electronic transactions were to be harmonized? <i>"Definitely yes."</i></p> <p>10. Do you believe that the issues listed under A-D above are problems in practice? <i>"Yes."</i></p> <p>12. Would it be useful for business to have an internationally harmonized regulatory framework for electronic contracting (similar to the United Nations Sales Convention)? <i>"Yes, although due consideration should be given to the fact that the application of the United Nations Convention is almost always excluded from contracts."</i></p> <p>13. If such a harmonized regulatory framework is developed, should there be separate rules for electronic contracting or would it be preferable to have the same rules apply irrespective of what medium is used (i.e. for both online and offline contracting)? <i>"Electronic contracts are not fundamentally different from paper-based contracts. Nevertheless e-commerce does not fully reproduce the contracting patterns used on contract formation through traditional means. Therefore, even though a harmonization effort to eliminate legal obstacles to the use of modern means of communication might not be primarily concerned with substantive law issues, some adaptation of traditional contract law rules could be needed to accommodate the needs of electronic commerce. To that extent, we believe that rules addressing the specificity of the medium should be elaborated. Not to mention the fact that consensus is more likely to be reached on electronic practices due to their novelty and to the lack of a consolidated legal tradition in such an area."</i></p> <p>14. What are the most urgent issues that you would like Governments and international organizations to address in electronic commerce in general and electronic contracting in particular? <i>"In general: (a) it should be clear what types of contract are to be governed; we believe that dealing solely in the area of international sales of tangible goods would be too limited, hence consideration should be given to any contract concluded or evidenced by electronic means; (b) specifically concerning electronic contracting: contract formation (i.e. offer and acceptance, expression of consent, receipt and dispatch, storage and retrieval of contract terms, automated computer systems, treatment of mistake); evidence; applicable law; dispute resolution/jurisdiction (also in business to business transactions)."</i></p>

V. SECURITY INTERESTS

A. Report of the Working Group on Security Interests on the work of its first session (New York, 20-24 May 2002)

(A/CN.9/512) [Original: English]

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I. INTRODUCTION

1. At its first session, held in New York from 20 to 24 May 2002, Working Group VI (Security interests) began its work on the development of “an efficient legal regime for security rights in goods involved in a commercial activity”.¹

2. The decision of the United Nations Commission on International Trade Law (UNCITRAL) to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.²

3. At its thirty-third session, in 2000, the Commission considered a report of the Secretary-General on possible future work in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries and in the share such parties had in the benefits of international trade. However, a note of caution was struck in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be coordinated with efforts on insolvency law.³

4. At its thirty-fourth session, in 2001, the Commission considered a further note by the Secretariat (A/CN.9/496). At that session, the Commission agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macro-economic benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in

particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.⁴

5. While some concerns were expressed with respect to the feasibility of work in the field of secured credit law, the Commission noted that those concerns were not widely shared and went on to consider the scope of work.⁵ It was widely felt that work should focus on security interests in goods involved in a commercial activity, including inventory. It was also agreed that securities and intellectual property should not be dealt with. With respect to securities, the Commission noted the interest of the International Institute for the Unification of Private Law (Unidroit). As to intellectual property, it was stated that there was less need for work in that area, the issues were extremely complex and any efforts to address them should be coordinated with other organizations, such as the World Intellectual Property Organization.⁶ As to the form of work, the Commission considered that a model law might be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include, where feasible, model legislative provisions.⁷ After discussion, the Commission decided to entrust a working group with the task of developing an efficient legal regime for security rights in goods involved in a commercial activity, including inventory. Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry and practice, the Commission recommended that a two- to three-day colloquium should be held.⁸ The colloquium was held in Vienna from 20 to 22 March 2002. The report of the colloquium is contained in document A/CN.9/WG.VI/WP.3.

6. The Working Group, composed of all States members of the Commission, held its first session in New York from 20 to 24 May 2002. The session was attended by representatives of the following States members of the Commission: Austria, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Spain, Sweden, Thailand and United States of America.

7. The session was attended by observers from the following States: Argentina, Australia, Belarus, Cyprus, Ecuador, Indonesia, Jordan, Peru, Philippines, Poland, Portugal, Republic of Korea, Switzerland and Venezuela.

¹Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 358.

²Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 455, and Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 347.

³Ibid., Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 459.

⁴Ibid., Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 351.

⁵Ibid., paras. 352-354.

⁶Ibid., paras. 354-356.

⁷Ibid., para. 357.

⁸Ibid., para. 359.

8. The session was also attended by observers from the following specialized agencies and other organizations in the United Nations system: International Monetary Fund and World Bank. It was also attended by observers from the following national or international organizations: American Bar Association, Association of the Bar of the City of New York, Commercial Finance Association (CFA), Federación Latinoamericana de Bancos, International Association of Ports and Harbors, International Chamber of Commerce, International Federation of Insolvency Professionals (INSOL International), International Institute for the Unification of Private Law (Unidroit), International Law Association, Max-Planck Institute for Foreign and Private International Law, National Law Center for Inter-American Free Trade, Union of Industrial and Employers' Confederations of Europe and Union Internationale des Avocats.

9. The Working Group elected the following officers:

Chairman: Kathryn Sabo (Canada);

Rapporteur: Abbas Saffarian (Islamic Republic of Iran).

10. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.VI/WP.1);

(b) Report of the Secretary-General on the draft legislative guide on secured transactions (A/CN.9/WG.VI/WP.2 and Add.1-12);

(c) Report of the Secretary-General on the United Nations Commission on International Trade Law-Commercial Finance Association international colloquium on secured transactions (A/CN.9/WG.VI/WP.3);

(d) Note by the Secretariat on the draft legislative guide on secured transactions: comments by the European Bank for Reconstruction and Development (A/CN.9/WG.VI/WP.4).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on secured transactions.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

12. The Working Group considered chapters I to V and X of the draft guide. The deliberations and decisions of the Working Group are set forth below in chapter III of the present report. The Secretariat was requested to prepare, on the basis of those deliberations and decisions, a revised version of chapters I to V and X of the draft guide.

III. PREPARATION OF A LEGISLATIVE GUIDE ON SECURED TRANSACTIONS

General remarks

13. General support was expressed for the preparation of a legislative guide on secured transactions. It was widely felt that an efficient secured transactions regime could have a positive impact on the availability of credit at affordable rates. It was also stated that the Commission's work was particularly timely as it was also preparing a legislative guide on insolvency law and could thus provide comprehensive and harmonized guidance to States. Particular emphasis was placed on the need to ensure harmony with insolvency laws, to build on texts completed by other organizations and to avoid duplication with texts currently under preparation in other organizations. In that connection, the Working Group was reminded, in particular, of the need to coordinate with Working Group V (Insolvency law) and of the decision of the Commission not to deal with security rights in securities or intellectual property.⁹ The Working Group noted that Unidroit had set up a study group whose mandate was to prepare harmonized rules on the taking of security in securities and expressed its wish that the Secretariat should identify the most efficient way of coordination with Unidroit (see also paras. 32 and 37 below).

14. As to the form of work, in response to a question, it was noted that a model law or a convention would be too rigid, while a guide with legislative recommendations would be a more flexible and yet sufficiently useful text. It was also noted that, once the draft guide had been completed, the Commission could consider the question of preparing a model law.

Chapter I. Introduction

A. Organization and scope

15. While general support was expressed for the discussion in the draft guide of the economic impact of secured transactions legislation, it was widely felt that the discussion should be stated in such a way so as not to suggest that, even though appropriate legislation was a necessary condition for a certain economic result, it was in itself sufficient to achieve that result. In that connection, it was stated that reference should be made, for example, to the appropriate infrastructure, judicial system and enforcement mechanisms necessary to ensure that a State enacting legislation based on the regime envisaged in the draft guide ("enacting State") could obtain the economic benefits referred to in the draft guide (i.e., increased access to credit at the appropriate credit terms and cost).

16. In addition, it was observed that the cost of establishing and applying the regime envisaged in the draft guide should also be discussed, at least with a view to addressing concerns that some States might have. Moreover, it was said that emphasis should be placed on the potential impact of secured transactions law (e.g., priority) on insolvency

⁹Ibid., paras. 354-356.

law, in particular in the case of reorganization proceedings, and on the need to ensure a proper balance between the interests, on the one hand, of debtors and creditors and, on the other hand, of secured, unsecured and privileged creditors (see also para. 23 below).

17. The Working Group agreed that the scope of the regime envisaged in the draft guide should be described more clearly. It was stated that work could first focus on goods, including inventory, and then possibly expand, if necessary, to other assets, such as receivables, provided that the main rules dealing with security rights in goods would not be affected. It was also observed that the more comprehensive the regime envisaged in the draft guide, the more value it would have for legislators. The example was given of the importance of addressing enterprise mortgages that could encompass both movable and immovable property. In response, it was observed, however, that security rights in immovable property gave rise to different issues from those arising in the context of security rights in movable property and was thus treated in separate statutes. It was also said that the fact that such security rights were treated in separate statutes did not raise any problem. It was stated, however, that treating assets of an enterprise in separate statutes could raise problems of enforcement and complicate the sale of the enterprise as a going concern. In that connection, it was stated that, whether the regime envisaged in the draft guide would apply to security rights in immovables or not, the draft guide needed to inform enacting States of the need to ensure that the secured transactions legislation would not overlap or be in conflict with other legislation.

18. Differing views were expressed as to whether the regime envisaged in the draft guide should cover consumer transactions. One view was that consumer transactions should be excluded altogether. It was stated, however, that if such an approach were to be taken, it would have to be explained in the draft guide. Another view was that consumer transactions should be addressed, provided that the rights of consumers under applicable consumer protection law would not be affected. It was observed that that result could be achieved by subjecting consumer transactions to the same rules applicable to commercial transactions, introducing exceptions only where necessary to protect rights of consumers under consumer protection law.

19. In the discussion, the suggestion was also made that the draft guide should discuss in more detail the problem of the cross-border recognition of security rights that were in many cases effectively lost once the encumbered assets were transported across national borders.

20. The Working Group took note of the suggestions made and, on the understanding that it might have to revisit scope-related issues in the context of its discussion of substantive issues, requested the Secretariat to address them in the next version of the draft guide.

B. Terminology

21. It was agreed that terminology could be more usefully discussed in the context in which the substantive matters

addressed in each definition arose in the draft guide. However, several suggestions were made, including to limit the definition of “debtor” to commercial debtors (see para. 18 above); and to refer in the definition of “encumbered assets” to immovable property and not only in the context of enterprise mortgages. In that connection, concern was expressed that such an approach would result in inappropriately expanding the scope of the draft guide (see para. 17 above).

C. Examples of financing practices

22. The Working Group took note of the list of examples of financing practices given in the draft guide and agreed to consider at a later stage whether to expand that list and whether to place it in chapter I or elsewhere in the draft guide.

Chapter II. Key objectives

23. General support was expressed for a general statement along the lines of chapter II of the main practical objectives of the regime envisaged in the draft guide. At the same time, a number of suggestions were made including to refer in objective A to “fair” rather than “full” value; to refer in objective C to the value of registration systems; to revise the reference in objective E to court proceedings being time-consuming, since that might not be an accurate statement of the situation prevailing in all countries and, in any case, in many countries there were expedited court proceedings; to add a new objective referring to the need to protect the interests of debtors; to reflect more clearly the impact of secured transactions legislation on credit discipline and corporate governance; to make it clear in objective H that there were other ways to promote responsible behaviour, and not just transparency, since debtors might not wish to disclose details about their financing transactions; and to add another objective to refer to the need to protect the interests of various types of creditors (e.g., secured, unsecured and privileged creditors, within or outside insolvency proceedings, as well as to long-term and short-term creditors).

24. It was also suggested that, beyond balance between debtors and creditors, as well as among various types of creditors, balance between the various objectives should also be achieved, since, for example, simplicity might be inconsistent with transparency and speedy enforcement might be inconsistent with a balanced approach to the rights of all parties. As to party autonomy, it was also stated that it might need to be limited in a regime dealing with proprietary rights (in rem), which, by definition, might affect the rights of third parties. The need to consider the objectives in the light of the main financing transactions to be covered in the draft guide was also highlighted.

25. As to registration, while it was agreed that it was a useful concept and should be discussed, it was stated that it was not an objective but rather related to the means for achieving one or more objectives. Reference was also made to studies by the Asian Development Bank, emphasizing the economic importance of registration systems, and to

projects in various Asian countries aimed at the introduction of such registration systems.

26. On the understanding that it might have to revisit the key objectives in the context of its discussion of subsequent chapters, the Working Group requested the Secretariat to revise them to take into account the suggestions made and the views expressed.

Chapter III. Basic approaches to security

27. It was stated that it should be made clear right at the beginning of chapter III that it was intended to provide an indication of the various approaches to the notion of security, the advantages and disadvantages of each approach and the various policy options before legislators.

A. Pledge

28. Support was expressed for the discussion of advantages and disadvantages of a pledge presented for the debtor and the secured creditor. It was observed that reference should also be made to the advantages of pledge-type security rights for third parties and, in particular, to the fact that it minimized the risk of fraud. With respect to liability of creditors in possession (for example, for contamination of the environment), it was stated that the draft guide should discuss in more detail existing legislation exempting the creditor from liability in cases where the creditor had no effective control of the encumbered asset and include a recommendation along those lines. It was observed that, if the creditor was not exempted from such liability, it would have to take insurance, the cost of which would be paid by the debtor and could significantly raise transaction costs.

29. In response to a question as to whether the creditor and the person holding the security right or the encumbered asset could be two different persons, it was noted that an agent or trustee could hold the right or the encumbered asset on behalf of the secured creditor, without becoming a secured creditor. It was agreed that the matter could be usefully explained in the draft guide.

B. Right of retention of possession

30. Support was expressed for the discussion in the draft guide of the right of retention of an asset by a party whose contractual partner failed to perform its obligations under the contract, since it was treated in some jurisdictions as a security right. However, a number of concerns were expressed with respect to the current formulation of the relevant issues in the draft guide. One concern was that it was not sufficiently clear that a right of retention could be statutory or consensual and that the former should be excluded from the scope of the draft guide, while the latter could be addressed. Another concern was that the right of retention, which was a contractual right even if accompanied by an authorization to a party to sell the asset, was presented as a property right. Yet another concern was that priority in payment, which was more relevant in the context of a discussion of security rights, was not discussed. Yet

another concern was that the current discussion of the matter might be inadvertently understood as allowing a party to sell an asset without court authorization, where necessary.

C. Non-possessory security

31. While a discussion of non-possessory security was generally thought to be appropriate, a number of suggestions were made including to expand on the description of non-possessory security rights to avoid giving the impression that the debate over whether to allow non-possessory security rights was new or inconsistent with legal traditions in various civil law countries; to discuss publicity as a solution to the issue of false wealth arising in the context of non-possessory security rights, but also as a tool to provide to third parties (including insolvency administrators) information on the basis of which to assess the risk of non-payment; to address the question of whether the secured creditor had the same rights where assets subject to an all-asset security right (global security right or “floating charge”) changed; to refer to the Model Inter-American Law on Secured Transactions, prepared by the Organization of American States (OAS) (the “OAS Model Law”), as a law covering both possessory and non-possessory security; and to emphasize that treating possessory and non-possessory security rights in separate statutes could lead to inconsistencies, lack of transparency and gaps. In that connection, it was suggested that the matter needed to be discussed further as many States had asset-specific legislation with respect to non-possessory security rights.

D. Security in intangibles

32. In response to a question, it was noted that the draft guide discussed security rights in intangibles since, in line with one of the key objectives of any efficient secured transactions system, it was based on the assumption that its scope would be as broad as possible. It was stated that, while the question of addressing security rights in some types of intangible assets should be discussed at some point in time, the Working Group should focus on security rights in goods, including inventory. It was also observed that intangibles should be discussed because of their economic value and their importance in the context of all-asset security rights or enterprise mortgages. In addition, it was pointed out that intangible assets, such as receivables and proceeds of goods, needed to be given particular attention. The need to coordinate with, and complement work by, other organizations was also emphasized (see also para. 13 above and para. 37 below).

E. Transfer of title

33. It was widely felt that transfer of title was appropriately discussed in the draft guide. At the same time, a number of suggestions were made including to clarify that transfer of title had been developed to circumvent the prohibition of or difficulties with non-possessory security rights and that it was not needed to the same extent in

systems with modern regimes on non-possessory rights; to address the question of whether assets subject to a transfer-of-title security device were part of the grantor's insolvency estate; and to highlight the fact that transfer of title was subject to reduced formal requirements.

F. Retention of title

34. Support was expressed for the discussion of retention of title in the draft guide. It was stated that insolvency administrators went to great length and cost to address the question of whether retention of title was a security right or not. It was, therefore, suggested that the draft guide could make a significant contribution to practice by recommending that retention of title should be treated as a security right. However, the Working Group made no decision as to whether retention-of-title arrangements should be regarded as conditional sales or secured transactions.

G. Uniform comprehensive security

35. It was widely felt that the draft guide should discuss both approaches taken in legal systems towards a uniform security right in all types of asset. It was stated that one approach was to abolish all existing security rights and to introduce a new one that could be created in all types of asset. As to title arrangements, it was observed that, in the context of such an approach, they could be identified and treated in the same way security rights were treated. The second approach was said to be the one currently discussed in the draft guide, in the context of which, instead of creating a new security right, the functional equivalents of a security right were subjected to the same rules.

H. Summary and recommendations

36. The Working Group agreed that the section entitled "summary and recommendations" could be retained on the understanding that it would be restructured to form a summary and some tentative conclusions for further consideration, since it was premature at the present stage to formulate any recommendations. It was stated that it was appropriate for that chapter to set out the different security devices, their advantages and disadvantages, and the various options available to legislators. It was also observed that the chapter should be as comprehensive as possible and leave open the way in which the various approaches could be implemented. It was also stated that the draft guide should express clear recommendations rather than focus merely on the description of existing practices.

37. As to the right of retention of possession, it was stated that reference should be made to the priority of the party having a right of retention. With respect to non-possessory security rights, it was observed that their treatment in the case of insolvency needed to be discussed in some detail. With respect to intangibles, it was pointed out that, while some types of intangibles (e.g., receivables and proceeds of goods) should be covered, other types (e.g., securities and

intellectual property rights) should not be covered in view of the need to focus on security rights in goods, the complexity of issues relating to security rights in securities, the need to use efficiently the resources of the Working Group with a view to completing its work within a reasonable period of time and the need to avoid duplication of efforts with other organizations (see also paras. 13 and 32 above).

38. After discussion, the Working Group requested the Secretariat to revise chapter III of the draft guide taking into account the views expressed and the suggestions made.

Chapter IV. Creation

39. It was stated that the presentation of the contents of the chapter in the introduction was helpful for the reader and should be considered for other chapters as well. It was also observed that the types of debtors and creditors to be covered should also be discussed. Support was expressed for the principle that secured transactions would be subject to insolvency rules relating to avoidance of preferential, undervalued and fraudulent transactions.

A. Accessory nature of a security right

40. It was suggested that the discussion of the principle of the accessory nature of a security right should be revised to make clear that a security right was always accessory to the secured obligation in the sense that the validity and terms of the security right depended on the validity and the terms of the secured obligation even in revolving credit transactions.

B. Obligations to be secured

41. A number of suggestions were made, including to revise the discussion of monetary and non-monetary obligations so as to avoid any discrimination against non-monetary obligations; to clarify that a security right securing a future obligation could not be enforced, rather than have no effect, before the obligation actually arose; and to clarify that some modern systems required parties to set a maximum limit to the obligation to be secured, while other modern systems did not have such a requirement.

42. Differing views were expressed as to whether the draft guide should recommend a maximum limit to the secured obligation. One view was that such a limit would make it possible for the debtor to use its assets to obtain credit from another party. It was observed that that matter was addressed in the draft guide (fluctuating amounts and description of secured obligation) with the presentation of two options. One option was to allow for the determination of the amount of the secured obligation in a general way and the other option was to allow an all-sums security. Another view was that the matter should be put in a practical context and the advantages and disadvantages of the various options should be discussed. It was explained that, unless the encumbered asset could be evaluated with some precision (as was the case, for example, with real property), maximum limits were not helpful. In such cases, the benefit

to be derived for the debtor from making it possible for the debtor to use its assets to obtain security from another creditor might not outweigh the benefits arising from the debtor putting no limit to the amount of the secured obligation (e.g., increased amount of credit at lower cost than otherwise). It was agreed that the matter needed to be discussed further in the context of the discussion of chapters V (A/CN.9/WG.VI/WP.2/Add.5, paras. 35-37) and VI (A/CN.9/WG.VI/WP.2/Add.6, paras. 11 and 12). It was also agreed that in chapter IV cross-references should be included to those chapters.

C. Assets to be encumbered

43. With respect to possible limitations, it was stated that both possible approaches should be discussed (property could not be encumbered at all or could be encumbered only up to a certain amount). It was also suggested that the draft guide should clarify whether it was the asset that was encumbered or the right of the grantor in the asset. In that connection, it was explained that the draft guide was based on the assumption that the security right was in the property of the grantor in the asset and not in the asset itself. It was also explained that the draft guide discussed also the possibility of the grantor creating a security right in an asset that the grantor did not own or could not dispose of at the time of the creation of the security right (see A/CN.9/WG.VI/WP.2/Add.4, paras. 48-51). Some doubt was expressed as to whether the security right was in the right of the grantor or in the asset itself. The Working Group agreed to revisit that matter.

44. Support was expressed for allowing security to be created in assets not existing at the time of the conclusion of the security agreement ("future assets") as well as in assets acquired after the conclusion of the security agreement ("after-acquired assets"). It was also stated that a description, such as "all assets", should be sufficient.

45. With respect to security in all assets of an enterprise ("floating charge"), it was stated that it should be discussed in more detail, with particular reference to the concept of "crystallization" of the security to particular assets. It was also observed that an all-assets security was not equivalent to an enterprise mortgage, because, *inter alia*, the latter could include also immovable property (enforcement was subject to the same rules but not registration). With respect to the advantage of an enterprise mortgage mentioned in the draft guide (i.e., the appointment of an administrator upon enforcement), it was observed that in practice that did not always prove to be an advantage since administrators appointed by secured creditors tended to favour secured creditors to the detriment of other creditors. It was also pointed out that recent studies in some countries had shown that enterprise mortgages might not be as advantageous as was originally thought, since banks often failed to monitor the assets and thus to contribute to the preservation of a business, while they had no interests in actively participating in reorganization proceedings, since they were fully secured. After discussion, it was agreed that the relationship between an all-assets security and an enterprise mortgage should be discussed in more detail.

46. As to the issue of over-collateralization arising in some legal systems as a result of an all-assets security or an enterprise mortgage, it was stated that it should be discussed in a more balanced way to highlight both the advantages and disadvantages of an all-assets security. One advantage mentioned, for example, was the reduction of the cost of monitoring the encumbered assets. One disadvantage mentioned was that it resulted in the one-banker problem, namely that the debtor was forced to obtain credit from only the banker to whom the debtor had given an all-assets-security. In response, it was stated that that might not be a real problem since in practice there was fierce competition and the debtor could refinance its debt. On the other hand, it was observed that such refinancing had some cost. It was stated though, that that cost was not the result of the all-assets security but was inherent in any refinancing. It was also observed that whether the debtor could obtain security from another party depended on the relationship between the value of its assets and the amount of the secured obligation.

D. Proceeds

47. Differing views were expressed as to whether civil fruits and proceeds could be grouped into the notion of proceeds and be subjected to the same rules. One view was that civil fruits and proceeds were two distinct notions and should not be subject to the same rules. Another view was that distinctions between those two notions were often very difficult to draw and, in any case, subjecting them to different rules could not be justified in view of the relationship between proceeds and fruits on the one hand and the original encumbered asset on the other hand. To clarify that relationship, it was said that distribution of fruits (e.g., dividends) was bound to affect the value of the original encumbered asset (e.g., stocks). To bridge the gap between the two views, it was suggested that, while terminological differences could be preserved, both proceeds and fruits should be treated as falling within the scope of the encumbered asset.

48. Recognition by the law of an automatic right of the secured creditor in proceeds was generally considered as one approach to the issue. It was stated that such a rule would function as a default rule applicable in the absence of contrary agreement of the parties. It was suggested that the other approach should also be mentioned, namely that parties could agree on extending the security right, for example, to inventory, receivables, negotiable instruments and cash. Such an approach could be taken in legal systems that allowed security to be taken in all types of asset, including future and after-acquired assets. It was explained that, in such a case, the right of the secured creditor would be a right in original encumbered assets described in the security agreement and not a right in proceeds. In response, it was stated that various approaches could be considered as long as they led to an acceptable practical result, keeping in mind that the regime envisaged in the draft guide should include clear rules as to priority in proceeds (see A/CN.9/WG.VI/WP.2/Add.7, paras. 51-59).

49. The Working Group generally agreed that the questions mentioned in the draft guide with respect to proceeds

(see A/CN.9/WG.VI/WP.2/Add.4, para. 33) were appropriately raised and requested the Secretariat to discuss possible efficient approaches, explaining the advantages and disadvantages of each approach. Particular emphasis was placed on the question of whether the right in proceeds was the same as the security right (i.e., a right in rem) or a new right (i.e., a personal right), as well as to the time when proceeds should be “identifiable” as proceeds.

50. The concern was expressed that the reference to publicity as a way to protect third parties that relied on the proceeds as original encumbered assets might inappropriately give the impression that there were no other ways to protect third parties. In that connection, it was noted that one of the fundamental working assumptions in the draft guide was that publicity was the most efficient way to protect third parties, in particular in the case of non-possessory security rights. It was also noted that the mandate of the Working Group was to “develop an efficient legal regime for security rights in goods”¹⁰ and not to collect information about and reflect all possible approaches, irrespective of whether they were generally thought to work in practice or not.

E. Security agreement

51. As to the parties to the security agreement, it was suggested that reference should be made also to the third-party security holder. That suggestion was objected to on the grounds that that third party was an agent of the secured party and had no rights of its own.

52. As to the minimum contents of the security agreement, it was stated that they should be reduced since their absence could result in an agreement being invalid. It was also said that such an approach would be in line with one of the key objectives of any efficient secured transactions regime, namely to ensure that security could be obtained in a simple and efficient manner. In particular as to the signature of the grantor, it was observed that it presupposed writing, which was not necessary in all cases. It was also said that it was not clear why the signature of the debtor was not required. Furthermore, it was said that secured creditors could be warned of the possible consequences of the absence of one of the elements mentioned from their agreements, without indirectly encouraging judges to look for grounds to invalidate such agreements.

53. While there was general agreement that formalities should be reduced to a minimum, differing views were expressed as to whether writing should be required for the security agreement to be valid. One view was that writing should not be a condition for the validity of the security agreement. It was stated that, as between the parties to the agreement, writing fulfilled a warning and an evidentiary function, while, as against third parties, writing fulfilled a fraud-prevention function. In that connection, it was observed that parties to sophisticated financing transactions did not need a warning or proof of the agreement, which could be provided by other means. As to third parties, it

was pointed out that they could be protected from fraudulent antedating by some form of publicity. It was stated, however, that writing would be necessary, irrespective of the form of publicity. In the case of a document registry, writing was necessary since the written agreement had to be registered. In the case of a notice registry, writing was necessary, since notice did not establish the validity of the security agreement.

54. Another view was that writing should be required only for non-possessory security rights. It was observed that possession of the encumbered asset by the secured creditor was sufficient to fulfil the function that writing would fulfil (i.e., proof and prevention of fraudulent antedating). Yet another related view was that writing could be required as proof of the agreement not between the parties but only if it was challenged by a third party. It was stated that such an approach would be based on a clear distinction between publicity and writing, notwithstanding the third-party effects of writing.

55. Yet another view was that writing was necessary not only as between the parties to the agreement but also as against third parties. It was stated that often writing was required in particular for banking transactions and consumer transactions. It was also pointed out that, irrespective of whether the agreement needed to be in written form for it to be valid inter partes, it had to be in writing for execution purposes, as well as for it to be accepted as valid in the context of insolvency. It was stated, however, that, if a written form requirement was introduced, the impact in particular on informal transactions relating, for example, to retention-of-title arrangements, which were often reflected only in the seller's general terms and conditions, would have to be carefully examined. In response, it was stated that, in the absence of writing, retention-of-title arrangements were not recognized in insolvency proceedings even in countries that did not require writing for the inter partes validity of such transactions.

56. After discussion, the Working Group requested the Secretariat to revise the discussion of the security agreement in the draft guide to reflect the views expressed and the suggestions made. In particular with respect to written form requirements, the Working Group requested the Secretariat to discuss the advantages and disadvantages of the various approaches, drawing, where necessary, distinctions between possessory and non-possessory security rights.

F. Other requirements for the creation of a security right

57. It was noted that, in many legal systems, the security agreement did not suffice to create a security right. Other requirements should also be met. For example, the grantor should have ownership (or some other property right) in the asset to be encumbered; in the case of a possessory security right, possession should be given to the secured creditor; in the case of a non-possessory security right in tangibles, the right should be publicized; in the case of a non-possessory security right in intangibles, control of the right should be given to the secured creditor.

¹⁰*Ibid.*, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 358.

58. It was suggested that the issue of whether only the owner of an asset or also the holder of a lesser right could grant a security right should be discussed in more detail. In response to a question, it was explained that a creditor could acquire a security right in good faith even if the grantor was not the owner or did not have the right to dispose of the asset, provided that the creditor had extended or had made a commitment to extend credit.

59. A reservation was expressed with respect to the use of the term “possession” as it implied that a person holding an asset did so on the basis that that person was the owner of or had some other property right in the asset. In order to address that concern, it was noted that, while use of the term “possession” in English was appropriate, in other language versions reference could be made to “detention”.

60. As to possession, publicity or control, it was stated that it needed to be clarified that possession was relevant only for possessory security rights, publicity was relevant for non-possessory security rights (in tangibles) and control for non-possessory security rights (in intangibles).

G. Summary and recommendations

61. It was noted that the recommendation as to the types of obligations that could be secured and the assets that could be encumbered did not deal with issues such as limits on the amount of the secured obligation or all-assets security rights. It was also noted that the recommendation as to rights in identifiable proceeds reflected a principle of the United Nations Convention on the Assignment of Receivables in International Trade. On that understanding, those recommendations received wide support. As to the recommendation on form requirements, it was agreed that it would be revised to reflect the discussion of the matter by the Working Group.

62. After discussion, the Working Group requested the Secretariat to revise chapter IV taking into account the views expressed and the suggestions made.

Chapter V. Publicity

A. Introduction

63. Differing views were expressed as to the need for a publicity system for security rights in movable property. One view was that such a publicity system was not necessary. In support, it was stated that, in a credit-dominated economy, parties ought to know that assets were likely to be encumbered or be subject to a quasi-security device (e.g., retention of title or lease). It was also observed that the information provided in the encumbrance registry envisaged in the draft guide would be either too much and thus raise issues of confidentiality and competition, or too little and thus be of no use. In particular with regard to confidentiality, it was pointed out that, in order to preserve it, many countries had no general credit reporting system or property registry. If the draft guide was to be addressed to such countries, it was said, it should discuss the advantages

and disadvantages of all possible publicity systems. In addition, it was said that an encumbrance registry might be too costly to establish and operate, with the result of increased transaction costs. Moreover, it was stated that the current version of the draft guide was not sufficiently balanced in that it did not present alternative publicity systems to registration. Alternatives mentioned included information available on balance sheets, company records or local banking systems (see A/CN.9/WG.VI/WP.2/Add.5, para. 44).

64. The prevailing view, however, was that a registry system was a crucial element of any modern and efficient secured transactions regime. It was stated that such a system replicated the publicity function of possession of an asset and was based on a universal principle of publicity and transparency. It was also observed that the system did not disclose confidential information and was beneficial to all parties concerned: debtors, because it allowed them to obtain access to credit at a lower cost and more expeditiously than in systems where information about the assets of the debtor was not readily available; creditors, because it allowed them to extend credit with relative certainty as to their rights; and third parties, because it put them on notice as to potential encumbrances in the assets of the debtor and provided an objective priority regime. In addition, it was observed that the principle of publicity and transparency had become a basic requirement in regulatory banking law to the extent that both central and commercial banks were required to do extensive credit checking with respect to borrowers. It was also pointed out that a major portion of interest rates (close to 60 per cent) was intended to cover risks arising out of lack of sufficient information on borrowers. Reference was also made to project financing and securitization practices, which were of crucial importance for the financing, in particular, of infrastructure projects and yet could not flourish in the absence of a reliable registration system. Moreover, it was stated that absolute secrecy with respect to secured transactions meant absolute power of secured creditors over debtors, since the creditor with intimate information about a borrower with whom that creditor had a long-standing relationship effectively controlled and thus deprived that debtor of the benefits to be derived from the access to competitive banking markets.

65. While the Working Group confirmed its interest in a registry for security rights in movables, several concerns were also raised. Issues of concern that were mentioned included the purpose of publicity; the scope of the registry; the cost of establishing and operating the registry; and costs for the industry to take advantage of the registry. In response, it was stated that the purpose and the scope of the registration system were set out in the draft guide and could be discussed in detail. It was also observed that the fact that some of the least developed countries in the world had established and operated registry systems, such as the one described in the draft guide, was a clear indication that it was cost-efficient. In that connection, it was mentioned that, in light of the advances in computer technology, registration systems could be established quickly and inexpensively and could be operated on a cost-recovery basis with nominal, flat-rate registration fees. In order to provide the information necessary to address the concerns

expressed, a number of suggestions were made, including to have a presentation of a modern registration system at the subsequent meeting of the Working Group and to set up an informal ad hoc group in the context of which interested delegations could discuss practical registration-related issues.

66. In that connection, reference was made to the Convention on International Interests in Mobile Equipment (Cape Town, 2001) and the Aircraft Protocol thereto, as well as to the OAS Model Law, which provided for publicity through the registration of limited data in a publicly accessible registry to deal with priority issues. With respect to the Convention and the Aircraft Protocol, however, it was observed that they involved a registry that was somehow different from the one envisaged in the draft guide in that it would be international, asset-based (i.e., it would involve the identification of the encumbered asset, not the debtor, by a unique serial number) and referred only to high-value equipment. As to the OAS Model Law, it was stated that it established a registry system, such as the one envisaged in the draft guide, which was cost-effective, comprehensive and accessible to the public and indicated the policy of the 34 countries participating in the OAS process to establish a dynamic, regional credit market.

67. After discussion, the Working Group decided to proceed with the examination of chapter V based on the working assumption that a publicity system, such as the one discussed in chapter V, would be part of the regime envisaged in the draft guide.

B. Title transactions versus security transactions

68. It was noted that the Working Group should address two key questions: first, whether transactions involving the transfer or retention of title for security purposes should be subject to registration; and second, whether certain pure title transactions should be subject to registration (e.g., long-term leases and outright assignments). A related question that was mentioned was whether, if certain pure title transactions were to be subject to registration, the approach to be taken should be based on an illustrative list of transactions or on a problem-oriented concept so as to ensure that transactions in which ownership and possession were separated would be subject to registration.

69. With respect to title transactions that were functionally equivalent to secured transactions, the view was expressed that they should not be subject to registration. It was reiterated that their existence was generally known in the market and, in any case, the registry envisaged in the draft guide provided either too much or very little information (see para. 63 above). It was also stated that such an approach might make it necessary for parties to true title transactions to register so as to obtain priority, a result that could inadvertently raise their cost.

70. On the other hand, the view was expressed that title transactions should be covered, at least to the extent that they served security purposes. It was stated that, if title

transactions that were functionally equivalent to secured transactions were not subject to registration, the registry system could not provide reliable information as to the existence of rights that could deprive secured creditors of the asset value they would rely upon in providing credit. It was also observed that retention-of-title arrangements made practices such as inventory financing particularly difficult, since inventory financiers could not determine whether inventory was subject to such retention-of-title arrangements and, if so, what was the scope of such arrangements. In addition, it was said that general knowledge that there might be a retention of title was not sufficient and, in such situations, financiers would either not accept inventory as security or would accept it but add a premium to the cost of the transaction to cover for the risk that a retention-of-title holder might have priority.

71. Moreover, it was observed that, from a comparative law perspective, it was clear that a growing number of title transactions were used for security purposes and that any distinction with secured transactions would be artificial and could not be drawn. It was also said that the scope of the retention of title was also an important issue, namely whether it covered both the relevant asset and any proceeds from its sale. In that connection, it was pointed out that, even in countries that drew a distinction, retention of title was treated as a security right with respect to the proceeds of the asset that was subject to a retention of title.

72. As to pure title transactions, it was stated that they should not be subject to registration as they fell outside the scope of the secured transactions regime. In addition, it was observed that pure title transactions should not be covered by the registration system, since the purpose of a secured transactions regime could not be to establish a property registry for movables. In response, it was stated that a priority system would not be reliable unless it was comprehensive in covering all possible priority conflicts. It was noted that, in order to ensure that result, the United Nations Convention on the Assignment of Receivables in International Trade covered priority conflicts even between assignments within and outside the scope of the Convention. It was also observed that pure title arrangements should be covered by the registration systems so that an owner would have a right (not an obligation) to register and obtain priority.

73. With respect to registration of title transactions, it was stated that, if they were to be classified as secured transactions in some countries, the following two approaches could be taken: the seller could be treated as an owner or as a secured creditor (in the latter case, title would pass to the buyer). In either case, the seller would have to register, while the asset would be part of the insolvency estate and the seller would be given a heightened priority (even over creditors with an earlier-in-time filed security right; see A/CN.9/WG.VI/WP.2/Add.7, para. 20). In other countries, it was observed, a different approach was followed. If a title transaction served security purposes, the relevant asset would be part of the insolvency estate and the buyer as the owner could grant a second ranking security right. In situations where a pure title transaction was involved, the relevant asset would be separated from the insolvency estate (in liquidation proceedings). It was also stated that,

from a legislative policy point of view, it would be preferable to convert title transactions to secured transactions, since, under such an approach, the rights of the buyer would be enhanced (the buyer would be treated as the owner) and the rights of the sellers could be protected through a heightened priority. In that connection, it was pointed out that the discussion of the rights of the buyer related also to a question discussed in a different context as to whether the grantor of a security right needed to have ownership or could have a lesser property right (see para. 58 above). In view of the importance of that issue, it was suggested that the relevant discussion should be placed in chapter III, dealing with the basic approaches to security.

C. Consensual versus non-consensual security rights

74. In response to a question, it was noted that, while the focus of the Guide was on security rights created by agreement (consensual security rights), it was intended to cover all potential priority conflicts, including conflicts between consensual rights and rights created by operation of law (non-consensual rights). It was noted that the United Nations Convention on the Assignment of Receivables in International Trade had followed the same approach. It was, therefore, suggested that the definition of “security right” should be adjusted to reflect that understanding, which had also been expressed at the UNCITRAL-CFA International Colloquium on Secured Transactions (see A/CN.9/WG.VI/WP.3, para. 8). In response to another question, it was stated that the term “non-consensual” was intended to cover prior preferential claims. In that connection, it was suggested that prior claims should be limited and transparent.

75. Differing views were expressed as to whether registration of a notice about a judgement by a creditor should give that creditor a right that was equivalent to a security right (see also A/CN.9/WG.VI/WP.2/Add.7, paras. 33-37). One view was that such an approach would encourage litigation or would even cause a “race to the court” by unsecured creditors and would result in the depletion of the debtor’s estate to the detriment of unsecured creditors. Another view was that utilizing the registration system for collection of claims confirmed in court judgements would reduce litigation relating to execution of court judgements since, once the judgement was publicized, the debtor would pay to terminate the registration so as to be able to sell or encumber its assets.

D. Single registry versus multiple registries

76. It was noted that the notion of a single registry referred to a single database and did not exclude multiple points from which to enter information into the database. It was also stated that the draft guide should emphasize that some civil law countries had long experience with asset-specific registries focusing on publicity rather than on fraudulent antedating. In addition, it was observed that decentralization in federal States often had to do with the federal structure of a State and might be avoided if an understanding was reached between the provinces and the federal State.

E. Notice versus document filing

77. While support was expressed for notice filing, a number of concerns were also expressed. One concern was that it might not provide adequate information and require third parties to look outside the registry for the necessary information, which would put a burden on and risk misleading third parties. Another concern was that notice filing made it necessary for the secured creditor to summarize the security agreement in the notice, a process that was said to be prone to errors. It was observed that document filing would not raise these concerns. In response, it was pointed out that document filing raised concerns as to cost, confidentiality and error. It was also stated that a notice filing system did not present those disadvantages.

F. Timing of registration

78. It was suggested that the issue of the timing of registration in the case of insolvency should be discussed in chapter V, VII or X. It was also suggested that post-transaction registration establishing priority as of the time of the conclusion of the transaction rather than of registration should also be discussed (see exceptions to the first-to-file rule; see A/CN.9/WG.VI/WP.2/Add.7, para. 20).

G. Content of notice

79. It was suggested that the location of the assets should also be mentioned in the notice to be registered. That suggestion was objected to. It was stated that, in view of the nature of movable assets, it would be very difficult to immobilize them to a place specified in the notice. It was also observed that that matter was better left to the parties to address in their security agreement (see A/CN.9/WG.VI/WP.2/Add.8). In response to a question as to whether the grantor should authorize or even sign the notice, it was noted that that matter was addressed in chapter VI (see A/CN.9/WG.VI/WP.2/Add.6, paras. 15-17).

H. Coordination between a general encumbrance registry and asset-specific title registries

80. It was stated that not all motor vehicle registries were title registries. It was also observed that there was no “one-size fits all” type of coordination between registries. Depending on the circumstances prevailing in a country, separate systems could be coordinated or joined in one system.

I. Registration and enforcement

81. It was stated that a distinction should be drawn between registration of notice of enforcement and registration of notice of a security right. In that connection, it was suggested that reference could be made to the OAS Model Law. It was also suggested that reference should be made to the consequences of failure to register in the case of enforcement or insolvency proceedings, an issue that could

be usefully expanded on in chapters VII (A/CN.9/WG.VI/WP.2/Add.7, paras. 43-45) and X (A/CN.9/WG.VI/WP.2/Add.10, para. 24) as well.

J. Debtor dispossession as a substitute for registration

82. Some doubt was expressed as to whether debtor dispossession eliminated the problem of the appearance of false wealth and whether the authority of the registry was reduced if, in cases where a creditor with a possessory security right relinquished possession and registered its right, the law permitted the effective date of security to relate back to the time of initial possession.

K. Third-party notice or control

83. It was noted that, in the case of a pledge of receivables, notification was considered in some legal systems as equivalent to possession. It was stated, however, that the discussion should be somehow adjusted to reflect that notification did not necessarily obligate an account debtor to pay the receivable owed. In that connection, it was observed that that obligation depended on the contract from which the receivable arose and, in particular, on whether the account debtor had any defences or rights of set-off, as well as on the payment instructions given to the debtor.

L. Third-party effects of unpublicized security rights

84. It was stated that the effects of publicity in the case of security rights in intangibles, such as receivables, needed to be further clarified.

M. Third-party effects of publicized security rights

85. It was observed that the notions of third-party effects and priority were distinct and should be further explained.

N. Summary and recommendations

86. The Working Group confirmed the universality of the principle of publicity, as reflected in paragraph 69 of document A/CN.9/WG.VI/WP.2/Add.5, and decided to delete the second sentence of that paragraph.

87. After discussion, the Working Group requested the Secretariat to revise chapter V taking into account the views expressed and the suggestions made.

Chapter X. Insolvency

88. The Working Group agreed on the need to ensure, in cooperation with Working Group V (Insolvency law), that issues relating to the treatment of security rights in insolvency proceedings would be addressed consistently with the conclusions of Working Group V on the intersection of the work of Working Group V and Working Group VI (see A/CN.9/511, paras. 126-127).

89. Various suggestions were made, including to refer to realization of value, rather than to enforcement, as a common objective of secured credit and insolvency law; to refer to stays issued at the discretion of the relevant court; to ensure the value of the security; to consider whether, subject to the public policy of the forum with respect to the ranking of privileged claims and to the avoidance of fraudulent or preferential transactions, the conflict-of-laws rules applicable outside insolvency should also be applicable in insolvency proceedings; to refer to the possibility that, if in liquidation proceedings the encumbered assets had not been sold within a reasonable period of time, the court could turn them over to the secured creditor, provided that there was a reasonable indication that the secured creditor could sell them more easily and at a better price; to recognize that privileged claims may be asserted against the encumbered assets but recommend that such claims should be limited, in number and amount, and be transparent; and to elaborate in the draft guide on post-commencement financing and on the treatment of security rights in reorganization proceedings.

90. There was support in the Working Group for those suggestions. It was agreed that they should be brought to the attention of and addressed in cooperation with Working Group V.

IV. FUTURE WORK

91. The Working Group noted that its second session was scheduled to take place in Vienna from 16 to 20 December 2002 and its third session was scheduled to take place in New York from 3 to 7 March 2003. It was noted that those dates were subject to the approval of the Commission at its upcoming thirty-fifth session, to be held in New York from 17 to 28 June 2002.

B. Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session
(A/CN.9/WG.VI/WP.2 and Add.1-12) [Original: English]

A/CN.9/WG.VI/WP.2

BACKGROUND REMARKS

1. At its thirty-third session, in 2000, the United Nations Commission on International Trade Law (UNCITRAL) considered a report of the Secretary-General on possible future work in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries and in the share such parties had in the benefits of international trade. However, a note of caution was struck in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be coordinated with efforts on insolvency law.¹

2. At its thirty-fourth session, in 2001, the Commission considered a further note by the Secretariat (A/CN.9/496). At that session, the Commission agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macro-economic benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and

international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.²

3. While some concerns were expressed with respect to the feasibility of work in the field of secured credit law, the Commission noted that those concerns were not widely shared and went on to consider the scope of work.³ It was widely felt that work should focus on security interests in goods involved in a commercial activity, including inventory. It was also agreed that securities and intellectual property should not be dealt with as matters of priority. With respect to securities, the Commission noted the interest of the International Institute for the Unification of Private Law (Unidroit). As to intellectual property, it was stated that there was less need for work in that area, the issues were extremely complex and any efforts to address them should be coordinated with other organizations, such as the World Intellectual Property Organization.⁴ As to the form of work, the Commission considered that a model law might be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include, where feasible, model legislative provisions.⁵

4. After discussion, the Commission decided to entrust a working group with the task of developing "an efficient legal regime for security rights in goods involved in a commercial activity, including inventory, to identify the issues to be addressed, such as the form of the instrument, the exact scope of the assets that can serve as collateral ...".⁶ Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry and practice, the Commission recommended that a two- to three-day colloquium should be held.⁷

5. In order to facilitate the work of the Working Group, the Secretariat has prepared, with the assistance of experts, the present first, preliminary draft legislative guide on secured transactions. In terms of scope of work, the draft starts from the working assumption that a guide should have as wide a scope as possible. The justification for this approach lies in one of the key objectives of any secured credit regime, namely the full utilization of assets for the purpose of obtaining credit, which requires a comprehensive regime in terms of assets, obligations and parties covered (see A/CN.9/WG.VI/WP.2/Add.1, para. 11). Modern secured credit regimes take a comprehensive and flexible approach to accommodate common practice in which a

¹Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 459.

²Ibid., Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 351.

³Ibid., paras. 352-354.

⁴Ibid., paras. 354-356.

⁵Ibid., para. 357.

⁶Ibid., para. 358.

⁷Ibid., para. 359.

borrower may utilize whatever asset it has and a lender can take security over any asset, tangible and intangible. This practice reflects the need to provide adequate security to lenders and facilitates access to low-cost credit. It also reflects the difficulty in drawing a clear distinction between tangible and intangible assets.

6. With a view to ensuring that there will be no overlap with the work of other organizations (for example, the Organization of American States, Unidroit or the Hague Conference on Private International Law), the Working Group may wish to consider referring in the guide to securities only in general terms, leaving the details to the legislative texts being prepared by other organizations. The approach followed in the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects with respect to the United Nations Convention on the Assignment of

Receivables in International Trade provides a good example of the harmonious co-existence between a legislative text and a guide.

7. Addenda to this introductory document contain the following draft chapters: I (introduction), II (key objectives of an efficient secured transactions regime), III (basic approaches to security), IV (creation of security rights), V (publicity), VI (publicity via filing), VII (priority), VIII (rights and obligations of parties before default), IX (default and enforcement), X (insolvency), XI (conflict of laws and territorial application) and XII (transition issues). The report of the international colloquium on secured transactions, organized jointly by the UNCITRAL secretariat and the Commercial Finance Association in Vienna from 20 to 22 March 2002, will also be issued as a working paper (A/CN.9/WG.VI/WP.3).

A/CN.9/WG.VI/WP.2/Add.1

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

[Prefatory remarks to be prepared at a later stage]

I. INTRODUCTION

A. Organization and scope

1. The purpose of the present Guide is to assist States in the development of modern secured transactions laws, with the goal of promoting the availability of low-cost secured

credit for commercial enterprises doing business in such States. The Guide is intended to be useful to States that do not currently have efficient and effective secured transactions laws, as well as to States that already have workable laws but wish to review or modernize them or to harmonize or coordinate their laws with those of other States (including through the mutual recognition of security rights validly created in other jurisdictions). The Guide is based on the premise that a sound secured transactions regime can have many benefits for States that adopt it, including attracting credit from domestic as well as from

foreign lenders, promoting the development and growth of domestic businesses and generally promoting trade. Such a regime also can result in benefits for consumers by lowering the cost of goods and services and promoting the availability of low-cost consumer credit.

2. The focus of the Guide is on developing laws that achieve practical economic benefits for States that adopt them. The Guide seeks to rise above differences among legal regimes to suggest pragmatic and proven solutions that can be accepted and implemented in States having divergent legal traditions.

3. All businesses, whether manufacturers, distributors, service providers or retailers, require working capital to operate, to grow and to compete successfully in the marketplace. It is well established, through studies conducted by such organizations as the International Bank for Reconstruction and Development (World Bank), the International Monetary Fund (IMF), the Asian Development Bank (ADB) and the European Bank for Reconstruction and Development (EBRD) that one of the most effective means of providing working capital to commercial enterprises is through secured credit.⁸

4. The key to the effectiveness of secured credit is that it allows borrowers to use the value inherent in their assets as a means of reducing credit risk for the creditor. Risk is mitigated because loans secured by the property of a borrower give lenders recourse to the property in the event of non-payment. Studies have shown that as the risk of non-payment is reduced, the availability of credit increases and the cost of credit falls. Studies have also shown that in States where lenders perceive the risks associated with transactions to be high, the cost of credit increases as lenders require increased compensation to evaluate and assume the increased risk. In some countries, the absence of an effective secured transactions regime has resulted in the virtual elimination of credit for consumers or commercial enterprises.

5. A legal system that supports secured credit transactions is critical to reducing such perceived risks and promoting the availability of secured credit. Studies have shown that secured credit is more readily available to businesses in States that have efficient and effective laws that allow for consistent, predictable outcomes for creditors in the event of non-performance by borrowers.

6. Creating a legal system that promotes secured credit not only aids in the cultivation and growth of individual businesses, but also in the economic prosperity of States as a whole. An inadequate legal system for secured transactions can result in significant losses in gross domestic product. Thus, countries that restrict the breadth or effectiveness of their secured transactions laws may deny themselves a valuable potential economic benefit.

7. Various concerns with respect to secured credit have been voiced. For example, providing a creditor with a

priority claim to a grantor's assets may limit the ability of the grantor to obtain financing from other sources. Additionally, a secured creditor can wield significant influence over a grantor's business, as the creditor may seize, or threaten seizure of, the encumbered asset upon default. To address these issues, the Guide suggests solutions that establish a balance between the interests of debtors, creditors, affected third parties and the State. This requires, among other things, coordination between the secured transactions and insolvency law regimes.

8. The Guide builds on the work of the United Nations Commission on International Trade Law (UNCITRAL) and other organizations. Such work includes the United Nations Convention on the Assignment of Receivables in International Trade, adopted in December 2001; the Convention on International Interests in Mobile Equipment, approved in November 2001; the EBRD Model Law on Secured Transactions, completed in 1994; the EBRD core principles for a secured transactions law, completed in 1997; the study on secured transactions law reform in Asia, prepared by ADB in 2000; the Organization of American States (OAS) Model Inter-American Law on Secured Transactions, prepared in 2002; the Hague Conference draft convention on the law applicable to dispositions of rights in securities and the Unidroit draft convention or model law on security interests in securities.

B. Terminology

9. The present Guide has adopted terminology to express the concepts that underlie a secured transactions regime. The terms used are not drawn from any particular legal system. Even when a particular term appears to be the same as that found in a particular national law, the meaning given the term may differ. The following paragraphs identify the principal terms used and the core meaning given to them in the Guide. The meaning of these terms is further refined when the terms are used in subsequent chapters.

Security right: A "security right" is a consensual right in movable property that secures payment or other performance of one or more obligations.

Secured obligation: The obligation secured by a security right is a "secured obligation".

Secured creditor: A "secured creditor" is a creditor that has a security right. The creditor may be either a physical or a legal person.

Debtor: A "debtor" is a physical or legal person that owes performance of the secured obligation. The debtor may or may not be the person who transfers the security right to a secured creditor (see grantor).

Grantor: A "grantor" is a physical or legal person who creates a security right in favour of a secured creditor. The grantor may or may not be the debtor who owes performance of the secured obligation (see debtor).

Security agreement: A "security agreement" is an agreement between a grantor and a creditor that creates a

⁸See, for example: Asian Development Bank, "Secured transactions law reform in Asia: unleashing the potential of collateral", December 2000.

security right that secures one or more of the debtor's obligations.

Encumbered assets: The movable property subject to a security right is an "encumbered asset". The Guide focuses on security rights in tangible and intangible movable property, including rights to the payment of a monetary sum. Unless otherwise indicated, the Guide does not deal with immovable property. For some purposes the Guide distinguishes between different types of encumbered assets. In general, encumbered assets are divided into tangible and intangible movable property (goods and intangibles, respectively). Each of these two general classes comprises several sub-types.

Goods: The term "goods" includes all forms of tangible movable property. Among the sub-types of goods are inventory, equipment and fixtures.

Inventory: "Inventory" includes not only a stock of goods held for sale or lease in the usual course of business but also raw materials, semi-processed goods and materials used or consumed by a person in the operation of its business.

Equipment: "Equipment" means goods other than inventory used by a person in the operation of its business.

Fixtures: The term "fixtures" means goods that have become or are destined to become so attached to immovable property that an interest in them arises under the law governing immovable property.

Intangibles: The term "intangibles" covers all movable property other than goods [perhaps with the exception of rights embodied in a negotiable instrument]. Among the sub-types of intangibles are claims, receivables and investment property.

Claims: The term "claims" includes both a right to the payment of a monetary sum and a right to the performance of a non-monetary obligation.

Receivables: The term "receivables" means a right to the payment of a monetary sum.

Investment property: "Investment property" includes (a) shares and other interests in enterprises; (b) bonds, debentures and other debt obligations of enterprises; and (c) commodity contracts. Investment property may be in tangible or intangible form. It may be held directly by a debtor or in an account with an intermediary.

Enterprise: An "enterprise" is a business establishment recognized by applicable law as having a separate legal existence. A security right in an enterprise covers all or designated types of movable property owned by the enterprise.

Proceeds: "Proceeds" includes the fruits of encumbered assets and whatever is received on the disposition of encumbered assets. Dividends paid by a company whose shares are held by a secured creditor as a pledge are proceeds, as are the monetary sums received when the shares are sold following the debtor's default.

Priority: The "priority" of a secured creditor refers to the extent to which the secured creditor may derive the economic benefit of its security right in preference to other parties raising a claim in the same property. Rules of priority rank security and other property rights in encumbered assets in the order in which they are to be satisfied.

II. KEY OBJECTIVES OF AN EFFICIENT SECURED TRANSACTIONS REGIME

10. In the spirit of providing practical, effective solutions, the Guide explores and develops the following key objectives and themes of an efficient secured transactions regime:

A. Utilize full value of assets to obtain credit

11. A key to a successful legal regime governing secured transactions is to enable grantors to utilize the value inherent in their property to the maximum extent possible to obtain credit. In order to achieve this objective, the Guide emphasizes the importance of comprehensiveness, by (a) permitting a broad range of assets to serve as encumbered assets (such as receivables, inventory, equipment, intellectual property and other intangibles, and investment property); (b) permitting a broad range of obligations (including future advances under a loan facility and other future obligations) to be secured; and (c) extending the benefits of the regime to a broad array of debtors, creditors and credit transactions.

B. Obtain security in a simple and efficient manner

12. The ability to encumber assets will only reduce the cost of credit if security rights can be obtained in an efficient manner. For this reason, the Guide suggests methods for streamlining the procedures for obtaining security rights and otherwise reducing transaction costs. Such methods include eliminating unnecessary formalities; providing for a single method for creating security rights rather than a multiplicity of security devices; and permitting security rights in after-acquired property without additional actions on the part of the parties.

C. Validate non-possessory security rights

13. Because the granting of a security right should not make it difficult or impossible for the grantor to continue to operate its business, the Guide recommends that the legal regime provide for non-possessory security rights in encumbered assets.

D. Establish clear and predictable priority rules

14. A security right will have little or no value to a creditor unless the creditor is able to ascertain its priority in the property relative to other creditors (including an insolvency administrator for the grantor). Thus, the Guide proposes

clear rules that allow creditors to determine and establish the priority of their security rights at the outset of the transaction in a timely and cost-efficient manner.

E. Facilitate enforcement of creditor's rights in a predictable and timely fashion

15. A security right will also have little or no value to a creditor unless the creditor is able to enforce the security right in a predictable and timely fashion. In addition, the involvement of courts in the enforcement process can be time-consuming. In view of these facts, the Guide proposes rules that allow creditors to enforce their security rights upon the occurrence of a default in a timely, predictable and cost-efficient manner and with an appropriate level of court control.

F. Provide for equal treatment of domestic and non-domestic creditors

16. Because healthy competition among all potential creditors (both domestic and non-domestic) is an effective

way of driving down the cost of credit, the Guide recommends that the regime apply equally to domestic and non-domestic creditors.

G. Recognize party autonomy

17. An effective secured transactions regime should provide maximum flexibility and durability to encompass a broad array of credit transactions and also accommodate new and evolving forms of credit transactions. In order to achieve this goal, the Guide stresses the importance of party autonomy, while at the same time protecting the legitimate interests of all parties (especially consumers).

H. Encourage responsible behaviour by enhancing transparency

18. Because an effective secured transactions regime should also encourage responsible behaviour by all parties to a credit transaction, the Guide seeks to promote transparency to enable the parties to assess all relevant legal issues and to establish appropriate consequences for non-compliance with applicable rules.

A/CN.9/WG.VI/WP.2/Add.2

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

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Draft legislative guide on secured transactions

I. INTRODUCTION

[The following text is to be added to the Guide as section C of chapter I]

C. Examples of financing practices to be covered in the Guide

1. Set forth below are three short examples of the types of secured credit transactions that the present Guide is designed to encourage and to which reference will be made

throughout the Guide to illustrate specific points. These examples represent only a few of the numerous forms of secured credit transactions currently in use and an effective secured transactions regime must be sufficiently flexible to accommodate many existing modes of financing, as well as modes that may evolve in the future.

[Note to the Working Group: In order to avoid distracting the reader with an overly complex discussion, only a few limited examples of the most basic and common transactions are given. The Working Group may wish to consider whether this discussion should be expanded to some of the more complex transactions such as project finance and securitization.]

1. Inventory and equipment purchase-money financing

2. Businesses often desire to finance specific purchases of inventory or equipment. In many cases, the financing is provided by the seller of the goods. In other cases, the financing is provided by a lender instead of the seller. Sometimes the lender is an independent third party, but in other cases the lender may be an affiliate of the seller.

3. This type of financing is often referred to as “purchase-money financing” and occurs in a number of different legal forms. In many States, the seller retains title to the goods sold until the credit is paid in full. These types of transactions are generally referred to as retention of title arrangements or conditional sales agreements (see also A/CN.9/WP.2/Add.3, paras. 31-39). In other States, the seller or lender is granted a security right in the goods sold to secure the repayment of the credit or loan.

4. An example of “purchase money financing” follows: Agrico is a manufacturer and distributor of agricultural equipment with facilities located in State X and customers located in multiple States. Agrico desires to purchase 10,000 units of paint from Vendor A and 5,000 wheels from Vendor B and to lease certain manufacturing equipment from Lessor A, all of which will be used by Agrico in manufacturing certain types of agricultural equipment.

5. Under the purchase agreement with Vendor A, Agrico is required to pay the purchase price for the paint within 30 days of delivery to Agrico and Vendor A retains title to the units until Agrico pays the purchase price in full.

6. Under the purchase agreement with Vendor B, Agrico is required to pay the purchase price for the wheels before they are delivered to Agrico. Agrico obtains a loan from Lender A to finance the purchase of the wheels from Vendor B. The loan is secured by the wheels being purchased.

7. Under the lease agreement with Lessor A, Agrico leases the manufacturing equipment from Lessor A for a period of two years. Agrico is required to make monthly lease payments during the lease term. Agrico has the option to purchase the manufacturing equipment for a nominal purchase price at the end of the lease term. Lessor A retains title to the manufacturing equipment during the lease term. Title will transfer to Agrico at the end of the lease term if Agrico exercises the purchase option.

2. Receivable and inventory revolving-loan financing

8. Businesses generally have to expend capital before they are able to generate and collect revenues. For example, before a typical manufacturer can generate receivables and collect payments, the manufacturer must expend capital to purchase raw materials, to convert the raw materials into finished goods and to sell the finished goods. Depending on the type of business, this process may take up to several months. Access to working capital is critical to bridge the period between cash expenditures and revenue collections.

9. One highly effective method of providing such working capital is a revolving loan facility. Under this type of facility, loans secured by the borrower’s existing and future receivables and inventory are made from time to time at the request of the borrower to fund the borrower’s working capital needs (see also A/CN.9/WG.VI/WP.2/Add.4, para. 13). The borrower typically requests loans when it needs to purchase and manufacture inventory and repays the loans when the inventory is sold and the sales price is collected. Because the revolving loan structure matches borrowings to the borrower’s cash conversion cycle (that is, acquiring inventory, selling inventory, creating receivables, receiving payment and acquiring more inventory to begin the cycle again), this structure is, from an economic standpoint, highly efficient and beneficial to the borrower.

10. An example of this type of financing follows: Agrico is a manufacturer and distributor of agricultural equipment with facilities located in State X and customers located in multiple States. It typically takes four months for Agrico to manufacture, sell and collect the sales price for its products. Lender B agrees to provide a revolving line of credit to Agrico to finance this process. Under the line of credit, Agrico may obtain loans from time to time in an aggregate amount of up to 80 per cent of the value of its receivables and of up to 50 per cent of the value of its inventory. Agrico is expected to repay these loans from time to time as it receives payments from its customers. The line of credit is secured by all of Agrico’s existing and future receivables and inventory.

3. Term-loan financing

11. Businesses often need to obtain financing for large, non-ordinary course of business expenditures, such as the construction of a new manufacturing plant. In these situations, businesses often seek financing that is not repayable until long after construction is completed. This type of facility is typically referred to as a term loan. In many cases, a term loan is amortized in accordance with an agreed-upon payment schedule, while in other cases the principal balance may be repayable in full at the end of the term.

12. For businesses that do not have strong, well-established credit ratings, term-loan financing will typically only be available to the extent that the business is able to grant security rights in assets to secure the financing. The amount of the financing will be based in part on the creditor’s estimated net realizable value of the assets securing the financing. In many States, real property is the only type of asset that generally secures term-loan financing. However, many businesses, particularly newly established businesses, do not own any real property and, therefore, may not have access to term-loan financing. In other States, term loans secured by other assets, such as equipment and even intellectual property, are common.

13. An example of this type of financing follows: Agrico is a manufacturer and distributor of agricultural equipment with facilities located in State X and customers located in multiple States. Agrico desires to expand its operations and construct a new manufacturing plant in State Y. Agrico

obtains a loan from Lender C to finance such construction. The loan is repayable in equal monthly instalments over a period of ten years. The loan is secured by the new

manufacturing plant, including all equipment located in the plant at the time of the conclusion of the financing contract and thereafter.

A/CN.9/WG.VI/WP.2/Add.3

**Report of the Secretary-General on the draft legislative guide
on secured transactions, working paper submitted to the
Working Group on Security Interests at its first session**

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Draft legislative guide on secured transactions

III. BASIC APPROACHES TO SECURITY

A. General remarks

1. Introduction

1. Over time, a broad variety of practices have been developed in different countries to secure a creditor's claims (usually for monetary payment) against its debtor. The present Guide focuses on the core practices that, in many countries, have proved to be particularly efficient (that is, the contractual creation of a property right).

2. In a general sense, it is possible to distinguish three major types of instruments that are used for the purposes of security. These are, first, instruments designed for and openly denominated as security (see sect. A.2 below); second, the recourse to title (ownership) for purposes of security combined with various types of contractual arrangements (see sect. A.3 below); and, third, a uniform comprehensive security (see sect. A.4 below).

2. Instruments traditionally designed for security

(a) Security rights in tangible movable property

3. Traditionally, most countries distinguish between proprietary security rights in tangible movable property ("tangibles"; covered in the present section) and those in intangible movable property ("intangibles"; see sect. A.2. (ii) (b) below). In fact, the tangible nature of an asset gives rise to forms of security that are not available for intangibles.

4. Within the group of security rights in tangibles, most countries draw a distinction based on whether the debtor (or a third party) granting the security can retain possession or not. The first alternative is traditionally designated as possessory security and the second alternative as non-possessory security.

(i) Possessory security

a. Pledge

5. By far the most common, and also ancient, form of possessory security in tangibles is the pledge. A pledge

requires for its validity that the debtor (or a third-party grantor) effectively give up possession of the encumbered tangibles and that these be transferred either to the secured creditor or to a third party agreed upon by the parties (for example, a warehouse). The required dispossession of the debtor (or other grantor) must not only occur at the creation of the security right but it must be maintained during the life of the pledge; return of the encumbered assets to the debtor usually extinguishes the pledge.

6. Dispossession need not always require physical removal of the encumbered assets from the debtor's premises, provided that the debtor's access to them is excluded in other ways. This can be achieved, for example, by handing over the keys to the rooms in which the encumbered assets are stored to the secured creditor, provided that this excludes any unauthorized access by the debtor.

7. The debtor's dispossession can also be effected by delivering the encumbered assets to, or by using assets that are already held by, a third party. Examples are merchandise or raw materials stored in a warehouse or a tank of a third party. An institutional (and more expensive) arrangement may be to involve an independent "warehousing" company, which exercises control over the pledged assets as agent for the secured creditor. For this arrangement to be valid, there cannot be any unauthorized access by the debtor to the rooms in which the pledged assets are stored. In addition, the warehousing company's employees must not work for the debtor (if they are drawn from the debtor's workforce, because of their expertise, they may no longer work for the debtor).

8. In the case of assets of a special nature, such as documents and instruments (whether or not negotiable), that embody rights in tangible assets (for example, bills of lading or warehouse receipts) or intangible rights (for example, negotiable instruments, bonds or share certificates), dispossession is effected by transferring the documents or instruments to the secured creditor. However, in this context, the line between possessory and non-possessory security may not always be easy to draw.

9. In view of the debtor's dispossession, the possessory pledge presents three important advantages for the secured creditor. First, the debtor is unable to dispose of the pledged assets without the secured creditor's consent. Second, the creditor does not run the risk that the actual value of the encumbered assets will be reduced through the debtor neglecting upkeep and maintenance. Third, if enforcement becomes necessary, the secured creditor is saved the trouble, time, expense and risk of having to claim delivery of the encumbered assets from the debtor.

10. On the other hand, the possessory pledge has certain disadvantages. The greatest disadvantage for the debtor is the required dispossession, which precludes the debtor from using the encumbered assets. Dispossession is particularly troublesome in situations where possession of the encumbered assets is necessary for the debtor to generate the income from which to repay the loan (as is the case, for example, with raw materials, semi-finished goods, equipment and inventory).

11. For the secured creditor, the possessory pledge has the disadvantage that the secured creditor has to store, preserve and maintain the encumbered assets, unless a third party assumes this task. Where secured creditors themselves are neither able nor willing to assume these charges, entrusting third parties will involve additional costs that will be directly or indirectly borne by the debtor. Another disadvantage is the potential liability of the secured creditor in possession of encumbered assets (for example, pledgee, holder of a warehouse warrant or a bill of lading) that might have caused a damage. This is a particularly serious problem in the case of liability for contamination of the environment, since often the monetary consequences (clean-up, damages) substantially exceed the value of the encumbered asset, let alone the prejudice to the reputation and image of the lender. Very few laws address environmental liability of secured creditors in possession. Some of them set it aside (see, for example, the Swedish Environmental Code of 11 June 1998, whose basic exemption principle was subsequently adopted by the European Commission in its white paper on environmental liability of 9 February 2000). Other laws limit the liability under certain conditions (for example, the Comprehensive Environmental Response, Compensation, and Liability Act of the United States of America, as amended).

12. However, where the parties are able to avoid the aforementioned disadvantages, the possessory pledge can be utilized successfully. There are two major fields of application. First, where the encumbered assets are already held by or can easily be brought into the possession of a third party, especially a commercial keeper of other persons' assets. The second field of application is where instruments and documents, embodying tangible assets or intangible rights, can be easily kept by the secured creditor itself (such situations are addressed by special laws).

b. Right of retention

13. A right of retention is a contractual (not a property) right. It allows a party whose contractual partner is in breach of contract to withhold its own performance and, in particular, an asset that, under the terms of the contract, the withholding party is obliged to deliver to the party in breach. For example, a repair shop need not return a repaired item to the customer if the latter, contrary to their agreement, does not pay the price agreed upon.

14. If, however, a contractual right of retention is reinforced by the power to sell the retained item, the party entitled to retention obtains a property right in the retained asset. In some legal systems, this property right is regarded as a pledge, although the method of its creation deviates from that of the pledge proper (see paras. 5-8 above). Alternatively, a reinforced right of retention may be regarded as having some of the effects of a pledge.

(ii) Non-possessory security

15. As noted above (see para. 10), a possessory pledge of tangibles required for production or sale (such as equipment, raw materials, semi-finished goods and inventory) is economically impractical. These goods are necessary for

the entrepreneurial activity of commercial debtors. Without access to, and the right and power of disposition over those assets, the debtor would not be able to earn the income necessary to repay the loan. This problem is particularly acute for the growing number of commercial debtors who do not own immovables that can be used as security.

16. To address this problem, laws, especially in the last 50 years, began providing for security in movable assets outside the narrow confines of the possessory pledge. While some countries introduced a new, functional security right, most countries, historically, insisted on the “pledge principle” as the only legitimate method of creating security in movable assets. The English common law “charge” was for some time the only genuine non-possessory security. In the twentieth century, legislators and courts have come to acknowledge the economic need to provide security without recourse to the possessory pledge.

17. Individual countries attempted to find appropriate solutions according to particular local needs and taste. The result is a diverse range of solutions. An external indication of the existing diversity is the variety of names for the relevant institutions, sometimes differing even within a single country, such as “fictive” dispossession of the debtor; non-possessory pledge; registered pledge; *nantissement*; warrant; *hypothec*; bill of sale; chattel mortgage; trust; etc. More relevant is the limited scope of application of the approaches taken. Only a few countries have enacted a general statute on non-possessory security (for a more comprehensive approach, see sect. A.4 below). Some countries have two sets of legislation, one dealing with security for financing of industrial and artisanal enterprises, the other with security for financing of farming and fishing enterprises. In most countries, however, there is a variety of statutes covering only small economic sectors, such as the acquisition of cars or of machinery or the production of films.

18. In some countries, there is even some reluctance to allow security rights in inventory. This is sometimes based on an alleged inconsistency between the creditor’s security right and the debtor’s right and power to sell. Another objection is that the disposition of inventory will often give rise to difficult conflicts between multiple transferees or multiple secured creditors. Yet another possible objection may come from a policy choice to make inventory available for the satisfaction of the claims of the debtor’s unsecured creditors.

19. Varied as the legislation providing for non-possessory security might be, it shares one common feature, namely that some form of publicity of the security right is usually provided for. The purpose of publicity is to dispel the false impression of wealth, which may be given by the fact that the security right in assets held by the debtor is not apparent (“secrecy”; for details, see chap. V, Publicity).

20. There appears to be a need to bridge the gap between the general economic demand for security in commercial assets that are and must be held by the debtor with the often limited access to such security. A major purpose of legal reform in the area of non-possessory security in general

and of the present Guide in particular is to develop suggestions for improvement in this special field and in the related field of security in intangibles (see sect. A.2 (b) below).

21. While modern regimes have shown that difficulties can be overcome, legislation on non-possessory security is more complicated than the regulation of the traditional possessory pledge. This is due mainly to the following four main characteristics of non-possessory security rights. First, since the debtor retains possession, it has the power to dispose of or create a competing right in the encumbered assets, even against the secured creditor’s will. This situation makes necessary the introduction of rules concerning the effects and priority of such dispositions (see chap. VII, Priority). Second, the secured creditor must ensure that the debtor in possession takes proper care of, duly insures and protects the encumbered assets to preserve their commercial value. This makes it necessary for the secured creditor to address these matters in the security agreement with the debtor (see chap. VIII, Pre-default rights and obligations of the parties). Third, if enforcement of the security becomes necessary, the secured creditor will often prefer to obtain the encumbered assets. However, if the debtor is not willing to part with those assets, court proceedings may have to be instituted. Proper remedies and possibly accelerated proceedings may have to be provided for (see chaps. IX, Default and enforcement, and X, Insolvency). Fourth, the appearance of false wealth in the debtor that is created by secret security rights in assets held by the debtor may have to be counteracted, where it is felt necessary, by various forms of publicity (see chaps. V, Publicity, and VI, Filing system).

22. In view of earlier legislative models (see paras. 16-19), legislators may be faced with three alternatives. One alternative may be to adopt uniform legislation for both possessory and non-possessory security rights (see sect. A.4 below). Another alternative may be to adopt uniform legislation for non-possessory security rights, leaving the regime on possessory rights to other domestic law (see Model Law of the Organization of American States; see also para. 40 below). Yet another alternative may be to adopt special legislation allowing non-possessory security for credit to debtors in specific branches of business. The prevailing trend of modern legislation, both at the national and the international level, is towards a uniform approach at least as far as non-possessory security is concerned. A selective approach is likely to result in gaps and inconsistencies, as well as in discontent in those sectors of the industry that might be excluded.

(b) *Security rights in intangible movable property*

23. Intangibles comprise a broad variety of rights (for example, right to the payment of money or the performance of other contractual obligations, such as the delivery of oil under a production contract). They include some relatively new types of asset (for example, securities, certificated or uncertificated, held directly by the owner or through an intermediary). Intellectual property rights (that is, patents, trade marks and copyright) form another group of intangibles. In view of the dramatic increase in the economic importance of intangibles in recent years, there is a growing demand to use these rights as assets for security. Even

in inventory or equipment financing transactions, security is taken in inventory- or equipment-related intellectual property rights and often the main value of the security is in those rights.

24. By definition, intangibles are incapable of (physical) possession. Nevertheless, most codes of the so-called “civil law” countries have dealt with the creation of possessory pledges (see paras. 5-12 above) at least in monetary claims. Some codes have attempted to create the semblance of dispossession by requiring the debtor to transfer any writing or document relating to the pledged claim (such as the contract from which the claim was derived) to the creditor. However, such transfer does not suffice to constitute the pledge. Rather, the debtor’s “dispossession” is usually (quite artificially) replaced by requiring that a notice of the pledge be given to the debtor of the pledged claim.

25. In some countries, techniques have been developed that achieve ends that are comparable to those attained by the possession of tangibles. The most radical method is the full transfer of the encumbered right (or the encumbered share of it) to the secured creditor. However, this goes beyond creation of a security right and amounts to transfer of title (see sect. A.3 (a) below). Under a more restrained approach, title to the encumbered rights is not affected but dispositions by the debtor that are not authorized by the secured creditor are blocked. This technique can be used where a person other than the person owing the performance in which the secured creditor’s right is created (the third-party debtor) has the power to dispose of the encumbered right. In the case of a bank account, if the debtor as holder of the account agrees that its account can be blocked in favour of the secured creditor, the latter has the equivalent of possession of a tangible movable. That is even more true if the bank itself is the secured creditor.

26. In modern terminology, such techniques of obtaining “possession” of intangible property are appropriately called “control”. The degree of control though may vary. In some cases, the control is absolute and any disposition by the debtor is prevented. In other cases, the debtor is allowed to make certain dispositions or dispositions up to a fixed maximum, as long as the secured creditor has access to the account. Control may be a condition for the validity of a security right (see A/CN.9/WG.VI/WP.2/Add.4, para. 54) or priority (see A/CN.9/WG.VI/WP.2/Add.7, para. 11).

3. *The use of title for security purposes*

27. In addition to instruments for security proper (see sect. A.2 above), practice and sometimes also legislation has in many countries developed an alternative approach for non-possessory security rights in both tangible and intangible assets, namely title (or ownership) as security (*propriété sûreté*). Title as security can be created either by transfer of title to the creditor (see sect. A.3 (a) below) or by retention of title by the creditor (see sect. A.3 (b) below). Both transfer and retention of title enable the creditor to obtain non-possessory security (for the economic need for, and justification of, non-possessory security, see para. 15 above).

(a) *Transfer of title to the creditor*

28. There are two features that make the security transfer of title attractive for creditors in certain jurisdictions. First, the requirements for transferring title to another person are often less demanding than the requirements for creating a security right. Second, in the case of enforcement and in the case of the debtor’s insolvency, a creditor often has a better position as an owner than as a holder of a mere security right. In other jurisdictions, there is no difference between title for security purposes and security rights with respect to the requirements for creation or enforcement.

29. The security transfer of title has been allowed by law in some countries and by court practice in other countries. In many other countries, especially from the civil law world, such transfers of title are regarded as a circumvention of their ordinary regime of security instruments proper and are therefore held to be void. Some jurisdictions compromise by reducing the effect of a security transfer of title to that of an ordinary secured creditor, especially where it competes with other creditors of the debtor.

30. Legislators are faced with two policy options. One option is to admit security transfers of title with the (usually) reduced requirements and the greater effects of a full transfer, thus avoiding the general regime for security rights. The other option is to admit security transfers of title, but to limit either the requirements or the effects or both to those of a mere security right. The first option may result in enhancing the secured creditor’s position, while weakening the position of the debtor and the debtor’s other creditors. This solution may make sense if the ordinary security regime for non-possessory security is underdeveloped. Under the second option, a graduated reduction of the secured creditor’s advantages and of the other parties’ corresponding disadvantages is possible, especially if the requirements of a transfer or its effects or both are limited to those relating to a security right. Any variant of this solution also may make sense to counter specific weaknesses of the ordinary regime for non-possessory security.

(b) *Retention of title by the creditor*

31. The second way of using title as security is by contractual retention of title (reservation of ownership). The seller or other lender of the money necessary to purchase tangible or even intangible assets may retain title until the full payment of the purchase price. This type of transaction is often called “purchase-money financing” (see description and example in A/CN.9/WG.VI/WP.2/Add.2, paras. 3-5).

32. A variation of a retention of title arrangement (or purchase-money financing) is achieved by combining a lease contract with an option to purchase for the lessee (for a nominal value), which may only be exercised after the lessee has paid most of the “purchase price” through rent instalments (see example in A/CN.9/WG.VI/WP.2/Add.2, para. 7). In some cases, where the lease covers the useful life of, for example, equipment, it is a retention of title arrangement even without an option to buy.

33. Economically, a retention of title arrangement provides a security right that is particularly well adapted to the

needs of, and therefore is widely used by, sellers for securing purchase-money credit. In many countries, this kind of credit is widely used as an alternative to bank financing that is not purchase-money financing. A bank may provide purchase-money financing, for example, where the seller sells to a bank and the bank sells to buyer with a retention of title or where the buyer pays the seller in cash from a loan and gives to the bank title as security for the loan. For the promotion of competition, this source of credit and its attendant specific security deserve special attention.

34. Owing to its origin as a term of a contract of sale or lease, many countries regard the retention of title arrangement as a mere quasi-security, and, therefore, not subject to the general rules on security, such as requirements of form, publicity or effects (principally priority). Contrary to the transfer of title, its retention by the creditor has, in many countries, a privileged status. This may be justified by the desire to promote purchase-money financing by suppliers as an alternative to bank credit that is not purchase-money financing. Another argument often used, but less convincing, is that the seller, by parting with the sold goods without having received payment, requires protection.

35. In contrast, a number of jurisdictions do not recognize or even prohibit retention of title clauses. Other countries restrict the scope of application of such clauses by denying them effect with respect to certain assets, especially inventory, on the theory that the seller's retention of title is incompatible with the seller granting to the buyer the right and power of disposition over the inventory.

36. Several policy options may be considered. One option is to preserve the special character of the retention of title arrangement as title device. Another option might be to limit the effect of the retention of title arrangement to only the purchase price of the respective asset to the exclusion of any other credit; and/or to the purchased asset to the exclusion of proceeds or products. Yet another option might be to integrate the retention of title arrangement into the ordinary system of security rights. In such a case, certain advantages should be granted to the seller-creditor. Yet another option might be to place the retention of title fully on a par with any other non-possessory security.

37. The first two options would preserve or even create a special regime outside a comprehensive system of non-possessory security rights. In particular, the first option provides the seller-creditor with extensive privileges, a result that has consequential disadvantages for competing creditors of the buyer, especially in the case of execution and insolvency. A technical disadvantage of the title approach is that it prevents the buyer from using the purchased assets for granting a second-ranking security to another creditor. Another disadvantage of the title approach is that executions by the buyer's other creditors are impossible or difficult without the seller's consent.

38. The last two options mentioned above (see para. 36) are more in line with a comprehensive system of security rights. These options accept that the seller extending credit deserves a certain privileged position since it parts with the sold goods on credit and purchase-money credit should be promoted for economic reasons. On the other hand, in the

interest of competing creditors, the privilege is limited to the purchase price for the specific asset and to the sold goods as such. By contrast, rights in proceeds or products of the purchased goods do not enjoy such a privilege and are subject to the rules applicable to ordinary security rights.

39. Conversion of retention of title to a security right would enhance the position of the buyer-debtor since it would be enabled to create a second-ranking (non-possessory) security right to secure a loan from another creditor. It would also improve the position of other creditors of the buyer-debtor in the case of execution with respect to the encumbered asset and in the case of the debtor's insolvency.

4. *Uniform comprehensive security*

40. The idea of a single, uniform, comprehensive security right was first developed in the United States of America in the middle of the twentieth century in the context of the Uniform Commercial Code. The Uniform Commercial Code, a model law adopted by all 50 states, created a single, comprehensive security right. Article 9 of the Code unified numerous and diverse possessory and non-possessory rights in tangibles and intangibles, including transfer and retention of title arrangements, which existed under state statutes and common law. The idea spread to Canada and New Zealand and has been adopted by a few countries in Europe. It is recommended in the Model Law on Secured Transactions of the European Bank for Reconstruction and Development. The Model Inter-American Law on Secured Transactions of the Organization of American States, which follows in many respects a similar approach, is restricted to non-possessory security, leaving possessory security to state law in view of the division of legislative powers in federal States.⁹

41. The main feature of a broad, all-comprehensive approach is that it merges the rules for the traditional possessory pledge with rules on non-possessory pledges and on the transfer or retention of title for security purposes. This approach results in the creation of a single, comprehensive and consistent system of security rights that avoids gaps and inconsistencies. The policies underlying the basic approach and the contents of the individual provisions implementing it can freely be determined by each legislature. For example, within this unitary system, special interests may be addressed by means of priority rules (for example, for purchase-money security).

B. Summary and recommendations

42. In certain, albeit limited, practical situations, the possessory pledge functions usefully as a strong security right.

⁹In States such as Argentina, Brazil and Mexico only the provinces have the legislative power to enact law on possessory pledges.

43. A contractual right of retention, if accompanied by the creditor's power of sale, functions as a possessory pledge (see para. 14).

[Note to the Working Group: The Working Group may wish to consider subjecting such a contractual right of retention to the same rules that govern possessory pledges, perhaps with the exception, at least in some cases, of the rules governing the creation of such rights of retention.]

44. Non-possessory security rights are of utmost importance for a modern and efficient regime governing secured transactions. Debtors need to retain possession of encumbered assets and secured creditors need to be protected against competing claims in the case of debtor default and, in particular, insolvency (see para. 15).

[Note to the Working Group: The Working Group may wish to consider whether such a regime should govern both possessory and non-possessory security rights or only non-possessory security rights (see para. 22).]

45. In light of the growing importance of intangibles as security for credit and the often insufficient rules applicable to this type of security, it would be desirable to develop a modern legal regime for intangibles (see para. 23).

[Note to the Working Group: To ensure consistency, the Working Group may wish to consider that a regime for security rights in intangibles should be as close as possible to that for non-possessory security in tangibles.]

The Working Group may also wish to discuss the recommendations to be made in the Guide with respect to

intangibles and particular types of intangibles, such as securities and intellectual property rights and receivables arising therefrom. In its discussion of this matter, the Working Group may wish to take into account the work of other organizations; the fact that intangibles may be taken as security in the context of transactions relating to security in tangibles (for example, inventory or equipment financing); and the complexity and feasibility of a regime on security interests in intangibles.

In addition, the Working Group may wish to consider whether the transfer of title for security purposes is useful and should be retained in an efficient and effective system of non-possessory security in tangible and intangible assets (see para. 30). The Working Group may also wish to consider whether retention of title should be treated as a title or a security device (see paras. 36 and 37).

If the Working Group decides to treat retention of title as a security device, it may wish to confer upon the seller-creditor or other purchase-money credit provider a special priority equivalent to that of a holder of title. Such a special priority could be limited to the sold asset and to its outstanding purchase price (to the exclusion of proceeds and other credits (see para. 38)). The Working Group may also wish to consider that treating the retention of title as equivalent to an "ordinary" security right should not prejudice its qualification for other purposes (for example, taxation, accounting, etc.).

Moreover, the Working Group may wish to consider the advantages and disadvantages of the approach taken in several modern security laws that introduce a uniform comprehensive security right (see paras. 40 and 41).]

A/CN.9/WG.VI/WP.2/Add.4

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

IV. CREATION

A. General remarks

1. Introduction

1. As the present Guide deals almost exclusively with contractual security rights (statutory or judicial security rights are only marginally mentioned, for example, in the context of conflicts of priority, see chap. XI), the present chapter outlines the contractual basis for creating a security right. As a contract alone is usually not sufficient to create an effective security right, the chapter also discusses the additional requirements (that is, transfer of possession, publicity or control). Before discussing the security agreement (see sect. A.3 below) and the additional requirements for the creation of an effective security right (see sect. A.4 below), the Guide outlines the two basic elements of both, namely the obligations to be secured (see sect. A.2 (a) below) and the assets to be encumbered (see sect. A.2 (b) below).

2. As distinct from ownership, which, in principle, does not allow ranking of several owners, no such monopoly exists for security rights. Several security rights in one asset can be ranked and therefore can co-exist. Admitting the co-existence of several security rights in the same asset enables the grantor to make full use of the economic value of the asset. Such co-existence is made possible by ranking the security rights according to the time an act is completed (for example, creation, publicity or control; for the conditions and effects of ranking, see chap. VII).

3. Even if a security right has been validly created, it may nevertheless fail to fulfil its most important function, namely, to ensure a preference to the secured creditor in the debtor's insolvency. This may occur, for example, where the creation of the security right contravenes provisions of insolvency law on the invalidity of dispositions of the debtor in the suspect period preceding the opening of an insolvency proceeding (for details, see chap. X).

2. Basic elements of a security right

4. Normally, the security is accessory to the secured obligation. This means that the validity and the terms of the security depend on the validity and the terms of the secured

obligation. In particular, the terms of the security cannot surpass the terms of the secured obligation (but they may be reduced if the parties agree). This principle has been somewhat restricted in order to accommodate modern financing practices that require the security to be somewhat independent of the secured obligation (for example, revolving credit transactions). However, it is still one of the main principles of secured credit law.

(a) Obligations to be secured

(i) Limitations

5. In countries with legislation only on specific types of non-possessory security, secured obligations are limited to those described in such legislation (for example, loans for the purchase of automobiles or loans to farmers).

6. No such limitations exist in countries with a general regime for possessory only, or also for non-possessory, security rights. However, even within a regime of unified rules some functional distinctions may be necessary for practical reasons (for example, to give priority to claims for purchase money).

7. In the interest of consistency and equal treatment of all debtors and secured creditors, functional distinctions of secured obligations should be avoided, if possible. Such special regimes should only be introduced or maintained where, for special reasons (especially social protection or grave economic imbalance), a protective regime is thought to be necessary. In any case, where necessary, special regimes should be specifically established by national legislators and not be prescribed for a broad variety of obligations.

(ii) Varieties of obligations

a. Monetary and non-monetary obligations

8. Like most national laws, the present Guide proceeds on the assumption that, in practice, the most important type of secured obligations are monetary obligations. There are, however, also cases where there is a demand to secure performance of non-monetary obligations (for example, for delivery of goods). This is accepted in many jurisdictions, provided that the secured non-monetary obligations can be converted by the time of enforcement into monetary obligations.

b. Type of the monetary obligation

9. From a legislative point of view, an exhaustive listing of the potential sources of monetary obligations that can be secured is impossible. In addition, it is unnecessary, since the legal source is irrelevant for the purposes of security, unless there is a special regime (for example, for loans by pawnbrokers). An indicative list of such monetary obligations would typically include obligations from loans and the purchase of goods on credit.

c. Future obligations

10. Securing present obligations, that is, obligations that have arisen before or at the same time when the security right is created, does not pose particular problems. Securing future obligations, that is, those arising after creation of the security right, while potentially giving rise to certain questions, is of great economic importance (for example, for revolving loan transactions; see A/CN.9/WP.2/Add.2, paras. 8-10). It would be a significant burden on business practice if each prolongation or increase of credit would require the corresponding security to be modified or even newly created.

11. For this reason, many jurisdictions recognize security for future obligations. The potential inconsistency with the principle of the accessory character of security rights (according to which the validity and terms of the security right depend on the validity and the terms of the secured obligation) is more apparent than real, since, while the security is created before, it does not have any effect until the secured obligation actually arises. In some jurisdictions, limits on future obligations are introduced in the interest of protecting the debtor. As a result, it may not be possible for the debtor to benefit from transactions, such as those relating to revolving-loan facilities.

12. Obligations subject to a condition subsequent are present obligations and, therefore, do not raise particular issues. Obligations subject to a condition precedent are normally treated like future obligations (see paras. 10 and 11 above).

d. One, several or all obligations/maximum amount

13. In some legal systems, there is a need to describe or set a maximum limit to the secured obligation. The assumption is that such a description or limit is in the interest of the debtor. However, such requirements may inadvertently result in limiting the amount of credit available or in increasing the cost of credit. This is the main reason why modern legal systems do not require specific descriptions and allow "all sums" clauses or, at least, do not set maximum limits for secured obligations (see paras. 14 and 16 below). The secured creditor cannot claim more than it is owed and, if the obligation is fully secured, better credit terms are likely to be offered to the debtor.

e. Fluctuating amount of obligation

14. As noted above (see para. 10), modern financing transactions no longer involve a one-time payment but frequently foresee advances being made at different points of

time depending on the needs of the debtor. Such financing may be conducted by a current account, the balance of which fluctuates daily. If the amount of the secured obligation were to be reduced by each payment made (in line with the principle of the accessory nature of security), lenders would be discouraged to make further advances unless they were granted additional security. This result could be avoided by a reasonable interpretation of the parties' intention, which would be to determine the amount of the secured obligation by the (fluctuating) amount of the balance of the current account, without regard to any intermediate lower maximum amount.

f. Foreign currency

15. The amount of the secured obligation may be expressed in any currency. Occasionally, difficulties of conversion into the currency of the place of payment, execution or insolvency may arise. This matter may be left to the agreement of the parties, which should be in line with the relevant laws.

(iii) Description

16. A specific description of each secured obligation is usually not necessary (see para. 13 above). However, the secured obligations and their amounts must be determined or determinable whenever a determination is needed (for example, upon enforcement by the secured creditor or upon execution by another creditor of the debtor) on the basis of the security agreement.

(b) Assets to be encumbered

(i) Limitations

17. As in the case of special regimes for certain types of secured obligations (see para. 5 above), special laws for specific types of non-possessory security rights may introduce limitations as to the types of asset that may serve as security. Assets that may not be encumbered are, for example, wages, pensions and essential household goods (except as security for obligations to pay their purchase price).

18. In the absence of a public policy reason for such regimes, it should be possible to create a security right in all types of asset, tangible or intangible, including rights to payment or other performance. Even monetary claims of the debtor against the secured creditor should be able to serve as security.

(ii) Future (including after-acquired) assets

19. The issue of whether future assets may be encumbered is of great practical importance. The term "future" is given a broad meaning. It covers assets that already exist at the time of the conclusion of the security agreement but do not belong to the debtor (or the debtor cannot dispose of them). It also covers assets that, at that point of time, do not even exist.

20. In some countries, the parties may agree to create a security right in a future asset of the debtor. The disposition is a present one but it becomes effective only when the debtor becomes the owner of the asset or becomes otherwise entitled to dispose of it. The United Nations Convention on the Assignment of Receivables in International Trade, adopted by the General Assembly on 12 December 2001, (“the Assignment Convention”) takes this approach (see art. 8, para. 2, and art. 2, subpara. a).

21. This is important, in particular, for revolving loan transactions (see para. 10 above). Assets to which this technique is typically applied are inventory, which by its nature is to be sold and replaced, and receivables, which after collection are replaced by new receivables. The main advantage of this approach is that one security agreement suffices to create a security in a succession of assets that fit the description in the security agreement. Otherwise, successive acts of creating new security rights would be necessary, a result that would increase the cost of the transaction. The same technique can also be applied if the security is to be fixed in an individual asset to be produced by the debtor or to be acquired by the debtor from another person.

22. In contrast, many other jurisdictions do not allow the creation of security in future assets. This is partly based on technical notions of property law. Another reason is the concern that allowing broad dispositions of future assets may excessively burden the debtor’s property, preventing the debtor from obtaining additional secured credit from other sources (see para. 26 below). Furthermore, the likelihood of unsecured creditors of the debtor obtaining satisfaction for their claims may be significantly reduced.

23. A proper balancing of the various interests may be difficult to achieve, in particular if the legal regime also covers non-commercial transactions. In a business context, it may be excessive to bar the charging of future assets of the debtor altogether because of possible, but uncertain, negative consequences in the future. It may be preferable to impose limitations only if, and when, dire consequences are likely to occur (for example, in cases of conflicts with unsecured creditors). Any dilemma of this type may best be resolved, if and when it occurs, as an issue of priority (see chap. VII).

(iii) *Assets not specifically identified*

24. Some types of asset, especially equipment, are stable and not subject to frequent dispositions and replacement. They can therefore be individually described and identified. This is not possible for other types of asset, especially inventory and, to some degree, receivables. For these (and other comparable) situations, many countries have developed rules that enable the parties to identify contractually the assets to be encumbered as a prerequisite for a valid disposition, even though the individual elements change (they are disposed of and regularly replaced). The specific identification, generally required, is transposed from the individual items to an aggregate, which in turn has to be specifically identified. For example, in the case of receivables, it is sufficient to identify them by referring to “all

debtors with initials A to G”. In the case of inventory, a sufficient identification may be “all assets stored in the debtor’s business premises room A”.

25. In some legal systems, even a description referring to all assets, present and future, may be sufficient. In some other legal systems, an all-assets security is not allowed with respect to consumers or even individual small traders.

26. Related to, though distinguishable from, the all-assets security is the issue of over-collateralization, that is, where the value of the security significantly exceeds the amount of the secured obligation. In accordance with the principle of the accessory nature of security rights, the debtor is not harmed because the secured creditor cannot realize or claim more than its secured claim plus interest and expenses (and perhaps damages). The question, however, is whether the excessive security ties up the debtor’s assets. In legal systems that allow the same asset to be given as security to more than one creditor that have different rankings, this problem may not arise. In legal systems where this may not be the case, over-collateralization may be addressed by parties setting maximum limits for the amount of the secured obligation and, if necessary, by reducing the security given to correspond to the amount of the secured claim.

27. Several countries provide for an institutionalized form of an all-assets security in the form of an “enterprise mortgage”. One type of such mortgages is a small enterprise mortgage, which is essentially limited to intangibles such as trade names, clientele or intellectual property rights (see art. 69 of the Organisation for the Harmonisation of Business Law in Africa (OHBLA) Uniform Act Organizing Securities). Because of its limited scope, this mortgage is of limited importance.

28. In contrast, the large enterprise mortgage plays a major role as security in the countries that have adopted it. A large enterprise mortgage may comprise all movable assets of an enterprise, whether tangible or intangible, although it may be limited to divisible parts of an enterprise. It does not comprise immovables, since they are subject to a distinct regime. As enterprise mortgages are distinct from mortgages in immovables, it is necessary to clarify the treatment of fixtures that may be subject to such mortgages.

29. A large enterprise mortgage is comparable to a regime where security may be taken over all assets of a debtor. An interesting aspect of this type of security is that, not only upon the debtor’s insolvency, but, in some countries, even upon enforcement by the secured creditor and upon execution by another creditor, an administrator can be appointed for the enterprise. The appointment of an administrator may assist in avoiding liquidation and in facilitating reorganization of the enterprise with beneficial effects for creditors, the workforce and the economy in general. This special feature is not exclusively part of an enterprise mortgage but might be considered generally for security rights and executions. However, to date, the institutional enterprise mortgage may offer the best vehicle for realizing this idea.

(c) *Proceeds*

(i) *Definition*

30. When encumbered assets are disposed of (or leased or licensed) during the time in which the indebtedness they secure is outstanding the debtor may receive, in exchange for those assets, cash or other tangible or intangible property. Such payment is referred to in many legal systems as “proceeds” of the collateral. In some cases, the original encumbered asset may generate proceeds that the debtor then sells, exchanges or otherwise disposes of in return for other property. Such proceeds are referred to as “proceeds of proceeds”.

31. In other situations, the encumbered asset may generate other property for the debtor even without a transaction occurring. Such assets, which are referred to in some legal systems as “civil” or “natural proceeds”, include, for example, interest or dividends on financial assets serving as security, insurance proceeds, newborn animals and fruits of crops. Other legal systems do not distinguish between these sorts of proceeds and proceeds arising from transactions entered into by the debtor.

(ii) *The nature and extent of the creditor’s rights*

32. Whenever, through a transaction or otherwise, the debtor obtains rights in proceeds of the original encumbered asset, two issues arise that must be addressed in a legal system governing security rights. The first issue is whether the creditor retains any security rights in an encumbered asset that is transferred from the debtor in the transaction generating the proceeds (for a discussion of this question, see A/CN.9/WG.VI/WP.2/Add.7, paras. 26-32).

33. The second issue concerns the creditor’s rights with respect to the proceeds. A legal system governing security rights should provide clear answers to the following questions:

- (a) Whether the creditor has a claim with respect to proceeds;
- (b) The circumstances under which such a claim arises;
- (c) The (proprietary or personal) nature and extent of such a claim;
- (d) The extent to which property must be “identifiable” as proceeds in order for a right in them to arise;
- (e) How situations in which the original encumbered asset becomes intermingled with or incorporated in other property are to be treated, in particular with respect to the relative priority of the right of the secured creditor as against other parties who may have interests in that other property;
- (f) Whether such a claim arises even if it was not provided for in the agreement between the parties; and
- (g) Whether “proceeds of proceeds” should be treated in the same way as initial proceeds of encumbered assets.

34. The justification for a right in proceeds lies in the fact that, if the creditor does not obtain rights in the proceeds of

the original encumbered asset, the value of security rights as a source of credit will be diminished. On the other hand, granting the secured creditor a proprietary right in proceeds of the encumbered asset might result in frustrating legitimate expectations of parties with a security right in proceeds as original encumbered assets, at least in legal systems in which there is no publicity system for such rights. In legal systems in which such publicity is foreseen and provides a basis for a comprehensive approach towards all conflicts of priority, this matter does not raise serious difficulties, at least to the extent that there are clear rules with respect to the tracing of proceeds.

3. *Security agreement*

(a) *Definition*

35. The security agreement is the agreement between the creditor and the debtor or a third-party security provider that constitutes (or is one of the constitutive elements of) a security right. The security agreement should be distinguished from an agreement to create security in the future (for example, if a credit is extended to the debtor). Only the security agreement may have proprietary consequences (for additional proprietary requirements, see section A.4 below).

(b) *Minimum contents*

36. Legislation often sets forth the minimum contents of a security agreement in order to protect parties. A failure to provide the required minimum contents will normally result in the security being null and void. Minimum contents may include:

- (a) Identification of the parties;
- (b) Description of the obligation to be secured;
- (c) Description of the encumbered assets;
- (d) Signature of the grantor of the security, by hand or in electronic form; and
- (e) Date of the agreement, unless the date is established by registration.

37. Even in jurisdictions where legislation does not specifically prescribe such minimum contents, a security agreement that is missing one of the elements mentioned above may be held to be null and void.

38. Parties normally negotiate additional clauses, in order to clarify their relationship. From a legislative point of view, it is advisable to have default rules in the absence of a specific agreement of the parties (for pre-default effects see chap. VIII; for post-default effects, see chaps. IX and X).

(c) *Formalities*

(i) *Writing*

39. In order to promote certainty as to the rights of the parties to the security agreement and of third parties, many

legal systems require a written document for the security agreement to be valid. In particular if the use of modern means of communication is permitted, the written form requirement need not create problems of time and cost. Such a requirement may be dispensed with for certain transactions, especially possessory pledges, since third parties are already protected to some degree by the debtor's dispossession.

(ii) *Additional formalities*

40. In some legal systems, a certification of the date by a public authority may be required for possessory pledges, with the exception of small amount loans where proof even by way of witnesses is permitted. The advantage of such certification is that it helps to avoid fictitious dating, although it may be a costly and lengthy process.

41. In other legal systems, a certified date or authentication of the security agreement is required for various types of non-possessory security (see, for example, articles 65, 70, 94 and 101 of the OHBLA Uniform Act Organizing Securities). While certification is more important for non-possessory security in order to avoid false dating, it is not necessary where publicity is a condition for effectiveness as against (or priority over) third persons (see chaps. V and VI).

42. In legal systems that have enterprise mortgages (see paras. 27-29 above), a written document or even a notarial, or equivalent court or other, document may be required. While such a requirement appears to be excessive, it may be justified by the fact that it may facilitate enforcement.

43. In the interest of saving time and cost, formalities should be kept to a minimum. For non-possessory security rights, a simple written communication (including modern means of communication) should be sufficient. For enterprise mortgages or cases where the security agreement is sufficient title for execution, a more formal document may be considered.

(d) *Effects*

44. Upon conclusion, the security agreement becomes immediately effective between the parties, unless otherwise agreed. Whether any additional steps are necessary differs from country to country. Even within one and the same jurisdiction, the answer may vary for different kinds of security rights. In addition, the issue of what proprietary effects will ensue is not uniformly resolved.

45. In many legal systems in which property rights are only those that can be asserted as against all persons, the security agreement alone does not suffice to create the security right. In other legal systems, in which a distinction is drawn between proprietary effects inter partes and as against third persons, the security agreement is sufficient to create the security right but, if there are competing claims, the claimant that has first met an additional requirement has priority. In both categories of legal systems, in addition to the security agreement, an act such as delivery of possession, publicity or control is required. In some countries,

there are certain exceptions to this rule for retention and transfer of title arrangements.

46. Where delivery of possession is required, a fictitious transfer by way of an additional agreement (of deposit or security) that superimposes on the debtor's direct possession the creditor's indirect possession (*constitutum possessorium*), may be sufficient. The same applies to situations in which, in the case of a sale or rent on credit, title is retained by a seller or lessor until full payment of the price or rent. The seller's or the lessor's retention of title normally means that, upon payment of the purchase price and performance of any additional secured obligation, title passes to the buyer. In countries where retention of title is absorbed by a uniform comprehensive security right, another approach is taken. Title is transferred to the buyer under the ordinary rules, but the seller retains a security right in order to secure payment of the purchase price (or performance of additional obligations).

4. *Additional requirements*

(a) *Introduction*

47. As mentioned above (see para. 45), in many legal systems, the conclusion of a valid security agreement alone does not suffice to create a valid and effective security right. Additional requirements must normally be met for the security right to be effective vis-à-vis third persons (or to have priority over competing claimants). In the countries that do not recognize proprietary effects only between the parties to the security agreement, no proprietary effects can come into existence before these additional requirements have been met.

(b) *Right of disposition of grantor*

48. The grantor of a security (normally the debtor and exceptionally a third person) must have the right to create the security. In some legal systems, the grantor has to be the owner of the assets to be encumbered. In other legal systems, it is sufficient if the grantor has the power to dispose of the assets even if the grantor is not the owner. With respect to future assets, it suffices if the grantor will become the owner, or will obtain the power of disposition at a future time (see paras. 20-21 above).

49. Where the grantor does not have the right or the power to dispose of the assets, the question arises whether the secured creditor can nevertheless acquire the security in good faith. In some legal systems, the creditor acquires the security right if the subjective good faith is supported by objective elements. These elements include that the creditor has or is about to extend credit to the debtor; and that the grantor is registered as owner or holds and transfers possession to the creditor.

50. Legislation on this subject often addresses the related issue of the validity and the effect of contractual restrictions on dispositions. In some countries, the need to preserve the debtor's freedom of disposition prevails, in

particular if the creditor in whose favour the security has been created is not aware of the restrictive clause. The United Nations Convention on the Assignment of Receivables in International Trade takes a similar approach to support transferability of a claim for the sake of commerce. Under article 9 of the Convention, the assignment is effective despite a contractual restriction on assignment and mere knowledge of the existence of the restriction is not enough for the avoidance of the contract from which the assigned claim arises. The party in whose favour the negative pledge or no-assignment clause had been agreed may remain free to claim damages from its contracting party for breach of the restraining contract clause, if such a claim exists under law outside the Convention. However, this claim may not be raised against the assignee by way of set-off (see art. 18, para. 3, of the Convention).

51. This approach promotes the granting of secured credit since it relieves the creditor of the task of having to examine the contract from which the assigned claim arose, in order to ascertain whether transfer of the claim has been prohibited or made subject to conditions. Otherwise, lenders would have to examine potentially a large number of contracts, which may be costly or even impossible (for example, in the case of future claims).

(c) *Transfer of possession, publicity and control*

52. The methods of producing proprietary effects (or establishing priority over competing claimants) vary from country to country, and even within individual countries, according to the type of security involved. There are three main methods of creating a security right that is effective as against all persons (although, as mentioned above, in some countries a distinction is drawn between proprietary effects as between the parties and proprietary effects as against third parties).

(i) *Transfer of possession*

53. The possessory pledge is created by agreement and transfer of possession of the asset to the creditor. Possession must be transferred to, and must remain with, the secured creditor or an agreed third person, who usually acts as the creditor's agent. Fictitious transfers of possession are also foreseen (see para. 46 above), but are not necessary in legal systems that admit non-possessory pledges. Possession can also be transferred by the delivery of negotiable instruments or documents, with an endorsement if necessary under the rules governing negotiable instruments.

(ii) *Publicity or control*

54. With the exception of cases where the security agreement suffices to create a security right, some form of publicity or control is required for the creation of non-possessory security rights and for their effectiveness as against third parties (or priority over competing claimants). Publicity or control may also be a condition for effectiveness against third parties or priority (for details on the forms, functions and effects of publicity, see chaps. V and VI).

B. Summary and recommendations

55. In a modern secured credit law, it should be possible to secure all types of obligations, including future obligations, and to provide security in all types of asset, including assets of which the debtor may not dispose or which do not exist at the time of creation of security right.

[Note to the Working Group: The Working Group may wish to consider whether any exceptions to this rule should be introduced. In addition, the Working Group may wish to consider the comparative advantages and disadvantages of a regime where security can be taken over all assets of any debtors, business debtors or just enterprises.]

56. The secured creditor should also be given a right in readily identifiable proceeds.

[Note to the Working Group: The Working Group may wish to consider the nature and the extent of the right in proceeds. Particular questions to be addressed include the following: whether the right in proceeds is a personal or a property right; whether it has the same priority with respect to the rights of competing claimants in the security right in the encumbered assets; and whether it covers proceeds of proceeds.]

57. The security agreement should be in written form, which should include modern means of communication. It should identify the parties and reasonably describe the encumbered asset and the secured obligation.

[Note to the Working Group: The Working Group may also wish to consider whether any exceptions to the written form rule should be introduced. It may also wish to consider additional elements for the minimum contents of the security agreement, as well as the effect of the security agreement and any additional requirements for the constitution of a security right.]

A/CN.9/WG.VI/WP.2/Add.5

**Report of the Secretary-General on the draft legislative guide
on secured transactions, working paper submitted to the Working Group
on Security Interests at its first session**

ADDENDUM

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Draft legislative guide on secured transactions**V. PUBLICITY****A. General remarks****1. INTRODUCTION**

1. As explained above (see A/CN.9/WG.VI/WP.2/Add.3, paras. 10 and 15-22), there is a need to facilitate the granting of non-possessory security rights. Non-possessory security, though known in the past, began to re-emerge only in the nineteenth century and is still restricted or even outlawed altogether in some States. This approach has been traditionally explained by the perceived need to protect other creditors from the misleading impression of false wealth created by the debtor's retention of possession.

However, the false wealth concern standing alone is a somewhat outmoded and insufficient rationale. In a credit-dominated commercial world, third persons should not be surprised to discover that a debtor's assets are charged with security or are subject to a supplier's or lessor's prior title. However, it does not follow that a secured transactions regime can safely dispense with any publicity requirement for non-possessory security. A reliable and effective system of publicity has significant efficiency and dispute-avoidance benefits.

2. Firstly, publicity enables prospective secured creditors to ascertain whether the relevant assets have already been charged with security in favour of a prior creditor, so as to be able to assess their priority ranking as against competing security rights. In the absence of publicity, secured creditors must rely on debtor assurances or undertake extensive

factual inquiries. This tends to impede access to credit by debtors without an established credit record and to restrict credit market competition by tying debtors to creditors with whom they have built up an established relationship of trust.

3. Secondly, publicity is needed to deal adequately with the consequences of an unauthorized disposition of the encumbered assets by the debtor. In the absence of publicity, legal systems are forced to choose between protecting secured creditors against the consequences of debtor misbehaviour, or protecting innocent transferees against the risk of secret liens of which they have no knowledge or means of acquiring knowledge. Publicity eliminates the need to mediate between these two extremes and enables legal systems to preserve the security of all consensual dealings in movable assets.

4. Thirdly, publicity reduces litigation to resolve suspicions of fraudulent antedating of security instruments by providing an objective mechanism for evidencing the effective date of security. Admittedly, the risk of fraudulent antedating is less pervasive in a credit market dominated by specialized and reputation-sensitive financial institutions. Moreover, the problem could be addressed by requiring the security agreement to comply with certain formalities without requiring that notice of the security right also be publicized. However, the added element of publicity enables unsecured creditors to assess more efficiently whether there is any unencumbered value left in a debtor's assets to satisfy their own claims. In the absence of publicity, the only source of information is the debtor, who may not be a cooperative or reliable source, forcing creditors to initiate what may turn out to be futile enforcement proceedings.

5. In the immovables context, the need for publicity has been largely satisfied by the establishment of a publicly accessible registry. A land registry is designed to provide comprehensive publicity to third parties of the current state of title to a particular immovable, including any encumbrances on title granted by the registered owner. Many States have established similar registries for a limited number of high value movables (for example, ships, aircraft, motor homes and sometimes other road vehicles). But most forms of movable property are not capable of being described with sufficient particularity, or are too dynamic or impermanent, to make the land title registry model workable. This is particularly true for intangible rights and for funds or universalities of circulating assets, such as inventory and claims.

6. In order to resolve these practical difficulties, the concept of a pure encumbrance registry has emerged. Instead of being organized by reference to title to the encumbered asset, registrations are entered and searched by reference to the name of the grantor. The question of the grantor's title, and whether the encumbered asset actually exists, is left to be determined by reference to off-record events and facts.

7. The idea of an encumbrance registry for security in movables dates back to the early nineteenth century and is historically associated with States in the common law tradition. However, the concept is no longer viewed as a particularly common law phenomenon. Such registries are

increasingly accepted as necessary infrastructure for a modern and comprehensive system of non-possessory security everywhere. This development is reflected in the model secured transactions laws of the European Bank for Reconstruction and Development and the Organization of American States, and in the recent Convention on International Interests in Mobile Equipment.

8. This chapter begins by examining the essential prerequisites for an effective and efficient encumbrance registry. The discussion then turns to the question of whether public registration should be required even for possessory security rights and whether alternative modes of publicity should be admitted. The chapter concludes by examining the question of whether publicity should operate as a precondition to the effectiveness of the security between the parties, or only against third parties. While this necessarily requires some more general analysis of the third-party effects of security, a complete discussion of the relationship between publicity and priority is left to the separate chapter on priority (chap. VII).

2. Public registration for non-possessory security in movables

(a) Title transactions versus security transactions

9. Although a pure encumbrance registry is not designed to provide evidence of the grantor's title to the encumbered asset, it does not follow that all title transactions should be excluded. The early encumbrance registries were primarily designed to give secured creditors a means of publicly evidencing security to protect themselves from allegations of fraudulent antedating by other creditors. This has remained the focus in some systems with the result that public registration is required only for security rights involving assets already owned by the debtor (for example, corporate charges). Since security generated by retention of title under a sale or lease does not by definition involve an attempt to extract value from the grantor's existing patrimony, registration is not required.

10. In the newer registry regimes, however, protection against fraudulent antedating is only an incidental aspect of the registry function. The principal focus is on true publicity. The aim is to maximize the ability of third persons to determine whether assets in the debtor's possession and control belong to the debtor or are subject to a property right in favour of a third person. To ensure maximum publicity, all security arrangements, whether constituted by way of security in the strict sense, or constituted by way of the transfer or retention of title, must be registered to preserve their third-party effectiveness.

11. Indeed, similar publicity concerns arise whenever a person is permitted to remain in possession and control of assets owned by another, even when ownership is not being employed for the purposes of securing debt. This favours extending the scope of the registry to all non-possessory transactions that are sufficiently pervasive in commercial practice to create the potential for third-party prejudice, even when they do not function to secure debt. This trend is reflected in the extension of the Convention on

International Interests in Mobile Equipment beyond charges and retention of title agreements in favour of sellers to include aircraft leasing arrangements, regardless of whether the lease operates as a security or represents a true lease in the sense that the rental payments accurately reflect the use value of the aircraft over the relevant term. This approach also operates to reduce litigation on the appropriate characterization of transactions at the economic borderline between security and ownership, retention of title sales agreements and leasing transactions being the principal source of difficulties. That issue cannot be completely eliminated since it is also relevant at the level of enforcement, but the imposition of a common publicity requirement reduces the potential for disputes.

12. To avoid regulatory overreach, some means of identifying the range of transactions caught by the registry is needed. Where the title transaction operates to secure debt, this can be accomplished by the use of a functional definition of security to include any transaction, regardless of the location of title as between creditor and debtor, that operates to secure performance of an obligation.

13. Where the transaction is not secured in nature, even from a functional perspective, the general legislative tendency has been to revert to a more formalistic approach. Those transactions which are regarded as representing the most common potential source of difficulty in the particular country are identified by reference to their formal structure. In regimes that have adopted this approach, the following illustrative list emerges (although not all regimes necessarily include all four transactional types within their scope):

(a) Long-term (for example, in excess of one year) leases even where these do not function to secure the equivalent of the acquisition value of the leased goods;

(b) Commercial consignments under which inventory is delivered to an agent for re-sale to the public unless the agent is widely known to creditors as dealing only in consigned inventory, for example, auctioneers and art dealers;

(c) Outright assignments (that is, sales) of account receivables or claims; and

(d) Outright sales of goods, if the seller is left in possession beyond a reasonable term.

14. The difficulty with this approach is that it is historically oriented. Transactional types that have posed publicity difficulties in the past are identified by their nominal structure. The future may bring new transactional structures that raise equivalent publicity concerns. Consequently, it may be preferable to use instead a problem-oriented concept so as to require registration in any situation where a person is left in possession or control of movable assets belonging to another beyond what is considered a statutorily ordained reasonable period.

(b) *Consensual versus non-consensual security rights*

15. In principle, a true publicity registry for movable security should extend to all security rights, whether created by operation of law or by agreement. Despite the difference in their method of constitution, they raise identical publicity concerns.

16. However, much depends on the third-party effects of the particular non-consensual security right. If the public policy basis for the non-consensual security right is sufficiently strong to require awarding the creditor superpriority over all other creditors, secured or unsecured, prior or subsequent, then publicity provides little practical benefit. But if ranking is based on a first-in-time rule, or if the holder of a non-consensual security right has a general right to pursue the encumbered asset even in the hands of bona fide buyers (*droit de suite*), there is much to be said for subjecting the non-consensual secured creditor to the same comprehensive publicity and priority framework that applies to consensual secured creditors.

17. A growing number of registry regimes permit judgement creditors (that is, creditors whose claim has been recognized in a court judgement) to register a notice of judgement in the movables security registry, with registration creating the equivalent of a general security right against the judgement debtor's assets. This approach indirectly promotes the prompt satisfaction of judgement debt without the expense and burden of having to pursue active judgement execution measures. Once the judgement is publicized, the judgement debtor is forced in practice to satisfy the debt and terminate the registration in order to be able to sell its assets or use them as security for further debt.

(c) *A single encumbrance registry versus multiple encumbrance registries*

18. Reflecting the ad hoc evolution of non-possessory security, unreformed registration regimes typically have separate registries depending on the nature of the assets (for example, book debts) or the status of the grantor (for example, corporations) or the formal nature of the security device (for example, mortgages, charges, assignments) or even the status of the secured creditor (for example, banks).

19. So long as the focus of registration was on protection against fraudulent antedating, the decentralized and frequently overlapping nature of encumbrance registries did not matter greatly. But with the modern shift in focus towards maximizing publicity, the existence of multiple overlapping registries detracts from the publicity function and creates uncertainty in determining the priority or third-party effects of competing security rights granted by the same debtor in the same assets but registered in different registries.

20. Consequently, the more modern regimes create a centralized registry venue for all security rights and analogous transactions. This, in turn, has enabled registration to provide a common presumptive formula for ranking interests according to a simple first-to-register rule (although retention of title agreements and functionally similar arrangements are normally given special protection from the consequences of that rule).

21. Centralization has been greatly aided by developments in computer technology. Computerization enables all registrations, regardless of the nature of the assets or the status of the parties, to be entered into a single database while still permitting multiple access points for both registrants and searchers.

(d) Notice versus document filing

22. Because their primary purpose was to provide objective proof against fraudulent antedating, the early regimes tended to impose rather onerous registration requirements. An actual copy of the security agreement had to be filed, sometimes accompanied by affidavits of good faith (with respect to other creditor rights) and execution. This approach imposed a counterproductive level of transaction costs and risk on secured creditors and created uncertainty as to whether registration effected publicity against third persons as to all the contents of the filed documentation, or only certain essential terms.

23. The modern registry regimes have radically simplified the registration process. Instead of having to file the actual security documentation, all that is needed is a simple notice setting out the basic information necessary to alert third parties to the nature and scope of the security. Relative to document-filing, notice-filing offers the following benefits:

- (a) A reduced administrative and archival burden for the registry;
- (b) Reduced transaction costs for secured creditors with a corresponding reduction in the risk of error;
- (c) Enhanced confidentiality of the debtor's affairs;
- (d) Increased flexibility in the negotiation and settlement of the terms of the security agreement; and
- (e) Greater certainty and enhanced publicity for third party registry searchers.

(e) Timing of registration

24. In a notice-filing system, it is unnecessary, as a practical matter, for the security agreement to have been concluded in order for registration to be effected. Whether advance registration should be authorized as a matter of policy is more controversial. Some regimes permit this. In other regimes, a formal security agreement must first exist, although no funds need yet have been advanced. There are advantages and disadvantages to each approach.

25. Assuming priority among secured creditors is ordered by reference to the time of registration, advance registration enables a secured creditor to establish its priority ranking without having to check for further registrations before actually advancing funds. It also avoids the risk of nullification of the security, or loss of priority, in cases where the underlying security agreement was technically deficient at the point of registration but is later rectified without any intervening prejudice to third persons.

26. On the other hand, advance registration complicates the priority ordering function of registration as against certain categories of third-party rights that vest after the filing is effected but before the security agreement is actually executed so as to constitute the security. As against other registerable rights, there is no difficulty since priority can be ordered by the order of registration, with each security right dating back to the time of registration for this purpose. But where the assets are sold to a buyer, or where an insolvency administrator is appointed, off-record factual evidence will be necessary to determine whether these

rights vested before or after the security were actually constituted. However, the same evidentiary burden arises even in a system that disallows advance registration. Since the source of the security is the agreement, not the registration per se, independent proof of the security agreement is still necessary. Although this detracts from the value of registration as a mechanism for avoiding fraudulent antedating, it is a necessary incident of the concept of notice filing.

27. Advance registration also increases the risk of false registrations in cases where the negotiations are aborted and no security is ever granted. This risk can be alleviated by providing a summary procedure for compelling discharge, a procedure that is needed in any event in cases where the secured obligation has been satisfied. Some systems attempt a compromise solution. Advance registration can be made provided it takes place within a specified time period (for example, 30 days) prior to the execution of the agreement. A grace period of this kind exacerbates the off-record evidentiary inquiry although it might be considered for consumer transactions where the grantor may not have the knowledge or acumen to take advantage of a statutory discharge procedure.

28. The issue of advance registration is, in part, related to the issue of what information must be contained in the registered notice of security. The more detailed the information that is required, the stronger the case for requiring an anterior security agreement and the less practical value advance registration will have.

(f) Required content of registered notice

29. To have minimal publicity value, a notice of security should identify the grantor and secured creditor and describe the encumbered assets. Because the name of the grantor is the principal search criterion, rules are typically prescribed for determining the correct legal name for registration and searching purposes. For individual grantors, additional information, for instance, date of birth, is sometimes prescribed in order to keep search results within manageable limits. For enterprise grantors, the registry database is sometimes linked to the business names registry maintained by the particular State so as to facilitate accuracy of entry.

30. Title registries normally require specific identification of the encumbered asset and the security is filed and searched by reference to the specific asset. In an encumbrance registry, grantor-name registration eliminates the need for a unique item-by-item description and thereby liberates the scope of the security capable of being efficiently publicized. A single filing is capable of publicizing security in both present and after-acquired assets and in circulating funds or universalities of assets (for example, "all claims" or "all inventory"). In such cases, third-party effect relates back to the time of registration, rather than to the time at which the debtor actually acquired rights in the particular asset. The system allows publicity to be effected against the entirety of the debtor's asset base (for example, "all present and after-acquired movables").

31. Such broad-based security rights are controversial. In part, this is because of concerns with the situational

monopoly acquired by the first-registered creditor over the debtor's access to secured financing. In part, it is because all-assets security has the potential to reduce or even eliminate the pool of unencumbered assets available for distribution to execution and insolvency creditors. A secured transactions regime should accommodate these policy concerns. But they should not be used as a justification for imposing arbitrary limits on the scope of assets capable of being effectively publicized by a generic or super-generic description in a registered notice of security. These concerns may be better dealt with through the articulation of substantive superpriority rules designed to preserve debtor access to more specialized sources of future financing or to protect particularly vulnerable categories of unsecured creditors. The need for superpriority rules of this kind is taken up in chapter VII (see A/CN.9/WG.VI/WP.2/Add.7, paras. 33-37). In the consumer financing context, these solutions may need to be supplemented by outright prohibitions on the grant of security in after-acquired consumer assets, a point already addressed in chapter IV (see A/CN.9/WG.VI/WP.2/Add.4, paras. 22, 23 and 55).

32. Even in legal systems that permit generic and super-generic descriptions, different approaches are taken to what constitutes an adequate description. In some systems, the registering party is required merely to indicate the generic nature of the encumbered assets (for example, goods), even if the security right is in fact limited to a specific item (for example, a single automobile). In other legal systems, the description is required to conform to the actual range of assets to be covered by the filing.

33. Each approach has advantages and disadvantages. A less precise description eases the filing burden for creditors and reduces the risk of descriptive error. It also permits the secured creditor and debtor to amend their security agreement to add new assets within the same generic category without having to make a new registration.

34. On the other hand, such a system has limited publicity value for third parties. In order to ascertain the precise scope of the security, they must obtain assurances from the secured creditor directly or through the debtor. Moreover, even if the existing security agreement covers a smaller range of assets, competing secured creditors who take security in any asset within the registered description will need to secure a waiver of priority from the first-registered creditor. Since priority ranking among secured creditors relates back to the initial registration, an explicit waiver is needed in order to protect the secured creditor against the risk that the grantor may later expand the asset base encumbered with security under a future agreement.

35. Different approaches are also taken to the question of whether the notice must specify the value for which the security is granted. In order to accommodate financing practices with indeterminate obligations (for example, revolving loan practices), none of the modern systems require the registered notice to specify the actual value of the secured obligation. However, some systems require a maximum value to be entered (for a discussion of maximum sum clauses in the security agreement, see A/CN.9/WG.VI/WP.2/Add.4, paras. 13 and 16). The main purpose of this requirement is to facilitate the grantor's ability to

obtain "second-ranking financing" from other secured creditors using the residual value left in the assets encumbered by the first-registered security. In the absence of such a requirement, the subsequent secured creditor must obtain a positive waiver of priority from the first registered creditor. Otherwise, since priority dates from the time of registration, the second-registered creditor will be subordinated to the extent of any subsequent advances made by the first-registered creditor. Indeed, if the system permits a single registration to publicize security under later agreements between the same parties, this risk arises even if the existing security agreement does not presently contemplate any further future advances.

36. Each approach has advantages and disadvantages. If the notice does not have to specify any maximum value, the first-registered secured creditor and the grantor have complete flexibility to increase the credit facility, or even enter into wholly new credit arrangements, without fear of loss of priority and without additional transaction costs at the level of registration. On the other hand, the grantor's ability to grant security against the residual value of the encumbered assets is reduced unless the first-registered creditor is willing to waive priority. In a competitive credit market, a debtor normally has sufficient leverage to obtain a waiver readily. However, a waiver may not be obtainable on reasonable terms if the security agreement includes a penalty clause for lost interest. At the same time, the protection afforded by the maximum-sum requirement is illusory if hugely inflated estimates are routinely registered. This is not likely to be a problem where the debtor has sufficiently strong bargaining power, but, in that event, the protection may not be needed in the first instance. In other cases, a procedure may have to be introduced to permit the grantor, at least in consumer transactions, to require the registered amount to be reduced where it does not reflect the actual lending obligation of the secured creditor under any existing agreement between them.

37. Both approaches impose a further inquiry burden on searchers. The parties must be contacted directly to determine the actual current state of accounts. This is true even if the maximum value must be publicized since that amount does not reflect the actual secured obligation outstanding at any given time, but merely the maximum value that the secured creditor is entitled to extract from the encumbered assets by virtue of its security.

*(g) Need for protection of remote transferees
of encumbered assets*

38. Real security generally gives the secured creditor the right to follow the encumbered asset into whosoever's hands it may be found. Otherwise, the grantor of the security would have the unilateral power to terminate the security. However, the secured creditor's normal droit de suite may need to be constrained in the context of a grantor-indexed encumbrance registry. In cases where the encumbered assets have been the object of unauthorized successive transfers, prospective purchasers or secured creditors cannot protect themselves by conducting a search according to the name of the immediate holder. The search will not disclose a security interest granted by a predecessor in title.

39. Solutions to this problem can take various forms depending on how a legal regime wishes to strike the balance between preserving security and preserving the reliability of the registry. Minimally, secured creditors should be required to amend their registrations to identify a transferee of the encumbered assets as an additional grantor on pain of subordination to interests acquired in the relevant asset after the secured creditor finds out about a transfer. Some legal regimes may wish to go further and protect all third parties, or at least particularly vulnerable categories of third parties, even where the secured creditor has no knowledge of the debtor's unauthorized disposition.

40. The remote-third-party problem can be significantly alleviated by requiring specific-asset identification for effective publicity against purchasers and competing secured creditors in the case of particularly high value assets with reliable numerical identifiers, for example, road vehicles, boats, motor homes, trailers, aircraft and so forth. Although this reduces the ability of secured creditors to publicize security in after-acquired assets, specific asset identification is practically necessary only for capital assets used in the grantor's business and consumer assets used for personal purposes. In the case of inventory, the problem is confined to cases where a dealer in used goods acquires assets subject to a security granted by the seller and then re-sells to the public. Consideration should be given to expanding the scope of the protection afforded to purchasers of assets transferred in the ordinary course of business to protect transferees of such assets. These matters are addressed further in chapter VII (see A/CN.9/WG.VI/WP.2/Add.7, para. 30).

(h) Linkages to registries for immovables

41. Modern secured transactions laws generally permit a movables security right to be granted in immobilized movables, that is, movable property destined for attachment to land without any loss of separate identity (for example, a furnace), as well as immovables that may be mobilized, that is, immovable property destined to become movable (for example, growing crops). The security right is subject to the same publicity requirements that apply to other categories of movables with one qualification. In order to take effect against persons claiming a right in the land to which the movables are attached or affixed, a notice of security must typically also be filed in the land registry, so as to preserve the comprehensive publicity function of the immovables registry.

42. The establishment of a comprehensive movables encumbrance registry raises the question of whether it is feasible to coordinate publicity where a security agreement covers both immovables and movables. No legal regime appears to have done this. Land registries are primarily organized by reference to the specific asset and operate as records of title as well as encumbrances. To the extent that a supplementary owner-name index also exists, a common filing system could be established. But this would require great coordination in the name conventions used in the two systems. Further, the need to maintain the integrity of the land registry would normally require the security to be registered by reference to the specific immovable, not

merely the name of the grantor. This is necessary since, in a title registry, there is normally no need at the level of publicity to worry about distinctions between pure security and security created by the transfer or reservation of title in favour of the secured creditor. Adequate publicity is achieved regardless of whether the creditor is identified on the record as the owner of the property or as the holder of an encumbrance on the registered owner's title. The distinction between ownership and security becomes important only at the level of enforcement.

(i) Linkages between a general encumbrance registry and asset-specific title registries

43. Similar considerations may create difficulties in coordinating or integrating registrations as between a movables encumbrance registry and asset-specific title registries for movables such as ships, aircraft, road vehicles and intellectual property. In the case of tangible objects, these difficulties can be alleviated to the extent the encumbrance registry builds in a supplementary capacity to carry out searches by reference to numerical asset identifiers. For intellectual property, the obstacles are more formidable because an equivalent asset identification system is not possible and because the intellectual property registries are not designed for the purpose primarily of facilitating commercial dealings. Whatever approach is taken, a general secured transactions law needs to establish the extent to which filing in an asset-specific register pre-empts filings in the general movables registry and to coordinate priorities between the different regimes. This is especially critical with respect to security in intellectual property and license and royalty payments associated with intellectual property, in view of the growing economic importance of property of this kind.

(j) Private registration or publication

44. Some regimes eschew a public encumbrance registry as such in favour of more limited notice venues: for instance, entry of a notice in the debtor's own books, or in the books of a notary or court official, or oral declamation, or newspaper notices. Although certain of these notice venues sufficiently address concerns with fraudulent antedating, they lack the permanence and ease of public accessibility needed to ensure true publicity and to establish priority against third persons. If a comprehensive encumbrance registry is established, they can be safely eliminated.

(k) Registration and enforcement

45. In some legal systems, a secured creditor is required to register its security right before being entitled to pursue enforcement remedies against the encumbered assets. In other legal systems, registration is not a precondition to enforcement. The question of which approach should be taken depends, in part, on who bears the responsibility for notifying third parties with a registered right in the secured assets of the initiation of enforcement action. If this burden is imposed directly on the secured creditor, registration of the enforcing creditor's own right may be unnecessary. If the burden is instead placed on the registrar or some other public official, then registration is needed in order to

inform the relevant official of the need to send out notices to other registered claimants. Indeed, in a legal system that adopts the latter approach, publicity by registration would be needed prior to enforcement even in the case of a security right initially publicized by dispossession of the debtor.

46. Advance registration of intended enforcement action may also reduce the inquiry burden for competing creditors, both secured and unsecured, who are contemplating the initiation of enforcement action. Otherwise, they will have to make further inquiry of all registered secured creditors in order to determine whether enforcement has been initiated. While some level of inter-creditor communication is invariably needed in practice in order to ensure adequate coordination, registration would at least enable other creditors to focus their inquiry efforts.

3. Debtor dispossession and equivalent control mechanisms

(a) Debtor dispossession as a substitute for registration

47. Possessory security rights are normally exempted from registration, except possibly at the enforcement level. Dispossession is felt adequately to address the principal sources of potential third-party prejudice. The appearance of false wealth is eliminated and unauthorized third-party disposition by the debtor becomes impracticable.

48. However, compared with public registration, dispossession less satisfactorily resolves the problem of fraudulent antedating in cases where the historical date on which possession was assumed is significant, for example, in respect of transactions occurring during a suspect period prior to the grantor's insolvency or where the possessory pledge comes into competition with a non-possessory security right. It is for this reason that some legal systems impose additional formal requirements designed to establish a certain date for possessory pledges. Registration would more efficiently address the same concern. Although a notice-filing registry does not fully resolve concerns with fraudulent antedating in the case of insolvency, it at least offers a solid evidentiary presumption.

49. The exemption of possessory security rights from registration also lessens the publicity value of the registry and complicates priority ordering. Third parties, including prospective secured creditors, cannot rely wholly on a registry search. They must make further inquiries to ensure that the assets in which security is taken are still within the debtor's possession and control. This is a normal part of the risk assessment process, as an encumbrance registry is inherently less reliable than one designed to record title as well as encumbrances on title. Even if possessory security rights were required to be publicized, secured creditors would still face the risk that the assets encumbered with security had been sold outright by the debtor or seized by an execution creditor. However, the latter risk is considerably reduced in systems that require publicity of judgements by registration. As a system becomes more comprehensive, the

case for requiring registration of even possessory security rights becomes stronger.

50. If possession of the encumbered asset by the debtor is permitted to substitute for registration, the question arises whether the secured creditor could relinquish possession by registering notice of the security, while still permitting the effective date of security to relate back to the date of initial possession. In principle, there is nothing objectionable about this, provided there is no gap in the continuity of publicity. Nonetheless, the result is a further diminishment in the authority of the registry.

(b) Quality of possession

51. Assuming that possession is retained as a substitute for registration, the concept should be defined in a fashion that protects against third party prejudice. Purely fictive constructive possession techniques, such as retention of possession by the debtor under an agreement to hold as trustee or agent for the debtor, should be eliminated.

52. Possessory security rights, however, should not be disqualified simply because the assets remain on the debtor's premises, as in the case of assets stored in a room to which the secured creditor has the exclusive means of access or warehousing arrangements of the kind described earlier in the present Guide (see A/CN.9/WG.VI/WP.2/Add.3, paras. 6 and 7). Provided there is continued and exclusive secured creditor control, the underlying policy of third-party protection is satisfied. Many of these techniques were developed in response to the historical inability of secured creditors to take an effective non-possessory security right. If the alternative of public registration is made generally available, such arrangements will naturally become less prevalent.

(c) Symbolic possession

53. Symbolic possession should also remain available where the relevant indicia or documents are widely accepted in general commercial practice as the sole or the most reliable means of transferring or pledging the asset or the value it represents. Illustrative techniques include the delivery, with any necessary endorsement, of share certificates and negotiable instruments and documents of title such as bills of lading or warehouse receipts. Some legal systems have established title certificate systems for road vehicles that enable secured creditors to publicize security rights adequately by taking possession of the title certificate. If the practice is well established and functions well, these forms of possession should also be preserved. On the other hand, delivery of lists of ordinary trade receivables generally should not qualify. These are insufficiently negotiable in commercial practice to protect third persons adequately against the risk of a competing disposition by the debtor (although there may be limited exceptions). Affixation of a plaque or other form of physical notice to the encumbered asset is more problematic because of the potential for abuse. On the other hand, much depends on local commercial practices: the nature of the asset and the required notice may make this form of symbolic possession sufficient.

(d) *Third-party notice or control*

54. Widespread recognition of the ability to pledge goods through delivery of a document of title, such as bills of lading or warehouse receipts, emerged because the third party is in control of the goods. The carrier or storer, as the case may be, is obligated in law to deliver possession of the underlying asset to the person in possession of the document. This illustrates the more general idea that effective dispossession can be achieved through a third person. Moreover, this technique is not confined to the holding of tangible objects. For example, effective dispossession of control over certificated investment securities can be effected by the entry of the name of the secured creditor in the books of the security issuer or by a notation in the books of a clearing agency.

55. A similar idea underlies the rule in some systems by which receivables can be pledged by giving notification to the debtor on the receivable. Because notification obligates the account debtor to make payment of the assigned receivable to the person giving notice, it effectively transfers the right to the monetary value of the receivable from the grantor to the secured creditor who has given notice.

56. In the context of trade-receivables financing, debtor notification forms the mechanism for binding the account debtor. However, legal systems that have adopted a public registry for security in movables generally have rejected notification as a mode of publicity against other third parties or a means of establishing priority. Priority in rights to payment between competing secured creditors and assignees is determined instead by the order of registration. This rule enables secured creditors and assignees to assess more accurately and rely on the value of assigned receivables and facilitates non-notification accounts-receivable financing against the bulk of a grantor's present and future claims.

57. However, some role for third-party notification or control as a method of publicity may be feasible and even preferable for certain high value payment intangibles, such as payments due under an insurance policy or a letter of credit, or even in connection with security granted in bank accounts or investment accounts or securities held with an intermediary. On the other hand, there is no clear consensus on how to resolve such questions as the extent to which control should be the sole publicity mechanism to the exclusion of registration; whether the third party's consent should be a precondition to effective publicity; and the relative priority, especially in the case of security granted in investment property held by an intermediary, in cases where the third party in control has taken security in the same asset, or re-pledged that asset to secure its own debt.

58. Whether debtor dispossession should substitute for registration is an open question. Assuming possessory security rights would not be required to be publicized by registration, the concept of debtor dispossession should be defined in a fashion that minimizes the ability of the grantor to create competing claims in the charged assets in favour of third persons. While this functional test would eliminate purely fictive forms of possession, it would also liberalize the idea of dispossession beyond physical delivery of the charged assets to include constructive

possession through documentary intangibles and tangibles and third-party holdings of both corporeal and incorporeal assets on behalf of the secured creditor.

4. *Third-party effects of unpublicized security rights*

59. Regimes vary on whether publicity is necessary to constitute security even between the immediate parties, or only for the purposes of effectiveness against third parties. While publicity is principally concerned with the idea of third-party notice, the latter approach may be more appealing, although there are a number of considerations.

60. Firstly, dispossession is essential to the effective constitution of the traditional possessory pledge. For legal systems where the pledge is the typical form of security in movables, public registration for non-possessory security is viewed as a substitute for physical delivery and is logically a constitutive step.

61. Secondly, many legal systems are not familiar with the idea of relativity of title, that is, with the idea that property rights can be constituted as against one person (here, the grantor) and not against others (here, competing third-party claimants). Either a full fledged property right exists or it does not.

62. These conceptual concerns cannot be ignored in a legislative guide for secured transactions designed to fit within the various legal cultures. However, concerns about how to formulate the publicity requirement (that is, as a constitutive or third-party opposability rule) are moot to the extent that the result is the same under both approaches. The difference becomes relevant only if it is desired to give some measure of third-party effect to an unpublicized security right. Different regimes adopt different policies on this point.

63. In some systems, publicity or debtor dispossession as a substitute for publicity is an absolute precondition to third-party effectiveness. A security may be set up against third persons only if and when it is registered or debtor dispossession occurs. Other systems begin from the converse presumption. Security is presumed to take effect as soon as the agreement is constituted, subject perhaps to certain minimal writing requirements. It follows that third parties are protected from an unpublicized security only if they can point to some explicit judicial or legislatively ordained source of protection.

64. The modern legislative tendency in countries with a truly comprehensive encumbrance registry favours denying or limiting the third-party effects of an unpublicized security against most significant categories of third-party interests. Exceptions are limited to transferees of assets who have not given value and possibly buyers in the ordinary course of business who take with actual knowledge of an unpublicized security right, although this latter exception may be more controversial (see A/CN.9/WG.VI/WP.2/Add.7, para. 32). Qualifications based on actual knowledge require a fact-specific investigation and diminish the efficiency of statutory rules by encouraging litigation. Certainly, actual knowledge should not be allowed to defeat the priority obtained by the order of registration or

debtor dispossession in a competition between secured creditors. To allow this would undermine the certainty and predictability of the priority rule. There is no unfairness to the holder of the unpublicized right under this approach. The competing creditor could always have protected itself by taking possession or registering in a timely fashion. For this reason, there is no bad faith inherent in a secured creditor asserting priority despite actual knowledge. If the system requires timely registration or possession for priority purposes, the secured creditor should be entitled to rely with confidence on the other creditor's failure to comply in assessing its own priority status.

5. *Third-party effects of publicized security rights*

65. If registration or debtor dispossession is made a precondition to the effectiveness of all security rights, it provides a common formula not only for determining the point at which the security right becomes effective against third parties who acquire an intervening interest in the secured assets, but also for determining priority disputes among competing security rights.

66. However, a secured transactions regime should also ensure that the security of ordinary marketplace dealings in movables is not unduly interfered with. This may require the articulation of exceptions to the priority effects of publicity to protect transferees of secured assets who acquire their interest in the ordinary course of the grantor's business, as well as holders and possessory transferees (including competing security claimants) of money and negotiable assets subject to a registered security right.

67. In addition, legal systems may not be prepared to impose the burden of searching and the risks of failure to search on relatively unsophisticated transferees even when they acquire their interest in a non-ordinary course of business transaction. This may require further exceptions in the case of transferees acquiring secured assets for non-business purposes or where the transaction involves a relatively low-value asset or low-transaction amount. On the other hand, the broader the categories of transferees allowed to take free of a registered security right, the less justification there is for imposing a registration burden on the secured creditor in the first instance. So, consideration might also need to be given to exempting secured creditors from any publicity requirement where they have no right to follow the asset into the hands of innocent transferees. Against this approach must be balanced the value of still requiring publicity as against insolvency and execution creditors.

68. Finally, secured creditors may need to be temporarily excepted from the burden of effecting or preserving publicity to take account of certain marketplace realities. For instance, it would be desirable to give retention-of-title secured creditors a "grace period" to effect publicity in order to facilitate on-the-spot financing in the sales and leasing sectors. Similarly, while security rights in proceeds should, in principle, be subject to the same publicity requirements that would apply to security rights taken in assets of the same kind, provision of a grace period to effect publicity may be needed in order to permit the secured creditor a sufficient opportunity to ascertain the

existence and nature of the proceeds. In addition, secured creditors who have publicized by debtor dispossession should be permitted, where the commercial context so demands, to release the secured assets to the grantor for a limited time period without loss of their priority ranking (for example, to enable a debtor to take delivery of charged assets represented by a document of title for the purposes, for example, of a sale or trans-shipment).

B. *Summary and recommendations*

69. In principle, security rights should be public, whether by way of possession or control, or by way of registration. It may be possible to develop a compromise solution under which publicity would be necessary as a general rule, subject to only very limited exceptions.

70. Publicity could be a constitutive requirement for an effective security right, or merely a precondition to the effectiveness of that right against specified classes of third persons. The related question of whether publicity should be a precondition to the exercise of enforcement recourses against the encumbered assets is addressed in chapter IX.

71. Whether debtor dispossession should substitute for registration is an open question. If possessory security rights are not required to be publicized by registration, the concept of debtor dispossession could be defined in a fashion that minimizes the ability of the grantor to create competing claims in the encumbered assets in favour of third persons.

72. As a general rule, the priority effect of security rights against competing claimants should be ordered according to the date at which registration or debtor dispossession was originally effected by the secured creditor, regardless of the presence or absence of actual knowledge of any competing claim, as long as there is no intervening period in which the security right is unpublicized. Exceptions and qualifications to this rule may be necessary to accommodate considerations of fairness and commercial practice (see A/CN.9/WG.VI/WP.2/Add.7, paras. 19-32).

[Note to the Working Group: The Working Group may wish to consider the concept of a comprehensive encumbrance registry for publicizing notice of security and other non-possessory rights in movables and for establishing the priority and effectiveness of these rights against third persons. To achieve maximum publicity value, the registry should be centralized in design and comprehensive in scope, covering all significant non-possessory transactions in movables, whether consensual or non-consensual, and whether title or security-based.]

In addition, the Working Group may wish to consider that the notice should contain an identification of the grantor and the secured creditor and a reasonable description of the encumbered assets.

Furthermore, the Working Group may wish to consider whether the notice should specify a maximum amount of secured credit to which the notice applies and whether the filing system should allow the filing of a notice prior to the conclusion of a security agreement and should cover all types of grantor.]

A/CN.9/WG.VI/WP.2/Add.6

**Report of the Secretary-General on the draft legislative guide
on secured transactions, working paper submitted to the Working Group
on Security Interests at its first session**

ADDENDUM

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Draft legislative guide on secured transactions**VI. FILING SYSTEM****A. General remarks****1. Introduction**

1. As noted in chapter V (see, for example, A/CN.9/WG.VI/WP.2/Add.5, paras. 6, 7 and 23), security rights regimes in many countries provide for publicity of a security to be made by filing notice of the security in a public registry or filing system. The term, “filing system” is preferred here to “registry”, to emphasize that, as opposed to an immovables registry, a filing system for most forms of movable property records notice of a security only. The filing system is a non-exclusive source of limited data and it is not the source of substantive property rights. It does not record information regarding the validity and nature of the grantor’s title and it does not evidence whether the security right exists or even whether the described asset actually exists.

2. The filing system is the forum where an announcement or advertisement is made, alerting searchers to the possibility that a security right may exist (or be acquired in the future) in certain encumbered assets that the grantor has (or may acquire in the future) an interest in. As such, the filing system has to be understood to exist in the context of alternate sources of information (for example, the grantor itself or credit information providers). The data that constitutes that announcement is referred to as a “notice”.

3. While the design and detail of the filing system will be determined by the substantive law of the particular security rights regime and may vary, its functions include:

(a) To provide a tool for assisting with priority determinations (see chapter VII). An effective filing system allows prospective competing interests to determine quickly and easily what their priority would be;

(b) To alert interested third parties to the possible existence, present or future, of a conflicting security right;

(c) To decrease the risk of fraud; and

(d) To serve as a precondition for enforceability of the security right against the grantor (see chapter IX).

4. A system of filing a notice (that is, limited data) rather than a copy of the financing transaction presents several advantages. It is fast, efficient and flexible. It minimizes the need for filing office resources, while maximizing privacy of financial details (see paras. 5-17; see also A/CN.9/WG.VI/WP.2/Add.5, paras. 22 and 23).

2. Key design issues

(a) Notice filing versus document filing

5. Assuming a notice filing system, as discussed above, is implemented, a security rights regime should state clearly that the term “notice” does not refer to a form or a document but to an aggregate of information. It should also state that notice may refer to one or more grantors and to one or more secured creditors and that the effect of a notice is not limited to a single transaction.

6. Regarding the information to be included in a notice, the regime might require only the minimum data necessary to warn searchers of the possibility of another claim. Searchers, if they wish, can then obtain any further information required from other sources. Obstacles to access and excessive formalities should be avoided.

7. The data required for a notice to be legally sufficient might be limited to three elements: identification of the debtor (or grantor, in the case of a third-party grantor); identification of the name of a secured creditor; and a description of the assets in the notice. These elements are discussed below in further detail.

(i) Identification of the grantor

8. Identification of the grantor is most important, since the key to discovery of the notice by a searcher is the grantor’s name (see para. 19 below). Many jurisdictions have an entity registration system providing a public record with the precise entity name and, quite often, the assignment of an identification number to the entity. Many jurisdictions also assign some identification number to each individual or use a birth date as an aid to identification. As an additional identification item, the identification number would assist searchers in determining whether a particular notice refers to the person with respect to whom the search is being made. This additional item need not be an element of legal sufficiency of the notice. This element might also include the grantor’s address as a desired additional item, but again, this need not affect legal sufficiency. Additional issues may arise from the search logic that the system employs. For example, names of individuals are usually indexed in alphabetical order based on family name, while names of entities are indexed alphabetically exactly as presented. Filing rules will be needed to require the party presenting the notice to identify whether the grantor is an individual or an entity and, in the former case, which is the family name.

(ii) Identification of the secured creditor

9. The key to finding a notice should be the grantor’s name, not that of the secured creditor. Identification of the secured creditor provides a method for establishing that a party that claims a benefit based upon the notice is indeed the party entitled to do so (the filing of the notice is for this party’s future benefit). This element need not be the name of the intended secured creditor itself, but may be an agent (whose agency status need not be disclosed; this approach is of particular value in syndicated loans). While this information is not as important as identifying the grantor, if the notice provides misleading information regarding the identification of the secured creditor, the secured creditor may suffer the consequences vis-à-vis the misled party, but this should have no effect on the legal sufficiency of the filing. An address for the secured creditor may also be desirable, though not as an element of legal sufficiency. If an address is required, the secured creditor should bear both the risk of loss actually caused to any third party by an incorrect address and the risk of non-receipt of any statutory communication to be sent to the secured creditor at the address provided in the notice (for example, a notification of a purchase-money security right).

(iii) Description of assets covered in the notice

10. The description of the encumbered assets in the notice need not be congruent with the description in the security agreement for the notice to be legally sufficient. Coverage by the notice does not expand the property rights created under the security agreement; it is the security agreement, not the notice, that creates the secured creditor’s property rights and determines the scope of the encumbered assets. The grantor should be enabled to police against, and have adequate remedies for, any unauthorized excess of encumbered assets coverage in the notice. The stringency of this requirement should go only to whether a searcher would reasonably have been put on notice of the possible coverage of a potential conflicting claim. As long as the grantor is adequately protected, regulation of the description in the notice of encumbered assets should be relaxed, so as not to create unnecessary inefficiencies and risk of error. Therefore, the description need not be specific and may be by type or category of asset. This is particularly useful in the context of coverage of future assets. Moreover, detailed descriptions may be confusing and lead to error.

(iv) Maximum amount

11. Another element that is sometimes suggested is a requirement that the notice specify a maximum amount of secured credit that gains the benefit derived (in terms of priority) from the filing of the notice. Since this is frequently discussed in the context of the content of the notice, it is also examined here.

12. The advantage of setting a maximum amount in the notice is that additional credit can thereby be obtained, as other credit providers can secure other obligations with any value in excess of the stated maximum, without needing an inter-creditor agreement with the existing secured creditor

(who otherwise would have priority (would be “senior”), having filed earlier). The disadvantage though of capping the priority attributable to a filed notice is that it complicates and increases the cost of obtaining additional credit from the existing secured creditor, who will often be the most likely and least costly source of additional credit. For a more detailed discussion of this matter, see A/CN.9/WG.VI/WP.2/Add.5, paras. 35-37 and Add.7, paras. 46-48.

(v) *Pre-filing*

13. A security rights regime should provide that a notice may be filed prior to the making of a security agreement, that is, no obligation need exist at the time of filing. The advantages and disadvantages of “pre-filing” have been explained in chapter V (see A/CN.9/WG.VI/WP.2/Add.5, paras. 24-28). The benefits of permitting pre-filing may well outweigh any concerns about protecting the grantor, in the event a filing made prior to the creation of the security right is rendered inappropriate because the transaction has not gone forward. The grantor could possibly be protected by provisions requiring the secured creditor to provide a termination upon appropriate demand, similar to the provisions applicable when the secured obligation has been satisfied by payment.

(vi) *Domestic and foreign grantors*

14. A single filing system, covering both domestic and foreign grantors, as well as all types of grantors (that is, every form of legal person as well as individuals), would maximize the efficiency of the security regime.

(b) *Authority to file and signature*

15. A filed notice that has not been authorized by the grantor (or, in the case of a termination or continuation, by the secured creditor) should have no legal effect. However, a signature should not be a standard requirement for the notice to be effective.

16. Imposing a requirement of a signature would increase the obligations of the parties to the transaction, as well as administrative costs. Even if electronic signatures were provided for (so that the signature requirement did not of itself preclude electronic filing), a signature requirement might well make the process more expensive and cumbersome, particularly if the electronic signature provisions of a jurisdiction dictate a specific technology. In fact, a traditional signature requirement does not preclude forgery. Moreover, filing office personnel may be ill-suited to detect forgery and the effort to detect forgery would be a diversion of scarce resources and would slow down the intake process for all filings.

17. In the rare case of a mischievous filing, an aggrieved grantor should be able to seek judicial relief. Further measures aimed at protecting the grantor may be provided, at a greater cost to the secured credit regime. One approach, for example, could be to give the grantor the right to initiate a process to expunge the unauthorized notice. In such a case, the filing office should be obliged to send a

notification to the secured creditor identified in the notice. If the secured creditor does not respond within a stated period of time, the regime could provide for a judicial decision or an automatic deletion of the notice from the record. The deterrent effect of such a statutory penalty is likely to effectively limit secured creditor misconduct. In any case, in determining whether there should be greater protection for the grantor, legislators may need to weigh the magnitude of the risk of filer error, intentional or not, against the cost and risk of loss that might be suffered by secured parties due to grantor error (for example, a grantor wrongfully filing a termination or wrongfully seeking deletion).

(c) *Grantor- or asset-based index*

18. Traditional registries familiar to many countries, such as those for aircraft or patents, are fundamentally ownership registries that may also encompass transfers of rights that are less than full ownership (these registries are asset-based). Such transfers involve high value, serial-numbered, non-fungible assets, in contrast to much of the property that will be covered by the movables security regime, where individual description, even of tangibles, is difficult if not impossible, particularly so if the regime covers future property. Use of asset description or serial numbers as the basis for the index in a general movables security filing system is impossible.

19. This leaves grantor identification as the basis for the index. This may be based on the grantor name, or, in some countries, grantor identification number (see para. 8 above), or even a combination of the two. This puts great importance on the grantor name being correct, which is a problem particularly in systems where the bulk of the filings can reasonably be expected to be against grantors who are individuals. This will depend on whether business is carried out in the sole proprietorship rather than in the entity form and on whether the filing system covers passenger motor vehicles. The significance of the difficulty in providing the grantor’s name with perfect accuracy will vary from country to country, depending on the existence of a mandatory identification or internal identification regime that could be the basis for a single reliable and verifiable name for each individual. In some countries, non-private identification numbers are issued to individuals; these might be used in addition to or in lieu of names. With respect to names of grantors that are legal persons, there is frequently a public registry of those entities that makes possible a single reliable and verifiable name.

20. Devising a filing system usable across borders would present issues relating to multi-lingual databases. Dealing with a multi-alphabet database may present more difficult problems, although within a particular jurisdiction, the issue of a multi-alphabet database is less likely to arise. These problems may be alleviated by the use of grantor identification by number or other element in view of recent technological advances.

21. With respect to certain types of high-value assets that can be individually identifiable, such as motor vehicles,

there is typically an identification number issued by a government agency or other recognized and reliable source. In such cases, the grantor-based index can, with respect to those types of asset, be supplemented by an asset-based index, with identification of the encumbered assets by number being made a condition to priority over specified competing interests, particularly buyers.

(d) *The filing process*

22. An issue that must be addressed at the outset is whether the filing system should be based on electronic filing, either exclusively or optionally, and whether it should accommodate input via paper filings.

23. There can be no dispute about the superior efficiency and speed of electronic filing. It appropriately shifts all responsibility for accurate data input from the filing office on to the filer. An electronic system can, upon filing, instantaneously process, index and confirm the fact of filing. It can also be programmed to reduce inputting errors on the part of the filer. This technology already exists and is in operation in several jurisdictions. There are significant cost savings in the operation and maintenance of an electronic system, once set-up costs have been met. With a view to encouraging the extension of credit by foreign credit institutions, an electronic system might facilitate even multinational searching.

24. While the utilization of computers in less developed countries may be limited, it is likely that higher volume filers (for example, financial institutions) will have access to computers. Given that, it is unlikely that any new system implemented in the future would involve paper input only. The additional operating costs and the added legislative complexity when both electronic and paper filing co-exist (for example, dealing with time lags between presentation and availability for search, an issue that exists only with respect to paper filings) militate in favour of preferring exclusively electronic filing, though this is dependent upon the infrastructure in the jurisdiction.

25. Issues such as the location of physical facilities are also alleviated by electronic filing. Only one repository (whether filings are on paper or electronic) is necessary, which should require few employees. A regime that provides multiple intake sites may encounter "proper place to file" issues (both ab initio and upon change of the determining factor) or, possibly, issues of simultaneous filings against the same debtor in different offices.

26. A regime might make clear the limited role of the system operator by specifying the only permissible grounds for rejection of filings. This issue is also mitigated by electronic filing, which eliminates human intervention in the intake process. Archiving, searching and reporting are non-discretionary tasks. Administrative staff should be fully cognisant of the differences between the filing system and traditional registries and all of their conduct should reflect those differences. The regime should also provide for the maintenance and destruction of records.

27. All design decisions should be tested against the general principle that the filing system, as a key element of

an effective and efficient movables security regime, should be simple, transparent and user-friendly both for filers and searchers. Even in a purely paper-input system, the database can and should be computerized. Computerization provides more efficient record-keeping and searching and should prove less costly to operate. It also enhances the integrity of the system by diminishing the possibility of human error and misconduct.

(e) *Duration of effectiveness of a filed notice*

28. Three options exist for the period of effectiveness of a filed notice. The period may be:

(a) Of unlimited duration, ended only by the authorized filing of a termination;

(b) A fixed term (including infinity) selected by the filer initially, subject to extension by the filing of a continuation; or

(c) A common statutory fixed term, subject to extension by the filing of a continuation.

29. Most personal property secured financing extends over a relatively short period, in many jurisdictions rarely more than five to seven years. It is, however, often difficult to foretell precisely how long the effectiveness of the filing may be needed, as some transactions are open-ended and others of a fixed term initially are often, by agreement or by reason of the debtor's default, extended beyond the due date initially provided for the credit. Consequently, when filers are empowered to select a term, they usually select a term longer than that fixed in the credit documents (higher fees are not a deterrent since debtors have to pay the filing fees as a cost of the credit extension).

30. Options (a) and (c) above have an administrative advantage, in that all filings are good forever or are good for a uniform fixed term, which avoids complications from individualization of the intake process (that is, from having to deal with individual duration selections and, therefore, with fee variations and the consequent potential for rejections if the correct fee is not paid). Option (c) has the further advantage of making the archive "self-cleansing" (that is, filings expire after a period of time). This is important not only in the paper context but also for electronic systems. While electronic archive space is less expensive than that for paper files, storage is not the only factor. There is also the factor of retention in the database and furnishing searchers with information that is no longer useful. Moreover, when a filing's life has ended by virtue of having been permitted to reach the end of the fixed term without the filing of a continuation, issues relating to filing of terminations are avoided.

31. While it is an issue of lesser significance in option (c), the termination of the effectiveness of a filing needs to be addressed in all three options. Terminations serve both the public purpose of clearing the archive of filings that are no longer effective (reducing the quantity of data provided in response to searches) and the private purpose of allowing the grantor to offer a clear record, showing no encumbrances (and therefore no existing priority), to a future credit provider. While the obligation of a secured creditor

to provide a termination is a matter of substantive law dealt with in chapter VIII, any system built on the filing of terminations must provide protection against terminations filed erroneously (by the secured creditor identified in the notice or by a stranger) or mischievously filed (by the grantor). In some existing systems, the filing office must notify the secured creditor that a termination has been filed (the termination only becomes effective if the secured creditor does not seek to prevent that termination within a stated time period). This method imposes time and monetary costs on the parties. Alleviation of these costs requires determining which party shall bear which risks and burdens.

32. Upon full satisfaction of all of the secured obligations, the grantor must be entitled to obtain a termination from the secured creditor. A statutory penalty may be imposed on the secured creditor in the event of non-compliance (for example, a fine or liability to damages). An alternative approach, as discussed above (see para. 31), might require the filing office to notify the secured creditor of receipt of a termination, which, in the absence of an objection by the secured creditor, would become effective upon the expiration of a fixed period. This approach would require some kind of system for adjudication in the event of dispute, and allocation of risk during the period preceding final adjudication. Credit suppliers will require reasonable notice from the filing office to minimize the risk of grantor mischief.

33. The security rights regime should clearly state what occurs if a secured creditor fails to file a continuation statement within the prescribed time and should make clear the effect of lapse on the priority previously enjoyed by the secured creditor (which might differ vis-à-vis different competing claimants). The regime should also provide for:

(a) The method for accomplishing continuation and termination;

(b) Judicial or administrative cancellation;

(c) The effect of, and method of dealing with, subsequent events such as, for example, a change in the name of the grantor; the transfer of encumbered assets by the grantor; a change in location of the grantor or of the encumbered assets (to the extent these are relevant to the determination of the proper place for filing); or the need to amend the name under which the filing is indexed in the event of a change in the name of the grantor;

(d) The method for dealing with other amendments (for example, encumbered assets changes and party changes such as an assignment of the security interest by the secured creditor).

3. Other basic elements

(a) Public access to the database

34. In many countries, with respect to traditional registries, it is normal practice to oblige an inquirer to establish a bona fide interest satisfactory to the registrar in order to search. In some countries, access is limited in the context of rules that only regulated financial entities are entitled to the benefit of certain movables security devices. However,

impediments to access, such as qualification by the filing office, may cause delay or inappropriate exclusion. Many persons having or considering any sort of dealings with the grantor may have legitimate reasons for seeking access to the database. As the notice provides only minimal data, privacy concerns are less significant. It is, therefore, important that the regime explicitly state that anyone may file or search the security rights filing system, without interference by its administrator.

35. Technically, the index and the database could easily be made available, at no charge, to remote searchers (excluding the ability to modify content). With respect to filing, the degree of security desired will influence the technological architecture of the system. In all events, any proposed restriction on access should be tempered by an objective to make the system user-friendly and a recognition that the goal of the movables security regime is to enhance the availability of lower-cost credit.

(b) Extent of detail in statutory text

36. Although the tasks of the filing office may be detailed, the regime need only regulate the basic intake, search facilitation and archiving responsibilities of the filing office. A balance must be struck between drafting simple and flexible regulation and ensuring certainty and administrative transparency. The duties and obligations, discretion and performance standards of the system operator should all be clearly prescribed by the regime.

(c) Fees

37. High filing and searching fees will undermine the policy objective of security transactions law reform to expand the availability of and reduce the cost of secured credit. Filing fees should be set at a low level to enable and encourage use of the filing system in the widest range of transactions.

38. Establishing the filing system as a revenue source (beyond cost recovery) would also run counter to an objective of promoting low-cost secured credit. Filing fees for financing statements designed to raise revenue are tantamount to a tax, borne by debtors, on secured transactions. The negative effect of stamp duties, including the consequent incentive to avoid the dutiable format, provides instructive experience.

39. While cost recovery should be the ultimate purpose of any fees charged, this notion should be viewed in light of the overall goals of the legislation. If a substantial initiation cost is incurred in setting up the filing system, this should be recovered over a long period of time in order to keep the fee as low as possible. Ultimately, it is the debtor who bears the burden of the fee.

40. Numerous methods of payment are now technologically feasible and, to ensure simplicity and flexibility, as many alternatives as possible should be offered, ranging from pre-arranged accounts (with prepaid deposits) maintained by frequent filers to capability to use credit or debit cards or a form of electronic funds transfer.

41. From a process design standpoint, the simplest structure may be to charge a fee only at the time of the initial filing (leaving subsequent filings free of any additional fees). The single fee might be determined by dividing the expected operating budget for the system by the expected number of initial filings. While this approach does shift some costs to grantors whose filing circumstances are less filing-intensive (for example, no amendments) from those whose circumstances do involve post-initial filings, overall simplicity for system users and for the filing office (plus the advantage of an early collection of the fee) support the adoption of this approach. Many existing systems already provide this feature to some extent by not requiring a fee for filing terminations (which also encourages the filing of terminations). A searching fee is not necessary if the system provides Internet or similar remote access to the database for self-searching (which requires no particular service by the filing office, although there will be some general system maintenance). A system that permits remote access for searching the index and the database, free of charge, might charge fees for certification or for copies of items in the database.

(d) Public or private operator

42. Reluctance to increase government bureaucracy should not be a basis for rejecting the notion of a filing system as part of a movables security regime. As the role of the system operator is limited, the system need not be operated by a government entity. However, each jurisdiction should provide a method for supervision and control of the operator of the system and allow users to seek review of filing office conduct or inaction (whether judicial, administrative or a combination of the two). The review methodology should be accessible and expeditious. If an effective general review methodology already exists in the jurisdiction, the secured transactions legislation need not address this matter.

(e) Effect of registry error and allocation of risk of loss

43. If the system is exclusively electronic, there will be little opportunity for filing office error. Even in a paper-based system, experience has not revealed many known losses suffered as a consequence of filing office error. The domestic legal system might already generally provide for either liability (or some sort of mandatory insurance) or immunity for filing office error.

44. In any case, it would be advisable for the security rights regime to allocate risks clearly between filers and searchers on the basis of efficiency. In most cases this would mean protecting the filer at the expense of the subsequent searcher, although this rule can be mitigated in certain cases if it is deemed desirable to do so. For example, a rule might provide that an indexing error does not preclude effectiveness of the filing. This approach might, however, be modified to provide that it does not render the filing ineffective but only subordinates it to a subsequent filer who can establish that it searched and was misled by the indexing error. The policy judgement is a matter of allocating the risks between the earlier filer and the later

filer. Thus, a rule that imposes the risk of an indexing error on the first filer would likely produce the practice of each filer performing a follow-up search. This practice, however, would burden all filings with extra cost and delay and would burden the system with many additional searches. Whether this approach is sensible depends in part on assumptions made about the likely frequency of both error and subsequent additional financing. This is also partly a matter of efficiency of the system in the sense that the decision might be affected by the availability of a remedy against the filing office. In many jurisdictions, the filing office enjoys sovereign immunity, while in others, a remedy for government error is available.

(f) Proof of content of database

45. Proof of content of the database is a matter of the law of evidence. A rule on this subject may be helpful in some jurisdictions.

(g) Alternative systems

46. Alternative systems include special systems for land, motor vehicles, air and sea vessels and certain types of intellectual property. Specific filing systems for these types of assets are designed primarily to assure ownership and may not be well-suited to the needs of modern finance (for a discussion of coordination between registries, see A/CN.9/WG.VI/WP.2/Add.5, paras. 41-43).

(h) Special issues in a federal State

47. While it is likely that a multi-unit State will have to confront special political problems and special choice of law issues, many of these issues can be rendered significantly less important by means of technology, particularly if the filing systems can provide for a unified index and database (whether there is a single filing office or multiple filing offices).

(i) Non-discrimination

48. The system should be accessible to both domestic and foreign creditors for both filing and searching purposes. In this way, sources of credit will be expanded to include foreign credit institutions.

B. Summary and recommendations

49. A notice filing system, as contrasted to a document filing system, is more suited to a security rights regime. For efficiency and cost-saving reasons, the information required might be limited to identification of the debtor, identification of the secured creditor and a description of the assets.

[Note to the Working Group: On the issue of a maximum amount in the notice, pre-filing and types of grantor covered, see the note to the Working Group at the end of chapter V in A/CN.9/WG.VI/WP.2/Add.5.]

50. A signature requirement for the legal sufficiency of a notice is not recommended, as this increases the obligations of the parties and administrative costs. A filed notice that has not been authorized by the grantor should have no legal effect. Other measures designed to protect the grantor may be introduced at a greater cost to the secured credit regime.

51. Much of the property that will be covered by a general security rights regime is not capable of individual description. This means it is not possible to use asset description as the basis for an index in a general security rights filing system covering movables. The system may instead be indexed on the grantor name, an assigned grantor identification number or a combination of the two. This may be varied for those types of assets that can be individually identified.

52. A system based on electronic filing is highly recommended, for reasons of efficiency, ease of use and increased access. These advantages apply equally to filers, searchers and administrators.

53. Different approaches may be taken to the period of effectiveness of a filed notice. The period may be of unlimited duration, ended only by the authorized filing of a termination; a fixed term (including infinity) selected by the filer initially, subject to extension by the filing of a continuation; or a statutory fixed term, subject to extension by the filing of a continuation. Certainty of the term of effectiveness is an important consideration, as is its termination. The regime should address the process for termination and provide remedies for misconduct. The regime should also provide processes for continuation and any amendments of the notice.

[Note to the Working Group: The Working Group may wish to consider whether international registries should be established as part of the regime envisaged in this Guide and, if so, discuss the issue of coordination between national and international registries. In its consideration, the Working Group may wish to take into account the international registries foreseen in various treaties such as the Convention on International Interests in Mobile Equipment and the United Nations Assignment Convention (optional annex).]

A/CN.9/WG.VI/WP.2/Add.7

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

VII. PRIORITY

A. General remarks

1. *The concept of priority and its importance*

1. The term “security right,” as used in the present Guide, refers to an in rem right (that is, a right in property granted to a creditor to secure the payment or other performance of an obligation). The term “priority,” on the other hand, refers to the extent to which the creditor may derive the economic benefit of that right in preference to other parties claiming an interest in the same property (see A/CN.9/WG.VI/WP.2/Add.1, para. 9, definition of “priority”). As discussed below, these competing claimants may include holders of consensual security rights in the property, holders of unsecured debt, sellers of the property, buyers of the property, holders of non-consensual security rights in the property (such as security rights arising from judgements or created by statute) and the insolvency administrator of the grantor.

2. The concept of priority is at the core of every successful legal regime governing security rights. While some have questioned why one creditor should ever be given priority over another creditor, it is widely recognized that a priority rule is necessary to promote the availability of low-cost secured credit. Moreover, a clear priority rule that leads to predictable outcomes allows all creditors, even unsecured creditors, to assess their positions in advance of extending credit and to take steps to protect their rights.

3. A creditor will normally extend credit on the basis of the value of specific property only if the creditor is able to determine, with a high degree of certainty at the time it extends the credit, the extent to which other claims will rank ahead of its security right in the property. The most critical issue for the creditor in this analysis is what its priority will be in the event of the grantor’s insolvency, especially where the encumbered asset is expected to be the creditor’s primary or only source of repayment. If the creditor has any uncertainty with respect to its priority at the time it is evaluating whether to extend credit, the creditor will place less reliance on the encumbered asset. At a minimum, this uncertainty will increase the cost of the credit to reflect the diminished value of the encumbered asset to the creditor and may even cause the creditor to refuse to extend the credit altogether.

4. To limit this uncertainty, it is important that secured lending laws include clear priority rules that lead to predictable outcomes. The existence of such rules, together with efficient mechanisms for ascertaining and establishing priority at the time credit is advanced, may be more important to creditors than the particulars of the priority rules themselves. It often will be acceptable to a creditor if certain competing claimants have priority, as long as the creditor can determine, with a high degree of certainty, that it will ultimately be able to realize a sufficient portion of the value of the encumbered assets to repay its claim in the event of non-payment by the grantor. For example, a creditor may be willing to extend credit to a grantor based upon

the value of the grantor’s existing and future inventory, even though the inventory may be subject to the prior claims of the vendor who sold the inventory to the grantor, or the warehouseman who stored the inventory for the grantor, as long as the creditor can determine that, even after paying such claims, the inventory may be sold or otherwise disposed of for an amount sufficient to repay its secured obligation in full.

5. It is important to note that no matter what priority rule is in effect in any jurisdiction, it will only have relevance to the extent that the applicable conflict-of-laws rules provide that such a priority rule governs. This issue is discussed in chapter XI.

2. *Priority rules*

(a) *First-to-file priority rule*

6. As discussed above (see paras. 2-4), in order to promote the availability of low-cost credit effectively, consideration should be given to establishing priority rules that permit creditors to determine their priority with the highest degree of certainty at the time they extend credit. As discussed in chapters V and VI, the most effective way to provide for such certainty is to base priority on the use of a public filing system.

7. In many jurisdictions in which there is a reliable filing system, priority is generally determined by the order of filing, with priority being accorded to the earliest filing (“first-to-file priority rule”). In some situations, this rule applies even if all of the requirements for the creation of a security right have not been satisfied at the time of the filing, which avoids the need for a creditor to search the filing system again after all remaining requirements for creation have been satisfied. This rule provides the creditor with certainty that once it files a notice of its security right, no other filing, except for the limited exceptions discussed in section A.3 below, will have priority over its security right. This certainty allows creditors to assess their priority position with a high degree of confidence and, as a result, reduces their credit risk. Other creditors are also protected because the filing will put them on notice of the security right, or potential security right, and they can then take steps to protect themselves. The first-to-file priority rule does not apply in some cases (for example, to purchase-money security rights, discussed in section A.3 (c) below, or to statutory creditors, discussed in section A.3 (f) below).

8. This first-to-file priority rule is illustrated in examples 2 and 3 (see A/CN.9/WG.VI/WP.2/Add.2, paras. 10 and 13). In these examples, Lender B and Lender C each have a security right in all of Agrico’s existing and after-acquired inventory and receivables. Under a first-to-file priority rule, the lender that filed a notice of its security right in the inventory and receivables first would have priority over the other lender’s security right, regardless of the time that each lender’s security right was obtained.

9. Some jurisdictions provide that, as long as filing occurs within a certain “grace period” after the date on

which the security right is created, priority will be based on the date of creation rather than on the date of filing. Thus, a security right that is created first, but filed second, may still have priority over a security right that is created second but filed first, as long as the first security right is filed within the applicable grace period. As a result, until the grace period expires, the filing date is not a reliable measure of a creditor's priority ranking, thus resulting in significant uncertainty. In legal systems in which no such grace periods exist, creditors are not at a disadvantage because they can always protect themselves by making a timely filing.

10. In principle, the ordering of priority according to the timing of filing should apply even if the creditor acquired its security right with actual knowledge of an existing unfiled security right. Qualifications based on actual knowledge require a fact-specific investigation and would subject filings to challenge, creating a new issue for litigation and an incentive to attack filings. All this would diminish certainty as to priority status and thereby reduce the efficiency and effectiveness of the system. As in the case of grace periods, there is no unfairness to secured creditors in this approach because they can always protect themselves by making a timely filing.

(b) Priority based on possession or control

11. As discussed in chapters III and IV (see A/CN.9/WG.VI/WP.2/Add.3, paras. 5-14, and Add.4, paras. 2 and 52-54), possessory security rights traditionally have been an important component of the secured lending laws of most jurisdictions and should be considered in crafting a priority rule. In recognition of this, in certain systems that have a first-to-file priority rule, priority alternatively may be established based on the date that the creditor obtained its security right by possession or control, without any requirement of a filing. In these systems, priority is generally afforded to the creditor that first either filed notice of its non-possessory security right in the filing system or obtained a security right by possession or control.

12. If priority may be established by date of possession or control, or alternatively by the date of filing, consideration should be given to whether a security right obtained by possession or control should ever have priority over a previously filed non-possessory security right. In the case of certain types of encumbered assets, creditors often require possession or control to prevent prohibited dispositions by the grantor. For example, creditors often require possession or control of instruments such as certificated investment securities or documents of title such as warehouse receipts and negotiable documents. For these types of assets, it may be most efficient for a security right established by possession or control always to have priority over a non-possessory security right, regardless of the date of the filing of the non-possessory security right. For other types of assets, consideration should be given to according priority to the first creditor to file a notice of its security right or obtain possession or control of the encumbered asset.

13. The availability of alternative modes of establishing priority (that is, control, possession and filing) raises the

question of whether a secured creditor who initially established priority by one method should be permitted to change to another method, without losing its original priority ranking with respect to the encumbered asset. In principle, there is nothing objectionable about this, provided there is no gap in the continuity of control, possession or filing (that is, at all times the security right is subject to one method or another).

(c) Alternative priority rules

14. In some systems, priority is based on the date that the security right is created as opposed to the date of filing (a different first-in-time rule). This approach has been adopted in some jurisdictions that permit non-possessory security rights but have not adopted a reliable, or any, filing system. In these jurisdictions, a creditor is not able to confirm independently whether there are any competing security rights and must rely solely upon representations of the grantor as to the absence of such rights. This serves as a major impediment to the availability of low-cost secured credit.

15. In other systems, with respect to certain types of assets such as receivables, priority is based on the time that specified third parties are notified of the security right. Like the system described in the preceding paragraph, this system also is not conducive to the promotion of low-cost secured credit because it does not permit the creditor to determine, with a sufficient degree of certainty at the time it extends credit, whether there are any competing security rights.

3. Types of competing claimants

(a) Other consensual secured creditors

16. As discussed above (see paras. 2-4), many legal systems allow the grantor to grant more than one security right in the same asset, basing the relative priority of such security rights on the priority rule (first-to-file or other) in effect under such a system or on the agreement of the creditors. Allowing multiple security rights in the same asset in this manner enables a grantor to use the value inherent in a single asset to obtain credit from multiple sources, thereby unlocking the maximum borrowing potential of the asset.

(b) Unsecured creditors

17. The grantor will often incur debts that are not secured by security rights. These general unsecured claims often comprise the bulk of the grantor's outstanding obligations.

18. While some question the fairness of giving secured creditors priority over unsecured creditors, it is well established that giving secured creditors priority over unsecured creditors is necessary to promote the availability of secured credit. Unsecured creditors can take steps to protect their interests, such as monitoring the status of the credit, requiring security in certain instances or reducing their claims to judgements (as discussed in sect. A.3 (e) below) in the event of non-payment. In addition, obtaining secured credit

increases the capital of the grantor, which in many instances benefits the unsecured creditors by increasing the likelihood that the unsecured debt will be repaid. Thus, an essential element of an effective secured credit regime is that secured claims, properly obtained, have priority over general unsecured claims.

(c) *Sellers of encumbered assets*

(i) *Purchase-money security rights*

19. Typically, the grantor acquires its assets by purchasing them. If the purchase is made on credit provided by the seller or is financed by a lender (“purchase-money financing”; see A/CN.9/WG.VI/WP.2/Add.2, paras. 2-4, and Add.3, paras. 31 and 32) and the seller or lender obtains a security right in the goods acquired to secure the purchase-money financing, consideration must be given to the priority of such rights vis-à-vis security rights in the same goods held by other parties.

20. Recognizing that purchase-money financing is an effective means of providing businesses with the capital necessary to acquire specific goods, many legal systems provide that holders of purchase-money security rights have priority over other creditors (including creditors that have an earlier-in-time filed security right in the goods) with respect to goods acquired with the proceeds of the purchase-money financing. This is a significant exception to the first-to-file priority rule discussed in section A.2 (a) above.

21. This heightened priority is important in promoting the availability of purchase-money financing. As illustrated in examples 2 and 3 (see A/CN.9/WG.VI/WP.2/Add.2, paras. 10 and 13), businesses often grant security rights in all or some of their existing and after-acquired inventory and equipment to obtain financing. In these situations, if purchase-money security rights are not afforded a heightened priority, purchase money financiers would not be able to place significant reliance on their security rights because they would rank behind existing security rights. In example 1 (see A/CN.9/WG.VI/WP.2/Add.2, paras. 4-7), Vendor A, Lender A and Lessor A would each be reluctant to provide purchase-money financing if their security rights in the goods financed ranked behind the existing security rights of Lender B in example 2 and Lender C in example 3.

22. Providing heightened priority for purchase-money security rights is generally not considered to be detrimental to the grantor’s other creditors, because purchase-money financing does not diminish the estate (that is, the net assets or net worth) of the grantor, but instead provides the estate with additional assets in return for the purchase-money obligations. For example, the security positions of Lenders B and C in examples 2 and 3 are not diminished by a purchase-money financing, because the lenders still have all of their encumbered assets plus a security right ranking behind the additional goods financed by the purchase-money credit transaction (“junior security right”). In order to promote the availability of both purchase-money financing and general secured credit, it is important that the

heightened priority afforded to purchase-money security rights only apply to the goods acquired with such purchase money and not to any other assets of the grantor.

23. To avoid other creditors mistakenly relying on assets subject to purchase-money security rights, it is important that purchase-money security rights be subject to the filing system. From the perspective of a competing creditor, it would be beneficial if a notice of such security rights was required to be filed at the time the rights were obtained. This would mean that any creditor could search the filing system and determine with certainty whether any of the grantor’s existing assets are subject to purchase-money security rights.

24. However, in order to facilitate on-the-spot financing in the sales and leasing sectors, a grace period for the filing should be considered. This grace period should be long enough so that the filing requirement is not an undue burden to purchase-money financiers, but short enough so that other secured creditors are not subject to long periods before they are able to determine if any competing security rights exist. In addition, it may be wise to require purchase-money financiers of inventory to give notice of their purchase-money security rights to the grantor’s other creditors that have security rights in inventory. The reason for such an approach lies in the fact that creditors who provide credit on a continual basis based on the value of a grantor’s existing and future inventory are unlikely to search the filing system each time they extend credit.

(ii) *Reclamation claims*

25. Consideration might also be given to allowing a supplier that sells goods on unsecured credit to reclaim the goods from the buyer within a specified period of time if the supplier discovers within that time that the buyer is insolvent. Although the supplier will want such a period to be as long as possible to protect its interests, other creditors will be reluctant to provide credit based on assets subject to reclamation claims. Moreover, if the supplier is truly concerned about the credit risk, the supplier could insist upon a purchase-money security right in the goods that it supplies on credit. Accordingly, although a reclamation claim is important so that suppliers can have some rights in the goods that they supply on unsecured credit, the reclamation period should be brief so that it does not impede lending generally. In addition, to avoid discouraging the availability of secured credit, reclamation claims relating to specific goods should not have priority over properly filed security rights in the same goods.

(d) *Buyers of encumbered assets*

26. The grantor may also sell assets that are subject to existing security rights. In this situation the buyer has an interest in receiving the assets free and clear of any security right, whereas the existing secured creditor has an interest in maintaining its security right in the assets sold. It is important that a priority rule address both of these interests.

(i) *Sales outside the ordinary course of business of the grantor*

27. In many countries, sales of encumbered assets outside the ordinary course of business of the grantor do not destroy any security rights that the secured creditor has in the assets, unless the secured creditor consents. In those jurisdictions, the secured creditor may, upon a default by the grantor, enforce its security right against the assets in the hands of the buyer. Without this protection, the rights of the secured creditor would be jeopardized any time that the grantor sells assets. This result would reduce the value of the encumbered assets as security, thereby impeding the availability of low-cost credit.

28. Even if the creditor would have a security right in the proceeds arising from the sale of the assets, the secured creditor would not necessarily be sufficiently protected, because proceeds often are not as valuable to the creditor as the original encumbered assets. In many instances, the encumbered assets may be sold in return for assets that have little or no value to the creditor as security. In other instances, it would be difficult for the creditor to identify the proceeds and, as a result, its claim to the proceeds may be illusory. Also, there is a risk that the proceeds may be dissipated by the grantor, leaving the creditor with nothing.

29. As long as the creditor's security right is subject to filing in a reliable and easily accessible filing system, the buyer may protect itself by searching the filing system to determine whether the asset it is purchasing is subject to a security right and, if so, seek a release of the security right from the secured creditor. Consideration might be given to whether any low-cost items should be exempted from this rule because the search costs imposed on potential buyers may not be justified for such items. On the other hand, it may be argued that, if an item is truly low-cost, a secured creditor is unlikely to enforce its security right against the asset in the hands of the buyer. In addition, determining which items are sufficiently low-cost to be so exempted would result in arbitrary line-drawing and would have to be continually revised to respond to cost fluctuations resulting from inflation and other factors. As a result, it may be best not to provide for such an exemption.

30. In some countries that have a filing system that is searchable only by the grantor's name, rather than by a description of the encumbered assets, a purchaser who purchases the assets from a seller who previously purchased the assets from the grantor ("remote purchasers") obtains the assets free of the security rights granted by such grantor. This approach is taken because it would be difficult for a remote purchaser to detect the existence of a security right granted by a previous owner of the encumbered assets. In many instances, remote purchasers are not aware that the previous owner ever owned the asset and, accordingly, have no reason to conduct a search against the previous owner.

(ii) *Sales made in the ordinary course of business of the grantor*

31. An exemption to the rule discussed in section A.3 (d)(i) above is generally provided for goods held as

inventory of the grantor and sold in the ordinary course of the grantor's business. For such goods, there is a commercial expectation that the grantor will sell them (and indeed must sell them to remain viable) and that the buyer of the encumbered assets will take them free and clear of existing security rights. Without such an exemption, a grantor's ability to sell goods in the ordinary course of its business would be greatly impeded, because buyers would have to investigate claims to the goods prior to purchasing them. This would result in significant transaction costs and would greatly impede ordinary course of business transactions.

32. As a consequence, many legal systems provide for an exception to the general rule of continuity of security rights in favour of buyers of encumbered assets if the sale is made in the ordinary course of the grantor's business and the asset being sold constitutes inventory of the grantor. To promote such ordinary course of business transfers, many legal systems provide that buyers in such transactions obtain the assets free and clear of any security right, even if the buyer had actual knowledge of the security right. This exception, however, is limited in some jurisdictions if the buyer had knowledge that the sale was made in violation of an agreement between the seller and its creditor that the assets would not be sold without the consent of the creditor.

(e) *Judgement or execution creditors*

33. In many legal systems, a security right is extended to certain classes of creditors felt to be deserving of such a right. In particular, many legal systems give a security right to general unsecured creditors once they have reduced their claim to judgement and have caused the seizure of specific property.

34. In this situation, an existing creditor that has an earlier-in-time consensual security right in certain assets has an interest in making sure that its security right retains its priority over the security right obtained by a judgement, particularly with respect to assets it has already relied upon in extending credit. On the other hand, the judgement creditor has an interest in receiving priority with respect to assets that have sufficient value to serve as a source of repayment of its claim.

35. Many legal systems that have a filing system rank priority in this situation by time of filing of the security right, that is, an earlier-in-time filed consensual security right in property will have priority over a subsequent security right in the same property obtained by judgement. Conversely, any attempt to grant a consensual security right in the property after a creditor has obtained some form of a judgement security right will result in an interest that is junior to the existing judgement security right. This approach is generally acceptable to creditors as long as the judgement security right is made sufficiently public so that creditors can become aware of it in an efficient manner and factor its existence into their credit decision before extending credit. To facilitate this, consideration should be given to subjecting judgement security rights to the general filing system for security rights, thus integrating them into the first-to-file priority regime.

36. There is generally an exception to this rule when it is applied to future advances (discussed in greater detail in section A.4 (a) below). While a previously filed security right customarily will have priority over a judgement security right with respect to credit advanced prior to the date that the judgement security right becomes effective, it will generally not have priority over the judgement security right with respect to any credit advanced after such effective date (unless such credit had been committed prior to the effective date of the judgement). For example, in example 2 (see A/CN.9/WG.VI/WP.2/Add.2, para. 10), Lender B makes loans from time to time to Agrico, which are secured by all of Agrico's receivables and inventory. If an unsecured creditor reduces its claim to a judgement against Agrico and thereby obtains a security right in Agrico's inventory, Lender B's security right in the inventory would have priority over the judgement security right with respect to loans that Lender B made prior to the date that the judgement became effective and for a specified period thereafter. However, the judgement security right would have priority with respect to any additional loans made by Lender B after the specified period (as long as Lender B did not commit prior to the effective date of the judgement to extend such additional loans).

37. To protect existing secured creditors from making additional advances based on the value of assets subject to judgement security rights, there should be some mechanism to put creditors on notice of such judgement security rights. In many jurisdictions in which there is a filing system, this notice is provided by subjecting judgement security rights to the filing system. If there is no filing system or if judgement security rights are not subject to the filing system, the judgement creditor might be required to notify the existing secured creditors. In addition, it may be provided that the existing secured creditor's priority continues for a period of time (perhaps 45 to 60 days) after the judgement security right is filed (or after the creditor receives notice) so that the creditor can take steps to protect its interest accordingly. The less time an existing secured creditor has to react to the existence of judgement security rights and the less public such judgement security rights are made, the more their potential existence will impede the availability of credit facilities that provide for future advances.

(f) *Statutory (preferential) creditors*

38. In many jurisdictions, as a means of achieving a general societal goal, certain unsecured claims are given priority over other unsecured claims, and in some cases, over secured claims (including secured claims that previously have been the subject of a filing). For example, to protect claims of employees and the Government, claims for unpaid wages and unpaid taxes often will, at some point, be given priority over previously existing security rights. Because societal goals differ from jurisdiction to jurisdiction, the types of these claims, and the extent to which they are afforded priority, also differ.

39. The advantage of establishing these preferential claims is that a societal goal may be furthered. The possible disadvantage is that these types of priorities can proliferate in a fashion that reduces certainty among existing and

potential creditors, thereby impeding the availability of low-cost secured credit. To avoid discouraging secured credit, the availability of which is also a societal goal, the various societal goals should be carefully weighed in deciding whether to provide a preferential claim. Preferential claims should only be provided to the extent that there is no other effective means of satisfying the underlying societal goal and the impact on the availability of low-cost credit is acceptable. If preferential claims exist, the laws establishing them should be sufficiently clear so that a creditor is able to calculate the potential amount of the preferential claims and to protect itself.

(g) *Creditors adding value to or storing encumbered assets*

40. Some legal systems provide that creditors who improve or fix encumbered assets, such as equipment repairers, have security rights in the encumbered assets they improve or fix and that such security rights generally rank ahead of other secured claims in the encumbered assets. This priority rule has the advantage of inducing those who supply such value to continue in their efforts and also has the advantage of facilitating the maintenance of the encumbered assets. As long as the amount that these security rights secure is limited to an amount that reflects the value by which the encumbered asset has been enhanced, such security rights and their elevated priority should be unobjectionable to existing secured creditors.

41. Some systems also provide that creditors who store encumbered assets, such as landlords and warehousemen, have security rights in the encumbered assets to secure the rental and storage obligations and such security rights often rank ahead of other secured claims in the same encumbered assets.

42. In many jurisdictions, the rights described in the preceding two paragraphs are not subject to any filing requirement and their existence can only be discerned through due diligence on the part of a prospective creditor. As a result, these security rights are often referred to as being "secret". While secret security rights have the advantage of protecting the rights of the parties to whom they are granted without requiring such parties to incur the costs associated with filing, they pose a significant impediment to secured credit because they limit the ability of creditors to determine competing security rights. As discussed in chapters V and VI, consideration should be given to requiring that notice of such security rights be filed in the security rights filing system.

(h) *Insolvency administrators*

43. It is particularly important that a secured creditor should be able to determine what its priority will be in the event that insolvency proceedings are commenced by or against its grantor, because there most likely will not be sufficient assets to pay all creditors and the secured creditor's encumbered assets may be its primary, or only, source of repayment. As a result, in deciding to extend credit and in evaluating priority, secured creditors generally place their greatest focus on what their priority will be in

insolvency proceedings of the grantor. Therefore, it is important that the priority of a properly obtained security right not be diminished or impaired in insolvency proceedings. The importance of this point in crafting an effective secured transactions law cannot be over emphasized. To the extent that secured credit laws are not clear on this point, the willingness of creditors to provide secured credit will be seriously diminished.

44. In order to compensate insolvency administrators effectively for their work in the insolvency proceedings, they are often given a preferential claim in the assets of the insolvent estate. As long as the amount of this preferential claim can be determined by secured creditors in advance with a high degree of certainty, this claim is generally not objectionable to secured creditors, because they can take action in advance to protect their claims. However, the greater this potential preferential claim, the less value prospective secured creditors will attribute to the encumbered assets.

45. As discussed in greater detail in chapter X, insolvency laws in many jurisdictions contain provisions that empower an insolvency administrator to challenge, within a limited period of time, the validity or priority of consensual security rights based on factors such as lack of consideration to the grantor, the inequitable conduct of the creditor or the fact that the security right was granted in violation of a particular law. It is important to emphasize that any successful security regime must be meshed effectively with applicable insolvency laws so that a prospective creditor may properly structure its credit transaction in compliance with such laws in order to ensure that the effectiveness and priority of its security right is maintained in the case of the grantor's insolvency.

4. Priority in future advances and after-acquired property

(a) Future advances

46. A secured creditor must be able to determine how much of its claim will be accorded priority. Some legal systems limit this priority to the amount of debt existing at the time of the creation of the security right. Other legal systems require publicity of the maximum amount of credit that will be extended priority. Yet other legal systems accord priority for all extensions of credit, even those made after creation of the security right.

47. The advantage of limiting priority to the amount of debt originally in existence at the time that the security right was created is that it matches priority with the contemplation of the parties at the time of creation and preserves only that priority against creditors then in existence. The disadvantage of this approach is that it requires additional due diligence (for example, searches for new filings) and additional agreements and filings for amounts subsequently advanced. This is particularly problematic because one of the most effective means of providing secured credit is on a revolving basis because this type of credit facility

most efficiently matches the grantor's particular borrowing needs (see example 2 in A/CN.9/WG.VI/WP.2/Add.2, paras. 8-10, and Add.4, para. 10). Accordingly, consideration might be given to affording to future advances the priority afforded to advances made at the time that the security right is first created.

48. To avoid tying up all the grantor's assets with one creditor, thus reducing the willingness with which subsequent creditors may extend credit to the grantor, many legal systems require that security right filings set forth a maximum amount of debt that may be secured by any given security right and limit priority to such a maximum amount (see A/CN.9/WG.VI/WP.2/Add.6, paras. 11 and 12). To avoid hindering the advancement of revolving credits as discussed above (see para. 47) or any other similar form of credit, consideration might be given to not limiting the amount to which future advances are afforded priority.

(b) After-acquired property

49. As discussed in greater detail in chapter IV (see A/CN.9/WG.VI/WP.2/Add.4, paras. 19-23), in some legal systems a grantor may provide for a security right in property to be acquired in the future. Such a security right is obtained simultaneously with the grantor's acquisition of the property, without any additional steps being required each time additional property is acquired. As a result, the costs incidental to the grant of a security right are minimized and the expectations of the parties are met. This is particularly important with respect to inventory, which is acquired for resale, receivables, which are collected and re-generated on a continual basis (see example 2 in A/CN.9/WG.VI/WP.2/Add.2, paras. 8-10) and equipment, which is replaced in the normal course of the grantor's business.

50. The allowance of security rights in after-acquired property raises the question of whether the priority dates from the time of the initial grant or from the time the grantor acquires the property. Different systems address this matter in different ways. Some systems vary the effect depending on the status of the creditor competing for priority (with priority dating from the date of the grant vis-à-vis other consensual security creditors and from the date of acquisition vis-à-vis all other creditors). Whatever the rule, it is important that it should be clear so that creditors can protect their interests accordingly.

5. Priority in proceeds

51. If the creditor has a right in proceeds of the original encumbered asset, issues will arise as to the status and priority of that right as against other competing claimants. Apart from the competing claimants mentioned already, competing claimants with respect to proceeds may include a creditor of the debtor who has obtained a right by judgment or execution against the proceeds and another creditor who has a security right in the proceeds.

52. A security right in proceeds can arise in two ways. The debtor may have granted the competing secured creditor a security right in the proceeds after the debtor acquired the proceeds; or the proceeds are a type of property in which the competing secured creditor has a pre-existing interest that covers after-acquired or future collateral. For example, Creditor A has a security right in all of the debtor's inventory and Creditor B has a security right in all of the debtor's receivables (including future receivables). Assume further that the debtor later sells inventory that is subject to the security interest of Creditor A and that this sale is on credit. The receivable generated by the sale is proceeds of the encumbered asset of Creditor A and is the encumbered asset of Creditor B.

53. The legal system governing security rights must answer several questions with respect to the claim of the secured creditor as against each of the above-mentioned competing claimants. The first question is whether the right of the secured creditor in the proceeds of its initial encumbered asset is effective not only against the grantor but also against competing claimants. The answer to this question must be affirmative, at least in some circumstances. Otherwise, the value of encumbered assets would be largely illusory. Security rights add economic security (thereby increasing access to credit at lower cost) only in cases in which the security right provides the creditor with the right to apply the value of the encumbered asset to the debt owed to the creditor before that value is applied to claims of other claimants.

54. Nonetheless, it must be recognized that the creation of a right in proceeds raises important concerns about the risks created for third parties. In particular, considerations that lead to a requirement of publicity for a security right in particular property to be effective against third parties may lead to a conclusion that similar requirements are appropriate for the right in proceeds.

55. Therefore, a legal regime should contain rules that determine when the publicity that is given to the security right in the original encumbered asset will suffice to publicize the creditor's right in the proceeds. In cases in which a different mode of publicity is required for the creditor's interest in the proceeds, the legal regime should provide a period of time after the transaction generating the proceeds in which the creditor may provide the publicity without losing its interest in the proceeds.

56. While determination of whether a new act of publicity is necessary in order for the creditor's right in proceeds to be effective against third parties is quite important, that determination alone is not sufficient to resolve the relative rights of the secured creditor's right in proceeds. In particular, priority rules are needed to determine the relative priority of the secured creditor's right.

57. The priority rules may differ depending on the nature of the competing claimant. For example, if the competing claimant is another secured creditor whose rights are also dependent on publicity, the rules determining the relative priority of the rights of the two secured creditors might depend on the nature and timing of the publicity. Priority

may depend on other factors when the competing claimant is a judgement creditor or an insolvency administrator (see paras. 33-37 and 43-45 above).

58. In many cases in which the competing claimant is another secured party, the priority rules for rights in proceeds of original encumbered assets may be derived from the priority rules applicable to the original encumbered asset and the policies that generated those rules. For example, in a legal system in which the first right in particular property that is publicized has priority over competing rights, that same rule could be used to determine the priority when the original encumbered asset has been transferred and the secured creditor now claims a right in the proceeds. If the right in the original encumbered asset was publicized before the right of the competing claimant in the proceeds was publicized, that right could be given priority.

59. In cases in which the order of priority of competing interests in the original encumbered asset is not determined by the order of publicity, a separate determination will be necessary for the priority rule that would apply to the proceeds of such an original encumbered asset. This might be the case, for example, if one of the competing rights in the original encumbered asset is a security right securing the purchase price of the encumbered asset and, accordingly, awarded higher priority than would otherwise be the case.

6. Voluntary alteration of priority: subordination agreements

60. The priority enjoyed by any secured creditor need not be unalterable. In many systems, priority may be, and frequently is, altered by private contract. As an example, a lender with a security right in all existing and after-acquired assets of a grantor could agree that the grantor might give a first priority security right in a particular asset so that the grantor could obtain additional financing from a source other than the lender based on the value of that asset.

61. Such agreements altering priority are perfectly acceptable as long as they affect only the parties who actually consent to such alterations. Subordination agreements should not affect the rights of creditors who are not parties to the agreement. Additionally, it is important that the priority afforded by a subordination agreement continue to apply in insolvency proceedings of the grantor.

7. Relevance of priority prior to enforcement

62. Another important issue pertaining to priority is whether priority only has relevance after the occurrence of an event of default by the grantor in the underlying obligation or whether priority also has relevance prior to default. Many jurisdictions allow the holder of a junior consensual security right to receive a regularly scheduled payment on its obligation before the secured obligation having priority is paid in full, absent a contrary agreement between the senior and junior claimant. If the junior claimant were to be

required to remit the payment, this would be a major impediment to the junior claimant providing financing.

63. The result may be different if the junior claimant received proceeds from the collection, sale or other disposition of the collateral. In that circumstance, some jurisdictions require the junior claimant to remit the proceeds to the senior claimant if the junior claimant received the proceeds with the knowledge that the grantor was required to remit them to the senior claimant. The rationale behind this rule is similar to the rationale discussed in section A.3 (d) above with respect to buyers of encumbered assets.

B. Summary and recommendations

64. The concept of priority is a critical component in any secured lending regime that seeks to promote the availability of low-cost secured credit. The availability of credit is dependent on the ability of creditors to determine, with a high degree of certainty prior to extending credit, what their priority will be if they attempt to realize their security. Because such realization often occurs in insolvency proceedings of the grantor, it is critical that a secured creditor's priority continue unimpaired in the insolvency proceedings.

65. It is therefore important that secured lending laws include priority rules that are clear and lead to predictable outcomes. These rules should allow all creditors, even unsecured creditors, to assess their positions in advance of extending credit and to take steps to protect their interests. Clear priority rules that result in predictable outcomes and efficient mechanisms for ascertaining and establishing priority at the time credit is advanced may be more important to creditors than the particulars of the priority rule itself.

66. This result may be achieved most effectively by establishing a filing system and basing priority according to the first to file a notice of a security right. In addition, assuming that the filing system is reliable and easily accessible, it may provide an effective mechanism for alerting creditors to competing security rights.

67. Exceptions to the first-to-file priority rule should only be considered to the extent that there is no other means to satisfy the underlying policy objective of the exception and that objective justifies the impact of the exception on the

availability of low-cost credit. Any such exceptions should be stated clearly, allowing creditors to assess the likelihood of any preferential claims and to take steps to protect themselves with respect to such claims. In order to alert creditors most effectively as to competing claims, consideration should be given to subjecting all claims, including preferential claims, to the security right filing system. Some important exceptions to the first-to-file priority rule that should be addressed in crafting secured transactions laws pertain to purchase-money security rights, creditors that add value to collateral (such as equipment repairers) and possibly also certain claimants (such as wage and governmental claimants) that legislatures may wish to protect to achieve general societal goals.

68. Recognizing priority with respect to future advances and after-acquired property is likely to encourage the availability of revolving and other similar credits to businesses. The simpler the procedure for a creditor to establish priority with respect to future advances and after-acquired property, the greater will be the availability of these credits.

69. At least in certain circumstances, the right of the secured creditor in the proceeds of its encumbered assets should be effective not only as against the grantor but also as against competing claimants. A legal regime should provide when a publicity act with respect to the security right suffices to publicize the creditor's rights in the proceeds or when a new publicity act is required. In addition, a legal regime should include priority rules with respect to rights in proceeds. Such rules may differ depending on the nature of the competing claimant.

70. Regardless of the priority rules of any secured transactions regime, creditors should be permitted to vary such rules by private contract in order to structure financing arrangements that best suit the grantor's needs. Such agreements should be recognized as effective among the parties thereto in an insolvency proceeding commenced by or against the grantor; however, they should not affect the rights of persons who are not parties to such agreements.

71. Finally, secured transactions regimes should specify the circumstances in which the holders of junior security rights in specific encumbered assets will be prevented from taking actions that are inconsistent with the rights of the holders of senior security rights in the same assets. Examples of such actions include retaining proceeds from the sale or other disposition of such assets with knowledge of the grantor's contractual obligation to remit those proceeds to the senior secured creditor.

A/CN.9/WG.VI/WP.2/Add.8

**Report of the Secretary-General on the draft legislative guide on
secured transactions, working paper submitted to the Working Group
on Security Interests at its first session**

ADDENDUM

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Draft legislative guide on secured transactions

VIII. PRE-DEFAULT RIGHTS AND
OBLIGATIONS OF THE PARTIES

A. General remarks**1. Introduction**

1. The legal requirements for a valid and enforceable security agreement are minimal and should be easily satisfied (see A/CN.9/WG.VI/WP.2/Add.4, paras. 36-46). However, efficiency and predictability call for the incorporation of additional terms into the security agreement aimed at covering other aspects of the transaction. For example, revenues deriving from the encumbered asset may be retained by the secured creditor and increase the value of the encumbered asset or may contribute to the payment of the secured obligation. The parties themselves are in the best position to tailor the terms of the security agreement to their own needs and wishes. However, to fill gaps that may arise if the parties do not include additional terms, secured transactions regimes normally include a set of default rules detailing the parties' rights and obligations before default.

2. The legislative imposition of default rules is necessary for an effective, efficient and responsive legal framework governing security rights in movable property. Comprehensive coverage, clarifying the position of the parties by filling potential gaps in the security agreement, constitutes a core principle for an effective regime of secured transactions in personal property, or at least one of its most important corollaries (see A/CN.9/WG.VI/WP.2/Add.1,

paras. 11 and 17). In this regard, the present Guide pursues a policy shared by many recent legislative reforms (for example, the Civil Code of Quebec and art. 9 of the Uniform Commercial Code of the United States of America), regional model laws (for example, the Model Law on Secured Transactions of the European Bank for Reconstruction and Development and the Model Inter-American Law on Secured Transactions of the Organization of American States), and international conventions dealing with some aspect of secured transactions in movable assets (for example, the United Nations Convention on the Assignment of Receivables in International Trade and the Convention on International Interests in Mobile Equipment).

3. There are two limitations to the scope of the present chapter. Firstly, it does not deal with the terms required to create a security agreement (for example, the minimum contents of the security agreement), since they fulfil a different function and are, therefore, addressed in chapter IV. Secondly, it does not deal with the rights and obligations of the parties to the security agreement after default, since after default different policy issues arise that are addressed in chapter IX.

4. The initial discussion below is focused on two important policy issues. The first relates to the principle of party autonomy and the extent to which the parties should be free to fashion their own security agreement (assuming that the agreement satisfies the substantive and formal requirements for the creation of a security right). The second relates to the type and number of default rules to be included, so as to encompass new and evolving forms of secured

transactions. The chapter concludes by outlining recommended pre-default rights and obligations of both the secured creditor and the debtor.

2. Party autonomy

(a) The principle

5. To the extent that consumer-protection legislation is not interfered with, party autonomy may be established as a cardinal principle governing the relationship of the parties to the security agreement before default. Adopting party autonomy as a governing principle covering the non-proprietary aspects of secured transactions favours contractual flexibility. While this empowers credit providers with significant choice in fashioning the security agreement, the goal, ultimately, is to provide debtors with wider access to credit at a lower cost.

6. Allowing ample room for contractual flexibility would also contribute to the regulation of transactions between the parties in the longer term, by filling potential gaps in the security agreement. In many cases the security agreement is not regarded as a static, one-shot transaction. The parties may anticipate a dynamic, ongoing financing relationship in which additional funds will be loaned by the secured creditor and property to be acquired in the future by the debtor will be offered as security. Requiring the parties to formalize all subsequent modifications and additions to their initial agreement would impose significant compliance costs, which would ultimately be borne by the debtor. Party autonomy would allow the parties to protect their legitimate interests in secured transactions that form part of a longer-term relationship.

(b) Limitations

7. As it is not possible to foresee all the circumstances in which a security right may be required to secure the performance of an obligation, it is advisable to avoid unnecessary restrictions, which may hinder the ability of the parties to adapt a secured transaction to their own needs and circumstances. There must be, however, some limitation of party autonomy to prevent overreaching by the secured creditor. Those limits should be clearly drawn on grounds of public policy (*ordre public*) and an overriding principle of good faith and fair dealing, narrowly tailored to prevent any perverse or dysfunctional allocation of burdens in the name of party autonomy.

8. Whereas the secured creditor and debtor should be mostly free to deal with their mutual contractual rights and obligations, such freedom does not extend to the proprietary effects of the security agreement that may have an impact on the rights and obligations of third parties. The notion of party autonomy in this context should be understood within the limits imposed by the wider field of property law.

9. Aside from such reasonable limits, which each jurisdiction will determine on criteria of their own, the parties should be given wide flexibility to:

(a) Agree upon the terms of the security agreement;

(b) Define the obligation to be secured and the events triggering its default; and

(c) Determine what the debtor can and cannot do with the encumbered asset.

3. Default rules

(a) Meaning

10. The rules included in the present chapter are meant to apply automatically in the absence of evidence that the parties intended to exclude them. The conceptual vocabulary used to identify rules “subject to agreement otherwise” varies from country to country (for example, *jus dispositivum*, *lois supplétives*, non-mandatory rules). These terms, however, have a common purpose as gap-filling law, in the sense that the rule applies only to the extent that the parties have failed to cover the point in their agreement. Whatever the language chosen to formulate these rules, it should make clear that they apply and are enforceable on the condition that the parties did not agree otherwise.

11. As to the number of default rules to be included, the present Guide does not include an exhaustive list of the rights and obligations of the parties during the lifetime of the secured transaction. Whereas the law might set forth those rules on which the parties themselves would be most likely to agree, the list of default rules are not meant to operate as a substitute for a standard form. The default rules should cover only the most normal or regular incidents arising during the course of a secured transaction, that is, the rights and obligations that the legislator fairly infers the parties had assumed despite the absence of an express term in the security agreement.

(b) Policy objectives

12. All of the default rules should pursue plausible policy objectives, such as the reasonable allocation of responsibility for caring for the encumbered asset, the preservation of its pre-default value and the maximization of its post-default value. Additional terms in the security agreement, to enhance the protection of secured lenders or debtors, are better left to the parties’ initiative without the need to incorporate them as default rules in the law envisaged by the present Guide. For example, if the parties would like to include a choice-of-law clause, or if the secured creditor would like the debtor to deposit any insurance proceeds in a given deposit account, or if the debtor who retains possession of the encumbered asset would like to receive a certain advance notice before the secured creditor exercises its right to inspect them, the contracting parties must expressly contract for those additional terms.

13. The default rules might pursue a set of policies fitting the needs and practices of each jurisdiction. However, most jurisdictions are likely to agree on the advantages of adopting default rules on personal property security that are conducive to widening access to credit at a lower price. For example, the party in possession of the encumbered asset should have a duty of preservation and care. This type of rule is meant to encourage responsible behaviour on the

part of those having control and custody of the encumbered asset, while at the same time maximizing the realization value of the encumbered asset in the case of default.

(c) *Types of default rules*

14. A distinction may be drawn between those rights and obligations which are common to a secured creditor in possession of the encumbered asset and those pertaining to the debtor in possession of the encumbered asset in the case of non-possessory security.

(i) *Possessory security*

15. In the context of possessory security rights, the pre-default rights and obligations of the parties should at the very least encourage the secured creditor to preserve the value of the encumbered asset, especially if the asset represents income-producing property. The following are among the most important duties and rights conferred on a secured creditor in possession of encumbered assets.

a. *Duty of care*

16. The best way to encourage responsible behaviour on the part of the secured creditor in possession is to impose on the creditor an obligation to take reasonable care of the encumbered asset. The scope and mode of exercise of this duty of care should be clearly stated, in detail. This should include a duty to preserve or maintain the encumbered asset in good condition, as well as to undertake all necessary repairs to keep that asset in good condition.

17. Depending on the circumstances, the duty of care may be discharged in different ways. In some cases, it may be enough for the secured creditor to notify the debtor, giving the encumbered asset back to the debtor so that the debtor can undertake the acts of preservation. In other cases, the debtor may not be reasonably expected to undertake such acts and it is the secured creditor in possession who must carry out this duty of care.

b. *Right to be reimbursed for reasonable expenses*

18. Those expenses that are reasonably incurred in pursuance of the secured creditor's duty of care should be borne by the debtor and the secured creditor should have the right to be reimbursed by the debtor for those expenses. Other types of expenses that the secured creditor chooses to incur should not be chargeable to the debtor.

c. *Right to make reasonable use of the encumbered asset*

19. In order to encourage the profitable use of the encumbered asset, the secured creditor should be allowed to make use of or operate the encumbered asset for the purpose of its preservation and maintenance, although always in a manner and to the extent that such use is reasonable.

d. *Duty to keep encumbered assets identifiable*

20. Unless encumbered assets are of a fungible nature, the secured creditor must keep tangible assets in an identifiable form.

e. *Duty to take steps to preserve the debtor's rights*

21. The secured creditor's duty of care of assets, such as the right to payment of money, intellectual property rights and other intangible movables, does not merely consist of the preservation of the document or instrument that embodies such right to payment or intellectual property right. The duty of care in these cases extends to an obligation to take active steps to maintain or preserve the debtor's rights against those who are secondarily liable (for example, a guarantor).

f. *Duty to allow inspection by debtor*

22. An additional obligation of the secured creditor in possession is to allow the debtor to inspect the encumbered asset at reasonable times.

g. *Right to impute revenues to the payment of the secured obligation*

23. Proceeds (including monetary profits, the offspring of animals and other "civil" or "natural" fruits) derived from the encumbered asset and received by the secured creditor may, unless remitted to the debtor, be retained by the secured creditor and imputed to the payment of the secured obligation.

h. *Right to assign the secured obligation and the security right*

24. A secured creditor should be entitled to assign both its payment claim against the debtor ("secured obligation") and the security right attached to that secured obligation. Where this is possible, the assignee succeeds to all the rights vested in the original secured creditor.

i. *Right to "repledge" the encumbered asset*

25. The secured creditor may also be entitled to create a security right in the encumbered asset as security for a debt. That is, the secured creditor may "repledge" the encumbered asset as long as the debtor's right to get the asset back when it fulfils its obligation is not impaired.

j. *Right to insure against loss or damage of the encumbered asset*

26. The risk of loss or deterioration of the encumbered asset remains on the debtor despite the creation of a security right (in most legal systems the debtor retains a property right in the encumbered asset). Yet, it is in the interest of the secured creditor to keep the encumbered asset insured in full. Therefore, the secured creditor should be entitled to contract insurance on behalf of the debtor and be reimbursed for that expense.

k. *Right to pay taxes on behalf of the debtor*

27. Taxes assessed against encumbered assets also fall under the responsibility of the debtor. However, a secured creditor should be entitled to pay those taxes on the debtor's behalf to protect its security right in the asset. Such payment should be regarded as a reasonable charge

incurred in the preservation of the encumbered asset for which the secured creditor should be entitled to reimbursement.

(ii) *Non-possessory security*

28. As a key policy objective of an effective secured transactions regime, a secured transactions regime should encourage responsible behaviour by the debtor who remains in possession of the encumbered asset while having granted a security right over that asset (see A/CN.9/WG.VI/WP.2/Add.1, para. 18). Accordingly, the policies underlying the default rules for non-possessory security are aimed at maximizing the economic potential of the debtor's assets (see A/CN.9/WG.VI/WP.2/Add.1, para. 11). Encouraging the economic utilization of the debtor's assets facilitates the generation of revenue for the debtor. Maintaining the pre-default value of the encumbered assets belonging to the debtor is consistent with the objective of maximizing the realization value of those assets for the benefit of the secured creditor.

a. *Duty to keep encumbered assets properly insured and to pay taxes*

29. The duty of care allocated to the debtor in possession includes keeping the encumbered asset properly covered by insurance and making sure that the property taxes are punctually paid. If these pre-default expenses are incurred by the secured creditor, its right to be reimbursed by the debtor is secured by the security right.

b. *Duty to allow the secured creditor to inspect*

30. The secured creditor should have the right to police the conditions in which the encumbered asset is kept by the debtor in possession. To this effect, the debtor should be bound to allow the secured creditor to inspect the encumbered asset at all reasonable times.

c. *Duty to account and to keep adequate records*

31. When the encumbered asset consists of income-producing property in possession of the debtor, the debtor's duties include the reasonable rendering of accounts regarding the disposition and handling of the proceeds derived from the encumbered asset. This duty should include maintaining adequate bookkeeping records regarding the status of the encumbered asset.

d. *Duty to take steps to preserve rights in encumbered assets*

32. In the case of intangible encumbered assets, such as the debtor's right to payment in the form of receivables, deposit accounts, royalties or rights on account of patents, copyrights and trademarks, the main aspect of the debtor's obligation of care includes the taking of necessary steps to preserve those rights.

e. *Right to receive revenues*

33. In the same way that the debtor is responsible for pre-default expenses and charges, the debtor also receives the

benefits from revenue and proceeds derived from the encumbered asset in the debtor's possession. These proceeds are typically made subject to the security right held by the secured creditor in the encumbered asset.

f. *Right to use, mix, commingle and process encumbered assets*

34. The debtor in possession is typically entitled to use, mix or commingle and process the encumbered asset with other assets, as well as to dispose of the encumbered asset in the ordinary course of its business.

g. *Right to grant another security right in the same asset*

35. The power of the debtor to confer a subsequent security right over an already encumbered asset should also be included as a default right.

B. Summary and recommendations

36. The default rules included in the present chapter seek to clarify the pre-default rights and obligations of the parties to the security agreement. These rules are permissive rather than mandatory, so that the expression, "unless otherwise agreed", should be read as a preamble to each of the rights and duties allocated to the parties. A corollary of the permissive nature of these rules is that the parties may waive or vary the rights and obligations allocated to them in the chapter, unless such waiver is against public policy or in conflict with an overriding principle of good faith and fair dealing.

37. A secured creditor in possession of the encumbered asset should care, preserve and maintain the asset in good condition. The secured creditor is also bound to undertake all necessary repairs to keep the encumbered asset in such condition. In case of tangible encumbered assets, the secured creditor should keep those assets properly identifiable, unless they are fungible movables.

38. Where the encumbered asset consists of the debtor's right to the payment of money or other intangible assets (for example, negotiable instruments or receivables), the obligation of care on part of the secured creditor should include the duty to preserve the debtor's rights against persons secondarily liable. The secured creditor should allow the debtor to inspect the encumbered asset at all reasonable times. Upon full satisfaction of the secured obligation, the secured creditor should return the encumbered asset to the debtor.

39. The secured creditor in possession should be entitled to retain as additional security any proceeds deriving from the encumbered asset and to impute it to the payment of the secured obligation unless remitted to the debtor. The secured creditor may also create a security right in the encumbered asset by repledging it.

40. Reasonable expenses incurred by the secured creditor while discharging the obligation of custody and care

(including the cost of insurance and payment of taxes) must be reimbursed to the secured creditor. The secured creditor's right to be reimbursed for those expenses should also be secured by the encumbered asset.

41. In the context of non-possessory security, the debtor who remains in possession of the encumbered asset should also be bound by a duty of custody and preservation. In fulfilling this duty, the debtor is bound to incur expenses such as insurance premiums, taxes and other charges.

42. The debtor in possession should be entitled to use, mix or commingle and process the encumbered asset with

other assets, as well as to dispose of the encumbered asset in the ordinary course of business. The debtor may also grant a subsequent security right in the encumbered asset.

43. The debtor in possession should also be bound to allow the secured creditor to police the conditions of the encumbered asset at reasonable times and to keep reasonable bookkeeping practices detailing the disposal or handling of the encumbered asset. If the encumbered asset consists of intangible movable property, the debtor's obligation of care extends to asserting or defending the debtor's right to be paid, or to take the steps that are necessary to collect what is due to the debtor.

A/CN.9/WG.VI/WP.2/Add.9

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

IX. DEFAULT AND ENFORCEMENT

A. General remarks

1. Introduction

1. The present chapter examines the secured creditor's enforcement of its security right if the debtor fails to perform ("defaults on") a secured obligation without being insolvent (insolvency is dealt with in chapter X).

2. A reasonable secured creditor expects a debtor to perform its obligations without the need for the creditor to have recourse to encumbered assets. A reasonable debtor will also expect to perform. Both will recognize, however, that there will be times when the debtor will not be able to do so. The failure may result from poor management or business misjudgements, but it may also be for reasons beyond the debtor's control, such as an economic downturn in an industry or more general economic conditions.

3. Reasonable creditors will periodically review their debtors' business activities or the encumbered assets and communicate with those debtors who show signs of having financial difficulties. Reasonable debtors will cooperate with their creditors to work out ways to overcome these financial difficulties. Creditors and debtors working together may enter into "composition" or "work-out" agreements, that extend the time for payment, reduce the debtors' obligation or modify security agreements. Negotiations to reach a composition agreement take place in the shadow of two principal legal factors: the secured creditor's right to enforce its security rights if the debtor defaults on its secured obligation and the possibility that insolvency proceedings will be initiated against the debtor.

4. At the heart of a secured transactions regime is the right of the secured creditor to look to the value of encumbered assets to satisfy the secured obligation if the debtor defaults. The availability and the cost of credit will be affected by the amount of the estimated proceeds of the disposition of the encumbered assets. The costs of realizing the value of a security right are also costs that the creditor will include when calculating the amount and cost of credit it is willing to extend to the debtor.

2. Key objectives

[Note to the Working Group: The Working Group may wish to consider whether this section should be retained and developed within this chapter or whether any substantive discussion of objectives should be contained in chapter II. If the latter approach is taken, there are some similarities between (a) and (d) below, and objectives A and G in chapter II, though chapter II may otherwise require some amendment to accommodate the points made here.]

5. Consistent with the key objectives of an efficient regime outlined in chapter II, a secured transactions regime should have the following specific objectives for a default and enforcement procedure:

- (i) Provide clear, simple and transparent legal rules for the enforcement of security rights following a debtor's default and for the post-default rights, obligations and priorities of interested parties

6. A secured transactions regime should provide procedural and substantive rules for the enforcement of a security right after a debtor has defaulted. These rules should permit the parties to determine what is to be done with encumbered assets and the allocation of the proceeds of any disposition of encumbered assets. They should also deal with any deficiency or surplus (that is, the difference between the monetary value of the secured obligation and the proceeds of any disposition of encumbered assets), which may be due from or to the debtor. These legal rules should be clear, simple and transparent to ensure certainty about the likely outcome of enforcement proceedings. A secured creditor will, otherwise, incorporate the added risk, created by any uncertainty, into the cost of credit it extends.

- (ii) Maximize the realization value of encumbered assets in a manner consistent with protection of the rights of interested parties and the public

7. All interested parties (that is, the secured creditor, the debtor, the grantor and other creditors) benefit from maximizing the amount that will be realized by disposing of encumbered assets after the debtor has defaulted. The secured creditor benefits if any deficiency the debtor may owe as an unsecured debt is reduced. At the same time, the debtor or grantor and the debtor's other creditors benefit, either by a smaller deficiency or by a larger surplus. A secured transactions regime may maximize the value realized by decreasing the transaction costs of the disposition, thus increasing the amount of the proceeds received on disposition of encumbered assets.

8. Any procedures implemented should be consistent with the need to protect the rights of interested parties and the public. The key issue for a secured transactions regime is what modifications, if any, should be made to the normal rules for debt collection. Some regimes, for example, provide for expedited court proceedings. Other regimes delegate to the secured creditor the authority to take possession of the encumbered asset and dispose of it with no direct government or independent administrative intervention. Expedited procedures and delegation of authority, however, should take into account the right of persons to be heard in protection of legitimate claims to encumbered assets. Moreover, the allocation of resources within the judicial system and any delegation to private persons necessarily raise issues of public interest.

- (iii) Provide transactional finality upon compliance with the enforcement procedure

9. After the process for realizing the value of the security right is completed, there should be finality. The secured creditor's security right in the encumbered asset should terminate. If encumbered assets have been disposed of, the grantor's rights in the assets should also terminate. The law should also determine whether the security rights of other secured creditors in encumbered assets continue, notwithstanding disposition of the assets in the enforcement

procedure. In this respect, the law may distinguish between senior and junior security rights (that is, whether or not other secured creditors have priority over the security right of the creditor initiating enforcement).

- (iv) Define clearly the extent to which the secured creditor and the grantor may agree on the procedure for realization of the value of the encumbered asset

10. The principle of freedom of contract rests upon the assumption that self-interested parties are the best judges of the value of a proposed contractual exchange. The aggregate of these contractual exchanges leads to an efficient allocation of resources within an economy. This principle must be balanced with the further principle that a bilateral contract should not affect adversely the rights of third parties or the public interest in such matters as abuse of rights. In the context of a regime for enforcement of security rights, the law must define the extent to which the secured creditor and debtor may agree on the procedure to be followed. In particular, the law may distinguish between those legal rights which can be modified in the original security agreement and those which can be modified only after default.

- (v) Coordinate the enforcement rights and procedures of the security right regime with the rights and procedures for security rights in insolvency proceedings

11. A security right is of particular importance to a secured creditor when the debtor is in financial difficulty. A debtor who is in financial difficulty is more likely to default on its obligations and may end up voluntarily or involuntarily in insolvency proceedings. If the value of a security right in insolvency proceedings is less than the value of that right outside such proceedings, the debtor and other creditors will have an incentive to precipitate the insolvency proceedings. A secured creditor subject to such a regime will, when extending credit, take into account the diminished value of the security right in insolvency proceedings and will reduce the credit extended or increase the costs of the credit to the debtor. Provision for recognition and enforcement of security rights within the insolvency process will create certainty and facilitate the provision of credit (for a discussion of enforcement of security rights in insolvency proceedings, see chapter X).

3. Default

(a) *The meaning of "default"*

12. If a debtor fails to perform a secured obligation the debtor is in "default". The parties' agreement and the general law of obligations will determine whether there has been a default. A loan agreement, for example, may list events of default that make the loan immediately repayable. The security agreement will usually define what constitutes default. In the unlikely case where the parties' contracts are silent, general principles of contract law establish whether a debtor has defaulted. A law governing secured transactions, therefore, need not define default. If a definition is

included, it is sufficient to state that a default occurs when the debtor fails to perform a secured obligation, or is otherwise in default as defined by the security agreement or other law.

(b) *Cure of default*

13. Whether the law should permit a debtor to cure or correct a default requires weighing protection of the debtor when default does not evidence a long-term inability to perform against protection of the creditor from the costs of delayed performance and a cycle of default cure. Although this issue of curing or correcting default could be left to the general law of obligations or special debtor protection legislation, the potential removal of encumbered assets from the control of the debtor may focus attention on the issue in the context of a secured transactions law. A secured transactions law that addresses the issue of cure of default should ensure that it is consistent with existing law and should provide explicit cross references to legislation that it does not displace to ensure transparency.

(c) *Notice of default*

14. The debtor's default is a precondition to the secured creditor's right to enforce its security right against the encumbered asset. A secured transactions law should address whether notice of the default should be given and to whom. The principal benefit of a notice is that it permits the debtor and other interested parties to protect their interests. A debtor, for example, may challenge whether default has occurred and, if the law so provides, seek to cure the default or to redeem the encumbered asset. Notice to other interested parties allows them to monitor subsequent enforcement by the secured creditor and, if they are secured creditors whose rights have priority, to take control of the enforcement process. The disadvantages of notice include its cost, the opportunity it provides an uncooperative grantor to remove encumbered assets from the creditor's reach and the possibility that other creditors will race to dismember the debtor's business. Although some secured transactions laws do not require notice of default, many do so.

15. As with other situations where notice may be necessary, a secured transactions law should spell out the minimum contents of a notice, the manner in which it is to be given and its timing. When doing so, the law might distinguish between notice to the debtor, notice to the grantor when the grantor is not the debtor, notice to other creditors and notice to public authorities or the public in general. The secured creditor might, for example, be required to give prior written notice to the debtor and grantor followed by filing a notice in a public register. The creditor might also be required to give written notice to those other secured creditors who have filed notice of their interests or who have otherwise notified the creditor. Alternatively, the registrar might be required to give such notice. As for the information to be included in the notice, the law might require the inclusion of the secured creditor's calculation of the amount owed as a consequence of default and detail the steps the debtor or grantor may take to cure the default or to redeem the encumbered asset. The secured creditor may

also be required to elect, at least provisionally, the steps it intends to take to enforce its security right.

(d) *Judicial or administrative review*

16. To ensure the integrity of the enforcement procedure, the debtor and other interested parties should have an opportunity to have judicial or administrative review of acts of the secured creditor. The debtor should have an opportunity to challenge the secured creditor's position that there has been a default, or the calculation of the amount owing as a result of the default. To avoid unduly delaying rightful enforcement, the review should be expedited. Safeguards should be built into the process to discourage debtors from making unfounded claims to delay the enforcement.

4. *Options following default*

17. Most legal systems recognize that a secured creditor may enforce the secured obligation by judicial action following the same procedure used to enforce any claim. If judgement is rendered on the secured obligation, the judgement may then be executed in the same way on any of the debtor's assets available to creditors, including encumbered assets. The discussion in the following paragraphs focuses, however, on enforcement of the secured creditor's security right in the encumbered asset, whether by judicial action or otherwise.

18. When the debtor defaults, the secured creditor may or may not be in possession of the encumbered asset. A secured creditor in possession is protected against potential abuse (for example, hiding or misusing the asset) by the debtor or grantor. A secured transactions regime should protect the non-possessing secured creditor from such abuse as well. Leaving aside the issue of protection against potential abuse, however, there is no reason to distinguish between a creditor with a possessory security right and other secured creditors and the same procedures for realizing the value of the security right may be applied to all secured creditors.

(a) *Judicial action to enforce the security right*

19. A key issue for a secured transactions regime is the extent to which the secured creditor must resort to the courts or other authorities (for example, bailiffs, notaries or the police) to enforce its security right.

20. In order to protect the debtor and other parties with rights in the encumbered asset, many legal systems require the secured creditor to resort to the courts or other authorities to enforce its security right. However, this approach may inadvertently result in delays and costs that the debtor may have to ultimately bear, because they are factored into the cost of the financing transaction and, in any case, reduce the realization value of the encumbered asset. In addition, this approach involves formal procedures that are not geared to yield a reasonable market price for the encumbered asset.

21. In order to avoid these problems, some legal systems limit the role of courts or other authorities in the

enforcement process. In these legal systems the secured creditor is often authorized to enforce its security right without any prior intervention of official state institutions, such as courts, bailiffs or the police. In other legal systems, there is only limited prior intervention of official state institutions in the enforcement process.¹ The justification for such an approach lies in the fact that having the secured creditor or a trusted third party take control and dispose of the assets will often be more flexible, quicker and less costly than a state-controlled process. It may also maximize the realization value of encumbered assets.

22. However, even in these legal systems the courts are available to ensure recognition of legitimate claims and defences of the grantor and other parties with rights in the encumbered asset. In order to inform these parties and give them an opportunity to react, the secured creditor is required to give them a notice of default and enforcement (see paras. 14 and 15 above). In addition, if the debtor does not consent, the secured creditor may not enforce its rights if such enforcement would result in a disturbance of the public order (see para. 30 below). Moreover, in disposing of the encumbered asset, the secured creditor has to act in a "commercially reasonable" manner (see para. 33 below).

23. Even if permitted to act without official intervention, a secured creditor is normally not precluded from seeking to enforce its security right by judicial action. The secured creditor may choose to bring a judicial action, for example, to avoid the risk of having its private actions challenged after the fact or may conclude that it will have to bring a judicial action anyway to recover an anticipated deficiency.

24. Whether or not they require a secured creditor to resort to the courts, many legal systems modify the normal rules of civil procedure when a secured creditor seeks to enforce security rights. These modifications may limit the time within which the court must act or limit the claims or defences that the parties may raise. If the court concludes that there has been default, the objective of any decision should be to satisfy the creditor's secured claim. The court should be authorized to order the debtor to pay the obligation, to dispose of the encumbered assets itself, or to turn over the assets to the secured creditor or to the court for disposition.

(b) *Freedom of parties to agree to the enforcement procedure*

25. Another key issue for a secured transactions regime is the extent to which the secured creditor and grantor may agree to modify the statutory framework for the enforcement of the security right. Permitting the parties to agree

¹For example, under the Model Inter-American Law on Secured Transactions of the Organization of American States, the secured creditor has to file a notice of default and enforcement in the public register and to deliver a copy to the debtor and any creditor with a publicized security right (see art. 54). The secured creditor also has to apply to a court for an order of repossession, which the court issues without a hearing (the debtor has to initiate independent proceedings to challenge this order; see art. 57). Once in possession of the asset, the secured creditor may sell it directly following certain prescribed procedures (see art. 59).

freely on the consequences of their exchange encourages an efficient allocation of resources. When, however, a secured transactions law imposes mandatory obligations on a secured creditor, especially in those regimes that authorize enforcement with limited state intervention, the law may also prohibit or limit the parties' ability to contract out of these obligations. The law may also distinguish between terms agreed to at the time the security agreement is concluded and terms agreed to after the debtor has defaulted.

(c) Acceptance of the encumbered asset in satisfaction of the secured obligation

26. Following default, the secured creditor may propose that it accept the encumbered asset in full or partial satisfaction of the secured obligation. Most jurisdictions make unenforceable an agreement that automatically vests ownership of the encumbered asset in the secured creditor upon default, if the agreement is set out in the security agreement, although some laws make a subsequent agreement enforceable. The advantage of permitting subsequent agreements is that enforcement costs are minimized and the security right is terminated more quickly. The disadvantage is that the secured party may put undue pressure on the debtor or grantor in cases where encumbered assets are more valuable than the obligation secured.

27. The law may guard against abusive behaviour by requiring the consent of the debtor and grantor, third parties or the court under certain circumstances, such as where the debtor has made substantial payments on the secured debt. Publicity may be required and a fixed delay before final settlement may be prescribed to allow an appeal to a court. The law might also require an official appraisal.

(d) Redemption of encumbered assets

28. Most laws permit a defaulting debtor or grantor to redeem the encumbered asset by paying the outstanding secured obligation, including interest and the costs of enforcement up to the time of redemption. Redemption brings the transaction to an end. The hope of redemption may encourage the debtor or grantor to search for potential buyers to purchase the encumbered asset and to monitor the secured creditor's acts closely. Redemption of the encumbered asset should be distinguished from reinstatement of the secured obligation. Reinstating the secured obligation (for example, by paying a missed instalment) cures a default and the restored obligation continues to be secured by the encumbered asset. Redeeming the encumbered asset discharges the secured obligation.

(e) Authorized disposition by the grantor

29. Following default, the secured party will be concerned about realizing the maximum value of the encumbered asset. Frequently, the debtor will be more knowledgeable about the market for the asset than the secured creditor. For this reason, the debtor is often given a limited period of time following default during which it is entitled to dispose of the encumbered asset.

(f) Removing encumbered assets from the grantor's control

30. Upon the debtor's default, the secured creditor who is not already in possession of the encumbered asset will be concerned about potential dissipation or misuse of the asset. This may be alleviated by placing the asset in the hands of a court, a state official, a trusted third party or the secured creditor itself. Permitting the secured creditor to take possession without any or only limited recourse to a court or other authority reduces the costs of enforcement (see para. 21 above). However, even those laws that permit such repossession by the secured creditor recognize the potential for abuse, especially the possibility of public disorder or intimidation. Most of these laws, therefore, condition repossession on avoiding a disturbance of the public order ("breach of the peace"). Some require prior notice of default as a precondition to taking possession.

31. In the special case where encumbered assets threaten to decline rapidly in value, most laws provide for preliminary relief ordered by a court or other relevant authority to preserve the value of the assets.

(g) Sale or other disposition of encumbered assets

32. A security right entitles the secured creditor to have the encumbered asset sold or otherwise disposed of. The objective of the disposition should be to maximize the value of the encumbered asset, while not jeopardizing the legitimate claims and defences of the grantor or other persons.

33. Requirements in existing legal systems range from the less to the more formal. Some legal systems require disposition subject to the same public procedures used to enforce court judgements. Other legal systems permit the secured creditor to control the disposition but prescribe uniform procedures for the disposition by public auction of encumbered assets, with rules on such matters as timing, publicity and minimum price. Yet other legal systems permit the secured creditor to control the disposition, subject to flexible rules on how to proceed. These systems may condition the right of the creditor on the consent of the grantor, whether in the security agreement or after default. A general standard is usually prescribed, which the secured creditor must observe (for example, "commercially reasonable" or "with the care of a prudent business person"). There may also be special rules for how the proceeds of a disposition are to be collected and kept pending distribution.

34. Most secured transactions laws share the requirement that notice must be given to certain parties with respect to a proposed disposition. Because of the finality of any disposition, detailed rules are necessary to alert interested parties to protect their interest. The issues regarding whom to notify, the manner of notification and the timing of notification are similar to those discussed in connection with default (see paras. 14 and 15 above). Special procedures are often prescribed for the sale of a business as a going concern.

(h) *Allocation of proceeds of disposition*

35. To minimize disputes, a secured transactions law should set out rules on the distribution of the proceeds of the disposition. The most common allocation is to pay reasonable enforcement costs first and then the secured obligation. The law should include rules on if and when a secured creditor is responsible for distributing proceeds to some or all other secured creditors with security rights in the same encumbered assets. These rules should require that notice of these other interests is to be given to the secured creditor. The law should also provide that any surplus proceeds are to be returned to the grantor.

36. The proceeds distributed to the secured creditor are applied towards satisfaction of the secured obligation. If there is a deficiency after the distribution, the obligation should be discharged only to the extent of the proceeds received. The law should provide expressly that the secured creditor is entitled to recover the amount of the deficiency from the debtor. Unless the debtor creates a security right in other assets for the benefit of the creditor, the creditor's claim for the deficiency is unsecured.

(i) *Finality*

37. A secured transactions law should provide finality following disposition of the encumbered assets. The secured creditor's security right in the encumbered asset should terminate, as should the grantor's rights. The law should also determine whether the rights of other persons in the encumbered asset (including other secured creditors) continue notwithstanding disposition of the asset in the enforcement procedure.

(j) *Variations on general framework*

38. A secured transactions law that includes within its scope many different types of encumbered assets may need to provide, where necessary, special rules for the disposition of some types of asset. This is especially true of intangibles, securities and negotiable instruments. For example, a secured creditor with a security right in a receivable should be entitled to inform the obligor of the receivable following the debtor's default.

39. A secured transactions law should also address the issue of how a secured creditor is to proceed when a single transaction includes security rights in both movable and immovable assets. Enforcement of a security right in fixtures may also require special rules to deal with the problem of severing a fixture from immovable property owned by someone other than the grantor.

5. *Judicial proceedings brought by other creditors*

40. The secured transactions law should be coordinated with general civil procedural law to provide a right for secured creditors to intervene in court proceedings to protect security rights and to ensure consistent ranking of claims. The other creditors of the debtor or grantor may resort to the courts to enforce their claims against the

debtor and procedural law may give these creditors the right to force the disposition of encumbered assets. The secured creditor will look to procedural law for rules on intervening in these judicial actions in order to protect its priority. In some cases, procedural law may provide exceptions to general rules of priority. In some legal systems, for example, a court may order a person who owes money to a judgement debtor to pay the judgement creditor. If a secured creditor has a security right in this receivable, the court order may effectively give priority to the judgement creditor. If this reversal of the general rules of priority is unintended, the relevant law should be corrected.

B. *Summary and recommendations*

41. The key objectives of provisions on default and enforcement in a secured transactions regime are to:

(a) Provide clear, simple and transparent rules for the enforcement of security rights following a debtor's default and for the post-default rights, obligations, and priorities of interested parties;

(b) Maximize the realization value of the encumbered assets in a manner consistent with protection of the rights of interested parties and the public;

(c) Provide transactional finality upon compliance with the enforcement procedure;

(d) Define clearly the extent to which the secured creditor and the debtor may agree on the procedure for realization of the value of the encumbered assets; and

(e) Coordinate the enforcement rights and procedures of the security rights regime with the rights and procedures for security rights in insolvency proceedings.

42. The law need not define "default". If a definition is included, it is sufficient to state that a default occurs when the debtor fails to perform a secured obligation or is otherwise in default, as defined by the security agreement or other law. The law should address the question whether notice of default should be given and to whom. The debtor should have recourse to the courts or other relevant authorities to challenge a creditor's claim of a default or the calculation of the amount owing as a result of the default. To avoid unduly delaying rightful enforcement, the review should be expedited. Safeguards should be built into the process to discourage debtors from making unfounded claims to delay the enforcement.

[Note to the Working Group: The Working Group may wish to consider the extent of judicial control of the enforcement process. The Working Group may wish to consider in particular (see paras. 19-25 and 30-34):

(a) *Whether, in the case of a non-possessory security interest, some type of official intervention should be required for the repossession of the encumbered asset by the secured creditor or whether the secured creditor should be authorized to remove the encumbered asset from the debtor's control, subject to provisions relating to public order; and*

(b) *Whether, subject to reasonable commercial standards and provisions guarding against abusive*

behaviour, the secured creditor should be authorized to dispose of the asset directly or through a court supervised procedure.]

43. Following default, the debtor or grantor should be permitted to redeem the encumbered asset by paying the outstanding secured obligation, including interest and the costs of enforcement up to the time of redemption.

44. The law should set out rules on the distribution of the proceeds of the disposition. Proceeds should be allocated in the following order: reasonable costs of disposition; the secured obligation; other secured obligations; and the surplus, if any, to the grantor. If application of the proceeds

to the secured obligation leaves a deficiency, the secured creditor should be entitled to an unsecured claim for the deficiency against the debtor. Following disposition of the encumbered asset, there should be finality.

45. Special rules for the disposition of intangibles, negotiable instruments and fixtures should be considered. The law should also provide guidance on applicable procedures when a single transaction includes security rights in both movables and immovables.

46. There is a need for coordination with general civil procedural law to provide for intervention in court proceedings to protect security rights and to ensure consistent ranking of claims.

A/CN.9/WG.VI/WP.2/Add.10

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

X. INSOLVENCY

A. General remarks

1. Introduction

(a) Scope and commercial context

1. The present chapter examines the effects of insolvency proceedings on the enforcement rights of the secured

creditor. It should be read together with the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law, which addresses the issues identified here in the broader context of insolvency law (see A/CN.9/WG.V/WP.57, A/CN.9/WG.V/WP.58 and A/CN.9/WG.V/WP.61 and Add.1 and 2).

2. While a legal system may have distinct regimes for secured transactions and insolvency, both regimes are concerned with debtor-creditor relations and both encourage credit discipline on the part of debtors. Effective regulation

in either area will contribute to positive outcomes in the other. A secured transactions law, for example, may expand the availability of credit, thus facilitating the operation of a business and the avoidance of insolvency. A secured transactions law may also promote responsible behaviour on the part of creditors to the extent it requires creditors to monitor the ability of debtors to perform their obligations, thereby discouraging over-indebtedness and consequent insolvency.

3. Nevertheless, there are tensions where secured transactions and insolvency law intersect, resulting from the different approaches taken to debt. A secured transactions regime seeks to ensure that certain obligations are met, while an insolvency regime deals with circumstances where obligations cannot be met. In addition, the former regime focuses on effective enforcement rights of individual creditors to maximize the likelihood that the obligations owed are performed. The latter regime, on the other hand, seeks to maximize the return to all creditors by preventing a race between creditors to dismember the assets of their common debtor. These results need to be considered by legislators; reform in one regime can have a wider regulatory effect, imposing unforeseen transaction and compliance costs on stakeholders of the other regime. For this reason, conflicts between the rights and obligations imposed by the different regimes governing secured transactions and insolvency should be identified by a country in its law reform process.

4. Insolvency regimes generally contain two main types of proceedings: liquidation, which involves the termination of the commercial business of the debtor and the subsequent realization and distribution of the insolvency debtor's assets, and reorganization, which is designed to maximize the value of assets, and returns to creditors, by saving a business rather than terminating it. In liquidation proceedings, the insolvency representative is entrusted with the task of gathering the insolvency debtor's assets, selling or otherwise disposing of them and distributing the proceeds to the debtor's creditors. To maximize the liquidation value of these assets, the representative may continue the debtor's business for a short time and may sell the business as a going concern rather than selling individual assets separately. In reorganization proceedings, on the other hand, the assumption is that the insolvency debtor's business will continue as a going concern. Thus, the goal of the proceedings is to maximize the value of the debtor's business by allowing the debtor to overcome its financial difficulties and resume or continue normal commercial operations.

5. In addition to legislative forms of insolvency proceedings, alternative approaches are evolving (for example, out-of-court settlements by the creditors of an insolvent debtor). These processes respond to the need to support economic stability by rapid adjustment of the claims of financial institutions, when it is uncertain whether the relevant insolvency institutions can act quickly and effectively.

[Note to the Working Group: The Working Group may wish to take into account in its deliberations that Working Group V (Insolvency Law) is considering these alternative approaches (see A/CN.9/507 and A/CN.9/WG.V/WP.61/Add.1).]

(b) Terminology

[Note to the Working Group: The Working Group may wish to consider whether these definitions should be moved to chapter I (see A/CN.9/WG.VI/WP.2/Add.1).]

6. The present chapter uses the following terms in the sense indicated:

Insolvent debtor: An "insolvent debtor" is a person [or entity] engaged in a business and which meets the criteria for, and is subject to, insolvency proceedings; an insolvent debtor may be either the "debtor" or the "grantor" as those terms are used in the present Guide.

Insolvency proceedings: "Insolvency proceedings" are collective proceedings which involve the [partial or total] divestment of the insolvent debtor and the appointment of an insolvency representative [for the purpose of either liquidation or reorganization of the business] [including both liquidation and reorganization proceedings].

Insolvency representative: An "insolvency representative" is a person [or entity] appointed by the court, which is in charge of administering the debtor's estate [and assisting and watching over the management of the business] with a view to either liquidation or reorganization of the business.

Secured claim: A "secured claim" is a claim made in insolvency proceedings, secured by a security right.

2. Key objectives

[Note to the Working Group: The Working Group may wish to consider whether the discussion of these key objectives should be included in chapter I (see A/CN.9/WG.VI/WP.2/Add.1).]

7. Legislation addressing the rights of a secured creditor when insolvency proceedings have been commenced against its debtor or grantor should be aimed at facilitating enforcement, establishing clear priority rules and recognizing party autonomy (see A/CN.9/WG.VI/WP.2/Add.1, sects. II.D, E and G).

8. If a security right is valid outside insolvency proceedings so that it is effective not only against the debtor but also against third parties, the validity of the security right should be recognized in the insolvency proceedings. Similarly, if a security right has priority over the claim of another creditor outside the insolvency proceedings, the commencement of insolvency proceedings should not alter the relative priority of these claims. Any exceptions should be limited to the extent possible and be clear and transparent to allow potential financiers to estimate the risk of non-payment and thus the cost involved in a transaction (see also objective 7 in A/CN.9/WG.V/WP.57, para. 21).

9. The secured transactions and insolvency regimes should be coordinated in regulating the enforcement of security rights. As already noted (see A/CN.9/WG.VI/WP.2/Add.9, para. 4), the secured creditor will take into account any limitation of its rights in insolvency

proceedings when assessing whether to advance credit to a debtor and at what cost. In addition, other creditors will have an incentive to commence insolvency proceedings when the debtor is in financial difficulty so as to limit the secured creditor's rights and increase the likelihood of their claims against the debtor being successful.

10. Most legal systems recognize party autonomy in private agreements. There may, however, be public policy reasons for restricting a secured creditor's ability to enforce a security right in some circumstances when insolvency proceedings have been commenced against the debtor. In such cases, certainty is needed. The more predictable these limitations are, and the more the economic value of the security right is preserved, the less adverse will be the impact on the credit enhancement otherwise provided by the use of security rights.

3. *Security rights in insolvency proceedings*

(a) *The inclusion of encumbered assets in the insolvency estate*

11. An initial question is whether the secured creditor's security right is subject to insolvency proceedings or, in other words, whether the encumbered assets are part of the "estate" created when insolvency proceedings are commenced against a debtor (see A/CN.9/WG.V/WP.58, paras. 46 and 47). The estate is comprised of those assets of an insolvent debtor that are made subject to administration in the insolvency proceedings.

12. Inclusion of encumbered assets within the insolvency estate can give rise to different effects. In many jurisdictions, this will limit a secured creditor's ability to enforce its security right (see para. 16 below). Any such legislative limitations on commercial agreements will be taken into account by creditors when deciding whether to extend credit to a debtor and at what cost. Some insolvency laws that require all assets to be subject to insolvency proceedings in the first instance allow the separation of encumbered assets from the estate where there is proof of harm or prejudice to the secured creditor's right.

13. To allow for an assessment of whether the continuation of the proceedings will maximize the eventual return to creditors overall, an insolvency law may subject encumbered assets to control within the insolvency proceedings. As a consequence, a secured creditor may be required to surrender possession of encumbered assets to the insolvency representative. This approach may be taken not only in reorganization proceedings, but also in liquidation proceedings in which the insolvent debtor's business is to continue while assets are liquidated in stages or where there is a likelihood that the business may be sold as a going concern. As it may not be possible to know at the commencement of insolvency proceedings whether it is desirable to continue the business, many insolvency regimes include encumbered assets in the estate for a limited time period.

14. An insolvency estate will normally include all assets in which the insolvent debtor has a right at the time

insolvency proceedings are commenced. In some jurisdictions, assets in which a creditor retains legal title or ownership may be separated from the insolvency estate. Examples include a retention of title by the secured creditor, a financial lease or a transfer of title to the secured party (see A/CN.9/WG.VI/WP.2/Add.3, sect. III.A.3). In other jurisdictions, in which these types of legal devices are assimilated with other forms of secured credit arrangements into a general category of "security right", title-based and other security rights are treated in the same way even in insolvency proceedings. This issue is an example of where it may be necessary to coordinate the approaches taken in the secured transactions and insolvency regimes.

15. Some secured creditors will participate in insolvency proceedings because they have both a secured and an unsecured claim. This is not limited to situations where the creditor has two separate obligations, only one of which is secured. It also occurs when the secured creditor is under-secured (that is, the value of the encumbered asset is less than the amount of the secured obligation). In such a case, the secured creditor has a secured claim only to the extent of the value of the encumbered asset and an unsecured claim for the difference (see also sect. A.3 (b) below).

(b) *Limitations on the enforcement of security rights*

16. Many insolvency laws limit the rights of creditors to pursue any remedies or proceedings against the debtor after insolvency proceedings are commenced, through the imposition of a stay or moratorium. The stay may be imposed either automatically or by court order. A number of jurisdictions extend the stay to both unsecured and secured creditors. The same reasons for including encumbered assets within the estate apply to the stay of enforcement of security rights. Limitations, however, on a secured creditor's ability to enforce its security right may have an adverse impact on the cost and availability of credit. An insolvency law must balance these competing interests (see A/CN.9/WG.V/WP.58, paras. 69-82).

17. With few exceptions (see para. 13 above), the need to stay enforcement of a security right is less compelling when the insolvency proceedings are liquidation proceedings. In most liquidation proceedings, the insolvency representative will dispose of assets individually rather than by selling the business as a going concern. Different approaches may be taken to account for this. For example, an insolvency regime may exclude secured creditors from the application of the stay, but encourage negotiations between the insolvent debtor and the creditors prior to commencement of the insolvency proceedings to achieve the best outcome for all parties. An alternative approach would provide that the stay lapses after a brief prescribed period of time (for example, 30 days) unless a court order is obtained extending the stay on grounds specified in the insolvency law. These grounds might include a demonstration that there is a reasonable possibility the business will be sold as a going concern, that that sale will maximize the value of the business, and that secured creditors will not suffer unreasonable harm.

18. A stronger case for a stay is made when the insolvency proceedings are reorganization proceedings. The

objective of such proceedings is to restructure a potentially economically viable entity so as to restore the financial well-being and viability of the business and to maximize the return to creditors. This may involve restructuring the finances of the business by such means as debt forgiveness, debt rescheduling, debt-equity conversions and sale of all or part of the business as a going concern. Removal of encumbered assets from the business will often defeat attempts to continue the business and sell it as a going concern. Accordingly, an insolvency law might extend the application of a stay to secured creditors for the time period necessary to formulate and present a reorganization plan to creditors.

19. If an enforcement action by a secured creditor is stayed, an insolvency regime should provide safeguards to protect the economic value of the security rights. Such safeguards might include court orders for cash payments for interest on the secured claim, payments to compensate for the depreciation of encumbered assets and extension of the security right to cover additional or substitute assets.

20. In addition, an insolvency law might also relieve a secured creditor from the burden of a stay by authorizing the insolvency representative to release the encumbered asset to the secured creditor. Grounds for such a release might include cases where encumbered assets are of no value to the estate and are not essential for the sale of the business or cases where it is not feasible or is overly burdensome to protect the value of the security right.

21. Where the value of an encumbered asset is greater than the secured claim, the insolvency estate has an interest in the surplus. In the absence of insolvency, the secured creditor would have to account to the grantor for the surplus proceeds. If the same assets are disposed of during insolvency proceedings, the surplus would be available for distribution to other creditors. As to who should dispose of encumbered assets, an insolvency law should address the question of whether the same policies that apply outside of insolvency should apply also in insolvency proceedings. For example, if the secured transactions law authorizes the secured creditor to dispose of an asset outside insolvency, the question is whether the secured creditor, rather than the insolvency representative, should control disposition of the relevant encumbered assets during insolvency.

*(c) Participation of secured creditors
in insolvency proceedings*

22. If secured creditors are required to participate in insolvency proceedings, the insolvency regime should ensure that participation is effective to protect the interests of secured creditors (see A/CN.9/WG.V/WP.58, paras. 199-203). For example, the notification to creditors announcing the commencement of insolvency proceedings should indicate whether secured creditors need to make a claim and, if so, to what extent.¹

¹For notification to foreign creditors, see article 14 of the UNCITRAL Model Law on Cross-Border Insolvency and paras. 106-111 of the Guide to Enactment of the Model Law.

23. In addition, if an insolvency law provides for creditor committees to advise the insolvency representative, the law should provide for adequate representation of the interests of secured creditors. Secured creditor representatives may sit on a committee with representatives of unsecured creditors or, alternatively, the law might provide for a separate committee for secured creditors. Concerns that the interests of secured creditors might dominate proceedings to the detriment of other creditors might be addressed by limiting the issues on which secured creditors may vote. For example, voting might be restricted to the selection of the insolvency representative and matters directly affecting encumbered assets or the economic value of security rights.

*(d) The validity of security rights
and avoidance actions*

24. In general, a security right valid outside of insolvency should be recognized as valid in insolvency proceedings. However, a challenge to the validity of a security interest in insolvency proceedings should be on the same grounds that any other claim might be challenged. Many jurisdictions allow an insolvency representative, for example, to set aside ("avoid") or otherwise render ineffective any fraudulent or preferential transfer made by the insolvency debtor within a certain period before the commencement of insolvency proceedings. The granting or transfer of a security interest is a transfer of property subject to these general provisions, and if that transfer is fraudulent or preferential, the insolvency representative should be entitled to avoid or otherwise render ineffective the security right. This would mean that a security right that is valid under the secured transaction regime of a jurisdiction may be invalidated, in certain circumstances, under the insolvency regime of the same jurisdiction (see A/CN.9/WG.V/WP.58, paras. 124-151).

(e) The relative priority of security rights

25. A secured transaction regime will establish the priority of claims to encumbered assets (see chap. VII). Insolvency laws may affect that priority (see A/CN.9/WG.V/WP.58, paras. 217-233). Many laws, for example, give a priority to claims for unpaid wages and employee benefits, environmental damage and government taxes ("privileged claims"). While most legal systems award these claims priority only over unsecured claims, some regimes extend the priority to rank ahead of even secured claims. It is desirable, however, that these types of exceptions to the first priority of secured creditors be limited as the greater the uncertainty regarding the number and amounts of such claims, the greater will be the negative impact on the availability and cost of credit.

[Note to the Working Group: The preceding paragraph focuses on the relative priority of secured and preferential creditors. Where insolvency laws do alter the pre-insolvency ranking of secured and unsecured creditors upon insolvency, unsecured creditors may have an incentive to commence insolvency proceedings. While this should be balanced against the corresponding incentive on secured creditors to monitor debtors, there will be a need for safeguards, in such regimes, to prevent abuse of the insolvency

regime as a debt collection method by unsecured creditors. The draft legislative guide on insolvency law does not recommend any alteration of the relative priority of secured creditors as against unsecured creditors. The Working Group may wish to consider whether to include discussion on this point in the draft legislative guide on secured transactions.]

26. The insolvency representative may incur costs in the maintenance of encumbered assets and pay for these costs from the general funds of the insolvency estate. Because such expenditure preserves the economic value of the security right, not to grant priority over the secured creditor for these administrative expenses would unjustly enrich the secured creditor to the detriment of the unsecured creditors. To discourage unreasonable expenditure, however, an insolvency law might limit the priority to the reasonable cost of foreseeable expenses.

27. An insolvency representative may be authorized to grant creditors that extend credit to the insolvency estate a security right in assets already encumbered by a security right created before commencement of the insolvency proceedings. The question arises here whether post-commencement secured creditors should be able to obtain priority over the rights of existing secured creditors. In legal systems where this type of priority is recognized, it is rarely given without the consent of the secured creditors that would be subordinated (see A/CN.9/WG.V/WP.58, paras. 187-190).

[Note to the Working Group: The Working Group may wish to consider elaborating in greater detail on the priority of post-commencement financing, including the minimum conditions that may be acceptable for granting a post-commencement secured creditor priority over an existing secured creditor.]

(f) Reorganization plans

28. The principal objective of reorganization proceedings is to maximize the value of the debtor's business (and the return to creditors) by formulating a plan for its rescue (see A/CN.9/WG.V/WP.58, paras. 261-286). A stay of proceedings during the formulation of a plan may postpone the exercise of the rights of secured creditors but need not affect their substantive secured rights. Once the plan has been formulated, however, the question arises as to who must approve the plan before it becomes effective (on the approval of the plan by secured creditors, see A/CN.9/WG.V/WP.58, paras. 276 and 277). Another question is who might be bound by the plan. If secured creditors are not bound by the plan and are entitled ultimately to the full economic value of their security rights, approval by the secured creditors would not be necessary because their rights would not be impaired.

29. However, as reorganization may only be feasible if the secured creditors receive less than the full value of their secured claims, most insolvency regimes require creditors to approve a plan by a certain majority in number and amount of the claims. Some jurisdictions permit secured creditors to vote as a class on a plan that proposes to impair their claims. Although a vote by the class to approve the

plan binds the dissenting secured creditors, these regimes usually require that the dissenters receive at least as much as they would receive in liquidation proceedings.

30. In most insolvency regimes, a court must confirm a proposed reorganization plan. In such jurisdictions, the insolvency law may set out grounds on which a court may reject the plan. These grounds include the likelihood that the proposed plan may not be feasible because secured creditors are not bound by the plan and may remove essential encumbered assets from the business subject to the plan. In these circumstances, some regimes provide that the court may bind secured creditors to the plan if certain conditions are satisfied. These conditions include ordering measures to provide adequate protection of the economic value of the security right.

[Note to the Working Group: The Working Group may wish to consider the treatment of security rights in the case of out-of-court restructuring, taking into account the relevant discussion by Working Group V (Insolvency law) (see A/CN.9/507, para. 244 and A/CN.9/WG.V/WP.61/Add.1).]

B. Summary and recommendations

31. A secured transactions regime should establish clear priority rules, facilitate enforcement and recognize party autonomy. Any exceptions should be limited, clear and transparent.

32. In principle, encumbered assets should be included in the insolvency estate. Whether assets that are subject to a retention or transfer of title arrangement (see chap. III, sect. A.3) should form part of the estate or not depends on whether such quasi-security devices are assimilated into a general category of security rights or not.

[Note to the Working Group: The Working Group may wish to consider whether transfer or retention of title arrangements should be assimilated into a general category of security rights.]

33. If secured creditors are required to participate in insolvency proceedings, the insolvency regime should ensure that participation is sufficiently effective to protect the interests of secured creditors.

34. The distinction between insolvency proceedings designed to liquidate the assets of an insolvency debtor and proceedings designed to rescue the business of the insolvency debtor support different treatment of security rights in those proceedings.

35. With few exceptions (see para. 13 above), the need to stay enforcement of a security right is less compelling when the insolvency proceedings are liquidation proceedings than when they are reorganization proceedings. Application of the stay, its duration, and the grounds for relief from the stay should be adjusted accordingly. In any event, the secured creditors should be provided with safeguards to ensure adequate protection of the economic value of their security rights when their right to enforce their security rights is deferred by the stay.

[*Note to the Working Group: The Working Group may wish to consider whether the same policies for determining who should dispose of encumbered assets outside of insolvency should generally apply in insolvency proceedings.*]

36. Subject to any avoidance actions, security rights created before the commencement of insolvency proceedings should be equally valid in the insolvency proceedings.

37. As a general rule, insolvency proceedings should not alter the priority of secured claims prevailing before the

commencement of the insolvency proceedings. Certainty and transparency with respect to any necessary exceptions will help limit the negative impact on the availability and cost of credit.

[*Note to the Working Group: The Working Group may wish to consider whether post-commencement financing secured by security rights in already encumbered assets should be given priority over secured creditors with existing security rights in the same assets and, if so, under what conditions.*]

A/CN.9/WG.VI/WP.2/Add.11

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

XI. CONFLICT OF LAWS AND TERRITORIAL APPLICATION

A. General remarks

1. Introduction

(a) Purpose of conflict-of-laws rules

1. The present chapter discusses the rules for determining the law applicable to the creation, publicity, priority and enforcement of a security right. These rules are generally referred to as conflict-of-laws rules and also determine the territorial scope of the substantive rules envisaged in the present Guide. For example, if a State has enacted the substantive rules envisaged in the Guide relating to the priority of a security right, these rules will apply to a priority contest arising in the enacting State only to the extent that the conflict-of-laws rule on priority issues points to the laws of that State. Should the conflict rule provide that the law

governing priority is that of another State, then the relative priority of competing claimants will be determined in accordance with the law of that other State and not pursuant to the substantive priority rules of the enacting State.

2. After a security right has become effective, a change might occur in the connecting factor for the choice of the applicable law. For instance, if security over tangible goods located in State A is governed by the law of the location of the goods, the question arises as to what happens if goods subject to a security right in that State are subsequently moved to State B (whose conflict rules also provide that the location of the goods governs security rights over tangible property). One alternative would be for the security to continue to be effective in State B without the need to take any further step in State B. Another alternative would be for new security to be obtained under the laws of State B. Yet another alternative would be for the secured creditor's pre-existing right to be preserved subject to the fulfilment in State B of certain formalities within a certain period of time (for example, 30 days after the goods have been brought into State B). These issues are addressed by the

conflict-of-law rules of some legal systems. The present chapter proposes a general rule in this regard.

3. Conflict-of-laws rules should reflect the objectives of an efficient secured transactions regime. Applied to the present chapter, this means that the law applicable to the property aspects of a security right should be capable of easy determination: certainty is a key objective in the elaboration of rules affecting secured transactions at both the substantive and conflict-of-laws level. Another objective is predictability. As illustrated by the questions in the preceding paragraph, the conflict-of-laws rules should permit the preservation of a security right acquired under the laws of State A if a subsequent change in the connecting factor for the selection of the applicable law results in the security right becoming subject to the laws of State B. A third key objective of a good conflict-of-laws system is that the relevant rules must reflect the reasonable expectations of interested parties (creditor, debtor and third parties). According to many, in order to achieve that result, the law applicable to a security right should have some connection to the factual situation that will be governed by such law.

4. Use of the Guide (including the present chapter) in developing secured transactions laws will help reduce the risks and costs resulting from differences between current conflict-of-laws rules. In a secured transaction, the secured creditor normally wants to ensure that its rights will be recognized in all States where enforcement might take place (including in a jurisdiction administering the insolvency of the debtor). If those States have different conflict-of-laws rules in relation to the same type of encumbered assets, the creditor will need to comply with more than one regime in order to be fully protected. A benefit of different States having harmonized conflict-of-laws rules is that a creditor can rely on one single law to determine the priority status of its security in all such States. This is one of the goals achieved in respect of receivables by the United Nations Convention on the Assignment of Receivables in International Trade (“United Nations Assignment Convention”).

[Note to the Working Group: Reference could be made in this context to the convention being prepared by the Hague Conference on Private International Law on the law applicable to dispositions of indirectly held securities, once that text is finalized.]

(b) Scope of conflict-of-laws rules

5. The present chapter does not define the security rights to which conflict-of-laws rules will apply. Normally, the characterization of a security right for conflict-of-laws purposes will reflect the substantive security rights law in a jurisdiction. The question arises, however, as to whether the conflict-of-laws rules for security rights should also apply to other transactions that are functionally similar to security, even if they are not covered by a secured transactions regime. To the extent that title reservation agreements, financial leases, consignments and other similar transactions would not be governed by the substantive law rules, a State might nonetheless subject them to the conflict-of-laws rules applicable to secured transactions.

6. A similar issue arises in respect of certain transfers not made for security purposes, where it is desirable that the applicable law for creation, publicity and priority be the same as for a security right over the same category of property. An example is found in the United Nations Assignment Convention, which (including its conflict-of-laws rules) applies to outright transfers of receivables as well as to security rights over receivables. This policy choice is motivated, inter alia, by the necessity of referring to one single law to determine priority between competing claimants to the same receivable. In the event of a priority dispute between a purchaser of a receivable and a creditor holding security over the same receivable, it would be more difficult (and sometimes impossible) to determine who is entitled to priority if the priority of the purchaser were governed by the laws of State A but the priority of the secured creditor were governed by the laws of State B.

7. Whatever decision a jurisdiction makes on the range of transactions covered by the conflict-of-laws rules, the scope of the rules will be confined to the property aspects of these transactions, which are matters that are outside the domain of freedom of contract. Thus, a rule on the law applicable to the creation of a security right only determines what law governs the creation of a property right. The rule would not apply to the personal obligations of the parties under their contract.

2. Conflict-of-laws rules for creation, publicity and priority

8. The determination of the extent of the rights conferred by a security right generally requires a three-step analysis:

- (a) The first issue is whether the security has been validly created (see chap. IV);
- (b) The second issue is whether the security is effective against third parties (see chaps. V and VI); and
- (c) The third issue is what is the priority ranking of the secured creditor (see chap. VII).

9. Legal systems do not all make specific conceptual distinctions between these issues. In some legal systems, the fact that a property right has been validly created necessarily implies that the right is effective against third parties. Moreover, legal systems that clearly distinguish between the three issues do not always establish separate substantive rules on each issue. For example, in the case of a possessory pledge complying with the requirements for the in rem validity of a security right results in the security being effective against third parties without any need for further action.

10. The key question is whether one single conflict-of-laws rule should apply to all three issues. The alternative is to allow for more flexibility, where it may be more appropriate that the law applicable to publicity or priority is different from that governing the creation of the right. Policy considerations, such as simplicity and certainty, favour adopting one rule for creation, publicity and priority. As noted above, the distinction between these issues is not always made or understood in the same manner in all legal systems, with the result that providing

different conflict-of-laws rules on these issues may complicate the analysis or give rise to uncertainty. There are, however, instances where selecting a different law for priority issues would better take into account the interests of third parties such as persons holding non-consensual security.

11. Another important question is whether on any given issue (that is, creation, publicity or priority) the relevant conflict-of-laws rule should be the same for tangible and intangible property. A positive answer to that question would favour a rule based on the law of the location of the grantor. The alternative would be the place where the encumbered asset is held (*lex situs*), which would, however, be inconsistent in respect of receivables with the United Nations Assignment Convention.

12. Simplicity and certainty considerations support the adoption of the same conflict-of-laws rule for both tangible and intangible property, especially if the same law applies to creation, publicity and priority. Following this approach, one single enquiry would suffice to ascertain the extent of the security rights encumbering all assets of a debtor. There would also be no need for guidance in the event of a change in the location of encumbered assets or to distinguish between the law applicable to possessory and non-possessory rights (and to determine which prevails in a case where a possessory security right governed by the law of State A competes with a non-possessory security right over the same property governed by the law of State B).

13. Not all jurisdictions, however, regard the law of the location of the grantor as sufficiently connected to security rights over tangible property (for “non-mobile” goods at least). Moreover, the law governing security would need to be the same as the law governing a sale of the same assets. This means that acceptance of the grantor’s law for every type of security would be workable only if jurisdictions, generally, were prepared to accept that rule for all transfers.

14. In addition, it is almost universally accepted that a possessory right should be governed by the law of the place where the property is held, so that adopting the law of the grantor for possessory rights would run against the reasonable expectations of non-sophisticated creditors. Accordingly, even if the law of the grantor’s location were to be the general rule, an exception would need to be made for possessory security rights.

[Note to the Working Group: If the scope of the law envisaged by this Guide is limited to commercial goods, equipment and trade receivables, it may be unnecessary to decide whether there should be special conflict-of-laws rules for certain categories of intangible property, such as non-trade receivables, securities, bank deposits, letters of credit and intellectual property. The issue should, however, be considered, as assets within these categories of property often comprise a significant part of the value of an enterprise. In particular, the absence of a conflict-of-laws rule for intellectual property could cause great difficulties in commercial transactions.]

In another vein, to the extent that the conflict-of-laws rules of this Guide might overlap in some respects with the rules proposed by other international organizations (for example, the Hague Conference, in the area of indirectly

held securities), the Working Group may wish to consider ways to ensure coherence and to avoid inconsistencies.]

3. *Effect of subsequent change in the connecting factor*

15. Whatever connecting factor is retained for determining the most appropriate conflict-of-laws rule for any given issue, there might occur a change in the relevant factor after the security has been created. For example, where the applicable law is that of the jurisdiction where the grantor has its head office, the grantor might later relocate its head office to another jurisdiction. Similarly, where the applicable law would be the law of the jurisdiction where the secured property was located, the property might be moved to another jurisdiction.

16. If these issues are not dealt with specifically, an implicit rule might be drawn. The general conflict-of-laws rules on creation, publicity and priority might be construed to mean that, in the event of a change in the relevant connecting factor, the original governing law continues to apply to issues that arose before the change (for example, creation), while the subsequent governing law would apply to events occurring thereafter (for example, a priority issue between two competing claimants).

17. The silence of the law on these matters might, however, give rise to other interpretations. For example, one interpretation might be that the subsequent governing law also governs creation in the event of a priority dispute occurring after the change (on the basis that third parties dealing with the debtor are entitled to determine the applicable law for all issues relying on the actual connecting factor, being the connecting factor in effect at the time of their dealings).

18. Providing a rule on these issues would appear to be necessary to avoid uncertainty, in particular where the connecting factor changes from a State that has not enacted the law envisaged by the present Guide to an enacting State.

4. *Conflict-of-laws rules for enforcement issues*

19. Where a security right is created and publicized under the law of one State, but is sought to be enforced in another State, an issue arises regarding what remedies are available to the secured creditor. This is of great practical importance where the substantive enforcement rules of the two States are significantly different. For example, the law governing the security could allow enforcement by the secured creditor without prior recourse to the judicial system unless there is a breach of peace (“self-help”), while the law of the place of enforcement might require judicial intervention. Each of the possible solutions to this issue entails advantages and disadvantages.

20. One option is to subject enforcement remedies to the law of the place of enforcement, that is, the law of the forum (*lex fori*). The policy reasons in favour of this rule include:

(a) The law of remedies would coincide with the law generally applicable to procedural issues;

(b) The law of remedies would, in many instances, coincide with the situs of the property being the object of the enforcement (and could also coincide with the law governing priority if the conflict-of-laws rules of the relevant State point to the situs for priority issues);

(c) The requirements would be the same for all creditors intending to exercise rights against the assets of a debtor, irrespective of whether such rights are domestic or foreign in origin.

21. On the other hand, the *lex fori* might not give effect to the intention of the parties. The parties' expectations may be that their respective rights and obligations in an enforcement situation will be those provided by the law under which the security was created. For example, if self-help is permitted under the law governing the creation of the security, self-help would also be available to the secured creditor in the State where the latter has to enforce its security, even if self-help is not generally allowed under the domestic law of that State.

22. An approach based on the reasonable expectations of the parties would mean a rule referring enforcement issues to the law governing the creation of the security right. This solution would also avoid separating the remedies from the nature of the rights conferred by a security. Such a separation is not evident where the remedies are closely linked to the attributes of the security (for instance, the remedies of a conditional seller may be viewed as stemming from the fact that it has remained the legal owner of the goods). To the extent that the conflict-of-laws rule on priority issues would be the same as for creation and publicity, another benefit of the law regarding creation of the security and the law governing enforcement coming from the same regime would be that priority and enforcement issues would be subject to the same law.

23. A third option is to adopt a rule whereby the law governing the contractual relationship of the parties would also govern enforcement matters. This would often correspond to their expectations and, in many instances, would also coincide with the law applicable to the creation of the security right since that law is often selected as also being the law of the contract. However, under this approach, parties would then be free to select, for enforcement issues, a law other than the law of the forum or the law governing creation, publicity and (or) priority. This solution would be disadvantageous to third parties, which might have no means to ascertain the nature of the remedies that could be exercised by a secured creditor against the property of their common debtor.

24. Therefore, referring enforcement issues to the law governing the contractual relationship of the parties would necessitate exceptions designed to take into account the interests of third parties, as well as the mandatory rules of the forum, or of the law governing validity and publicity. Procedural matters would, in any case, need to be governed by the law of the forum. As a result, the various enforcement issues would be treated differently.

[Note to the Working Group: Consideration might also be given to the impact of insolvency on any conflict-of laws rule for enforcement measures and whether this Guide

should deal with this issue or whether it is more appropriately dealt with in the draft legislative guide on insolvency law.]

B. Summary and recommendations

[Note to the Working Group: As to the law applicable to the creation, publicity and priority of security rights, the Working Group may wish to consider the following alternatives:

Alternative 1

General rule: The creation, publicity and priority of a security right over tangible and intangible property are governed by the law of the location of the grantor (the location of the grantor would have to be defined; see, for example, article 5(h) of the United Nations Assignment Convention, which locates a commercial grantor in the State in which it has its place of central administration).

Exceptions: The law of the location of the property governs the creation, publicity and priority of a possessory security right and the priority of a non-possessory security right over tangible property, money, negotiable documents and instruments (other classes of intangible property capable of being subject to a possessory pledge may have to be added).

Alternative 2

General rule: The creation, publicity and priority of a security right are governed by the law of the location of the property.

Exceptions: The law of the location of the grantor governs the creation, publicity and priority of a non-possessory security right over intangible property, and of any security right over tangible property of a type that is normally used in more than one jurisdiction. A sub-alternative would be to subject mobile goods to the law of the place where their movements are controlled.

Consideration might be given to providing for an additional rule for goods in transit. A security right over such goods may be validly created and publicized under the law of the place of destination provided that they are moved to that place within a certain time limit.

The above rules do not specifically refer to proceeds, on the assumption that the conflict-of law rules for proceeds should, in principle, be the same as those applicable to a security right initially obtained over the same type of property.]

25. A security right validly created and publicized under the law of a State other than a State that has enacted the legislation envisaged in the present Guide continues to be valid and publicized in an enacting State after the connecting factor changes to the enacting State, if the publicity requirements of the enacting State are complied with within a specified grace period. This rule would imply that creation issues continue to be governed by the initial governing

law while publicity (and priority to the extent that priority is governed by the same law as publicity) would be governed, after the change, by the law of the enacting State.

[*Note to the Working Group: With regard to the law applicable to enforcement issues, the Working Group may wish to consider the following alternatives:*

Alternative 1

Substantive matters affecting the enforcement of the rights of a secured creditor are governed by the law of the State where enforcement takes place (that is, by the law of the forum).

Alternative 2

Substantive matters affecting the enforcement of the right of a secured creditor are governed by the law governing the creation [and the priority] of the security right.

Alternative 3

Substantive matters affecting the enforcement of the rights of a secured creditor are governed by the law governing the contractual relationship of the creditor and the debtor, with the exception of [...].

A/CN.9/WG.VI/WP.2/Add.12

Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session

ADDENDUM

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Draft legislative guide on secured transactions

XII. TRANSITION ISSUES

A. General remarks

1. General rule as to pre-effective-date transactions

1. In many cases, the rules embodied in new secured transactions legislation will be different from the rules in the law pre-dating the legislation. Accordingly, such legislation should specify the date when it will enter into force (the “effective date”).

2. As debts that are secured by rights in the debtor’s property are often payable over a long period of time, it is likely that there will be many rights created before the

effective date of any new secured transactions legislation that will continue to exist, securing debts that are not yet paid on the effective date of the new legislation. Therefore, another important decision that must be made with respect to any new secured transactions legislation is the extent, if any, to which the new legislation will govern transactions entered into prior to the effective date.

3. One possibility would be for the new legislation to apply prospectively only and, therefore, not to govern any transactions entered into prior to the effective date. While there is a certain logical appeal in such a solution, especially with respect to issues that arise between the debtor and the secured creditor, it would create significant problems. Foremost among those problems is that it would be quite difficult for parties to existing secured transactions to gain the advantages of the new legislation, which may be

important in particular if the existence of rights created under the prior regime cannot be determined easily. Another problem is that, if the new legislation did not apply to pre-effective-date transactions, priority conflicts between rights created before the effective date and those created after the effective date would be difficult to resolve and might be subject to old law indefinitely. As a result, significant economic benefits of the new legislation would be deferred for a substantial period.

4. Another possibility would be for the new secured transactions legislation to govern all secured transactions, including those already in existence, as of a designated effective date, with only such exceptions as are necessary to assure an effective transition to the new regime (see paras. 5-10 below). Such an approach would avoid the problems identified above.

2. *Exceptions to the general rule*

(a) *Disputes before a court or arbitral tribunal*

5. When a dispute is in litigation (or a comparable dispute resolution system) at the effective date of the new legislation, the rights of the parties have sufficiently crystallized so that the effectiveness of a new legal regime should not change the outcome of that dispute. Therefore, such a dispute should not be resolved by application of the new legal regime.

(b) *Effectiveness of pre-effective-date rights as between the parties*

6. When a security right has been created before the effective date of new legislation, two questions arise regarding the effectiveness of that right between the debtor and the creditor. The first is whether a right that was not effective between the parties under old law, but would be effective if the new law applied, should become effective on the effective date of the new law. The second question is whether a right that was effective between the parties under the old law, but would be ineffective if the new law applied, should become ineffective between the parties on the effective date of the new law. With respect to the first question, consideration should be given to making the right effective as of the effective date of the new law. With respect to the second question, a transition period might be created during which the right would remain effective between the parties, so that the creditor could take the necessary steps to make the right effective under the new law. At the expiration of the transition period, the right would become ineffective between the parties unless it had become effective under the new law.

(c) *Effectiveness of pre-effective-date rights as against third parties*

7. Different issues are raised as to the effectiveness against third parties of a right created before the effective date. As new legislation will embody public policy regarding the proper steps necessary to make a right effective against third parties, it is preferable for the new rules to

apply to the greatest extent possible. It may, however, be unreasonable to expect a creditor whose right was effective against third parties under the previous legal regime to comply immediately with any additional requirements of the new law. Accordingly, a right that was effective against third parties under the previous legal regime but would not be effective under the new rules, should remain effective for a reasonable period of time (as determined by the new law) so as to give the creditor time to take the necessary steps under the new law.

8. If the right was not effective against third parties under the previous legal regime, but is nonetheless effective against them under the new rules, the right should be effective against third parties immediately upon the effective date of the new rules. After all, presumably the parties intended effectiveness as between them, and third parties are protected to the full extent of the new rules.

(d) *Priority disputes*

9. An entirely different set of questions arises in the case of priority disputes. If relative priority between two competing rights in encumbered assets has been established before the effective date of new rules and nothing has happened that would change the priority other than the effective date having been reached, stability of relationships suggests that the priority established before the effective date should not be changed. If, however, something occurs that would have had an effect on priority even under the previous legal regime, there is less reason to continue to utilize old rules to govern a dispute that has been changed by an action that took place after the effective date of the new rules. Therefore, there is a much stronger case for applying the new rules to such a situation.

10. If the priority dispute is between one party whose right was established before the effective date and another party whose right was established after the effective date, however, each party has an interest in application of the rules that were in effect when its interest was established. In such a case, while it is preferable to have the new rules govern eventually, it may be appropriate to provide a transition rule protecting the status of the creditor whose right was acquired under the old regime while that creditor takes whatever steps are necessary to maintain protection under the new regime. The transition rule might also provide that creditor with priority to the same extent as would have been the case had the new rules been effective at the time of the original transaction and those steps had been taken at that time.

B. *Summary and recommendations*

11. New secured transactions legislation should specify a date as of which it will enter into force.

[*Note to the Working Group: The Working Group may wish to consider the extent to which the new legislation should apply to all transactions, including those already in existence.*]

**C. Report of the Secretary-General on the United Nations Commission
on International Trade Law—Commercial Finance Association
international colloquium on secured transactions
(Vienna, 20-22 March 2002), working paper submitted to
the Working Group on Security Interests at its first session
(A/CN.9/WG.VI/WP.3) [Original: English]**

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I. INTRODUCTION

1. At its thirty-fourth session, the United Nations Commission on International Trade Law (UNCITRAL) decided to establish a working group with the mandate to develop an efficient legal regime for security rights in goods involved in a commercial activity, including inventory, to identify the issues to be addressed, including the form of the instrument and the exact scope of assets that can serve as security.¹

2. At that session, the Commission emphasized the importance of the subject of security interests and the need to consult with representatives of the relevant practice and industry and recommended that a colloquium should be held before the first session of Working Group VI (Security interests).²

3. The colloquium, organized jointly with the Commercial Finance Association (CFA), was held in Vienna from 20 to 22 March 2002. The colloquium was designed to

provide a forum for dialogue among practitioners, international organizations and government representatives on the work of the Commission on security interests.

4. It was attended by approximately 50 experts from around 20 countries, including officials of Governments and international organizations, such as the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund (IMF) and the International Federation of Insolvency Professionals (INSOL International). Speakers included experts who had significant experience in secured credit and insolvency law.

5. The present note provides a summary of the discussions that took place amongst the participants of the colloquium.

II. ECONOMIC BACKGROUND AND SCOPE

6. General support was expressed for a comprehensive scope of work that would encompass a broad range of assets as encumbered assets, a broad range of obligations to be secured and a broad array of debtors, creditors and credit transactions. It was noted that such an approach would be consistent with one of the key objectives of any

¹Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 358.

²Ibid., para. 359.

efficient secured credit law, namely the need to permit parties to utilize the full value of their assets to obtain credit. However, a note of caution was struck that, to facilitate the completion of work within a reasonable timeframe and the wide adoption of the new regime, the scope of work should not be overly ambitious. It was also stated that while immovables should not be covered, there were cases where a distinction might be difficult to draw (as was the case, for example, with fixtures and crops or enterprise mortgages, which could include both movable and immovable assets).

7. It was emphasized that the new regime would be part of national law and as such would apply not only to international but also to purely domestic credit transactions.

(a) Terminology

8. It was agreed that, while the focus should be on consensual security rights, priority conflicts with non-consensual security rights should also be addressed. It was, therefore, suggested that in any definition of “security right”, reference should be made both to consensual (created by agreement) and to non-consensual (created by law or court judgement) security rights. It was also suggested that “security right” should be defined as a property right (that is, a right in rem). As to the use of a uniform term “security right”, it was stated that it did not prejudge the issue whether one uniform, functional security right should be introduced to replace all security rights or quasi-security rights existing under national law or a specific security right that would coexist with the various security devices used in the various legal systems (see para. 14 below).

9. It was stated that a distinction should be drawn between the terms “debtor” (the person that owes the secured obligation) and “grantor” (the person that gives an asset as security) to cover cases where a third party gives an asset as security in favour of the debtor. It was also observed that use of these terms should be consistent and the reasons for using one or the other term should be clear.

(b) Key objectives

10. General support was expressed for the view that the economic impact of secured transactions legislation should be emphasized. It was agreed that the overall objective of any efficient secured transactions legislation should be to promote increased availability of low-cost credit.

11. As to the particular objectives of such legislation, a number of suggestions were made. One suggestion was that the importance of balancing the interests of debtors, creditors and affected third parties should be emphasized. Another suggestion was that key objectives should be clear, simple and concise. Yet another suggestion was that the need to avoid exposing secured creditors to liabilities, such as environmental liabilities, should be highlighted. Yet another suggestion was that the importance of coordination between the secured transactions and insolvency law

regimes should be emphasized. Yet another suggestion was that, while recognizing party autonomy was an important objective, it was often limited by statutory limitations. In that connection, it was stated that reference should be made to the United Nations Convention on the Assignment of Receivables in International Trade, which contained principles with respect to certain statutory limitations. Yet another suggestion was that it should be made clear that transparency could be achieved in various ways and not only through registration.

III. GENERAL APPROACHES TO SECURITY

12. It was noted that possessory security rights that were traditionally regarded as providing strong security were sufficiently regulated. However, the law in many countries needed to be further developed with regard to non-possessory security rights, for which there was a clear economic need. A number of questions were identified. One question was whether both possessory and non-possessory security rights should be covered and, if so, whether the same rules could apply to both. Another question was whether quasi-security devices (for example, retention and transfer of title arrangements) should be covered. Yet another question was whether a new uniform, functional security right should be established or a new special type of right to co-exist with other types of current security or quasi-security rights.

13. It was stated that both possessory and non-possessory security rights should be covered and treated in the same way, unless a different treatment was justified by practical realities, as was the case, for example, with the issue of repossession of the encumbered asset by the secured creditor. In addition, it was observed that quasi-security rights should also be covered. Moreover, it was said that a new uniform, functional, comprehensive security right in all types of asset should be introduced. On the other hand, it was pointed out that replacing existing security devices with a new uniform, functional security right might not be feasible or even desirable. In addition, it was said that covering retention and transfer of title arrangements in a secured transactions project might be particularly problematic and needed to be considered very carefully with a view to identifying advantages and disadvantages. It was agreed that the costs and benefits of a comprehensive, functional approach as compared with a specific approach should be explained in detail.

IV. CREATION OF SECURITY RIGHTS

14. It was stated that it should be possible to give any type of asset as security and to secure any type of obligation. Particular reference was made to the need to allow security to be created in assets acquired after the conclusion of the security agreement and in changing pools of assets in order even to secure obligations arising after the conclusion of the security agreement and obligations in revolving credits. It was recognized that in order to achieve that objective, it was necessary to adapt requirements as to the description of the encumbered asset or the secured obligation. It was also

observed that policy choices to protect certain debtors (for example, consumers) or unsecured creditors could be accommodated by way of limited exceptions. For example, household goods should not be made subject to security other than that necessary to secure their purchase price. Furthermore, it was said that a modern secured transactions regime should allow security to be created over an asset, whether the grantor had ownership or a limited right (for example, a usufruct or a pledge). In that respect, it was pointed out that the object of security was not the asset itself but the grantor's right in the asset.

V. PUBLICITY

15. The discussion focused on whether an effective secured transactions regime dealing with non-possessory security rights required the establishment of a system in the context of which notices could be filed to alert potential financiers of the possible existence of security rights and to provide a basis for resolving conflicts between competing claims in the same assets. One view was that such a public registry was unnecessary. It was stated that fraudulent antedating of security instruments could be dealt with through less costly and complex requirements. It was also observed that the appearance of false wealth created by the debtor's continued possession of the encumbered assets was not a valid concern. It was pointed out that, in a credit-dominated economy, parties ought to know that an enterprise's or even a consumer's assets were likely to be encumbered or be subject to a quasi-security device (for example, lease or title retention).

16. In addition, it was said that parties should be presumed to be acting honestly and in good faith. The law should encourage that behaviour by providing for civil and even criminal penalties for dishonest or bad faith behaviour. Potential financiers could be adequately protected by the debtor's representations as to the existence of security rights combined with the debtor's promise not to give the same asset as security to another creditor without the consent of the secured creditor. It was also stated that the establishment and operation of a filing system would add cost and complexity to secured transactions. Moreover, it was observed that the filing system might inappropriately disclose confidential information even to competitors and thus harm debtors. Furthermore, it was said that priority rules based on filing of a notice about a transaction could inappropriately favour bank over supplier credit. Such supplier credit was said to be in many countries much more substantial in value and importance for the economy than bank credit.

17. In response, it was observed that anti-fraud and date-certain features were incidental partial benefits, but not the primary function of the filing system, which was to alert potential financiers of any existing security rights and to serve as a tool for resolving priority conflicts. It was also said that potential financiers could not rely only on the debtor's representations as to any existing security rights. In a global market, debtors may not be known to creditors or may not yet have established a relationship of trust with creditors. In that connection, it was pointed out that misrepresentations were not necessarily the result of dishonesty or

bad faith. For example, in the absence of expert advice, a debtor might not easily understand that the fact that it had granted security over a general category of assets to one creditor precluded the debtor from offering specific assets from that category as security to other creditors. Miscalculation of the value of assets was also said to be a normal occurrence in practice that was not the result of dishonesty or bad faith.

18. As to the costs of establishing and operating a filing system, it was stated that such a system had been established and was working at a minimal cost even in some of the least developed countries of the world. It was also observed that one of the key characteristics of the filing system was low, flat filing fees. A system with high, ad valorem filing fees was generally found to be completely undesirable. In addition, with regard to the concern that a filing system might inadvertently disclose confidential information, it was observed that an efficient notice-filing system disclosed very little information. In any case, that information was not confidential, but was available on balance sheets or through various credit reporting agencies. On the other hand, it was pointed out that, if such information was available, a filing system was not necessary and would unnecessarily increase transaction costs. Disagreement was expressed with that view since credit reporting systems could not play the function of alerting potential financiers to the possibility of the existence of any security rights or the function of resolving priority conflicts. It was also pointed out that there was a cost associated, in particular in the context of insolvency proceedings, with determining priority in a legal system that did not provide sufficient information about competing claims. Moreover, as to the concern expressed as to the relevant priority of supplier credit, it was observed that even in countries with a notice-filing system priority was given to suppliers as long as they filed a notice about their claim. In that context again, the concern about publicizing a business relationship was raised, in particular with respect to retention of title arrangements (see paras. 20-22 below).

VI. PRIORITY

19. It was stated that a system providing priority to different creditors permitted the use of the same asset as security for credit granted by multiple creditors. That result would facilitate the full utilization of the value of assets for the purpose of obtaining credit, which was said to be one of the key objectives of any efficient secured transactions regime. It was also observed that that objective could most effectively be achieved by a first-to-file priority rule. However, several objections were raised.

20. One objection was that requiring suppliers with a retention of title to secure payment of the price to file a notice each time they supplied goods would unnecessarily add cost and complexity to the transaction, while encouraging irresponsible or even dishonest behaviour on the part of the debtor or other grantor. It was stated that supplier credit was important for the economy and should not be disrupted. It was, therefore, suggested that a first-to-conclude-a-contract rule would be more appropriate. A creditor providing general credit should be expected to rely on the

debtor to describe accurately to the general secured creditor the rights that the debtor may have granted to a supplier. Failure of the debtor to report such information accurately to the general secured creditor should make the debtor subject to civil or even criminal penalties.

21. In response, it was stated that suppliers should not need to file a notice each time they supplied goods but that one notice should be sufficient for goods provided during the duration of the contract. It was also observed that the filing fee should be nominal, reflecting only the operating cost of the filing office. In addition, it was said that the absence of any notice also had cost implications since it was bound to create uncertainty. Moreover, it was stated that superpriority could be given to suppliers in order to protect supplier credit. Such an approach would be based on the fact that, once a notice was filed about the supplier's rights, other lenders, whether previous or subsequent, would be on notice about the supplier's superpriority. As to the extent of the priority of supplier credit, it was stated that whether it would extend to proceeds (for example, receivables) of the encumbered assets (for example, inventory) would depend on whether the legislator wanted to promote more receivables as opposed to inventory financing.

22. As to the suggestion that a general creditor should rely on the representations of the debtor, several countervailing considerations were mentioned. One consideration was that it was questionable whether the secured creditor could rely on the debtor to know accurately and specifically the scope and nature of the rights that it might have given to the supplier. It was stated that relying on the debtor assumed a certain quality of record keeping, which especially with a company in financial distress might not be available or readily accessible. Another consideration was that relying on the debtor's description of the rights given to the supplier might not be safe as there was the possibility that the supplier might have a different view of the scope and nature of its rights against the debtor and its assets from that given by the debtor. Yet another consideration was that while criminal penalties might be severe, their implementation might not be sufficiently certain since the standards required to find liability under criminal law were normally greater than under civil law. Lowering those standards was said to be inappropriate. In addition, criminal penalties from the secured creditor's perspective were not a substitute for repayment of its debt pursuant to recourse to the property of the debtor.

23. On the other hand, it was stated that a secured transactions regime that would include retention of title rights (purchase-money security rights) would be complex. In response, it was stated that the nature of that financing was relatively simple and straightforward and that suppliers and secured creditors were easily identified for purposes of the debtor providing the applicable information to the general secured creditor. That fact was confirmed also by the absence in many countries of a requirement that suppliers should comply with notice filing to establish priority. It was also observed that the absence of a filing might involve additional evidentiary burdens. The supplier, for example would have to prove that it had a valid reservation of title and the date such rights were established. The possibility

was also raised that rights in property to secure debt, such as pursuant to a retention of title by a seller of goods, might continue to exist as a separate category of rights, but could still be made subject to a filing system as a method of establishing priority relative to other types of security rights.

24. The need to grant superpriority to certain non-consensual rights (for example, of the State for taxes or of employees for wages) was also emphasized. Divergent views were expressed as to whether notice should be filed about such rights.

VII. PRE-DEFAULT RIGHTS AND OBLIGATIONS OF THE PARTIES

25. There was general support for the view that any default rules should be limited to those which were absolutely essential and those which the parties would most likely have agreed to. Some doubt was expressed as to the need for a rule providing that the encumbered assets should be insured. It was noted that in some jurisdictions insurance was not made available for many types of assets.

26. The need to distinguish between rights and obligations for possessory and non-possessory security was questioned in view of the fact that some of the default rules applied to both possessory and non-possessory security (for example, the secured creditor's right to assign the secured obligation). It was also noted that the right to repledge conferred on the secured creditor referred to the right to repledge the security right in the encumbered asset rather than the encumbered asset itself.

VIII. DEFAULT AND ENFORCEMENT

27. The importance of providing for effective enforcement of security rights was emphasized. It was stated that the best law for the creation of security rights would be of no practical use if secured creditors were unable to realize the economic value of their rights. In that connection, attention was called to the need to review the institutional context in which enforcement took place and to assess frankly the efficiency of procedures used by institutions such as the civil courts. It was observed that reference should be made also to arbitral tribunals and other non-judicial bodies.

28. The diversity of possible mechanisms for realizing the economic value of security rights was also emphasized. With respect to procedures for initiating enforcement, it was stated that there were several alternatives. Alternatives mentioned included enforcement by the secured creditor without prior court intervention, enforcement by the creditor with executory title registered with a court or notarized, and enforcement based on presumptions or a limitation of defences in cases where judicial action was required. Some preference was expressed in favour of enforcement by the creditor without prior court intervention, with executory title issued by a notary as the second-best solution. It was also stated that, if judicial action was required, debtor

defences should be limited to avoid dilatory practices. For example, in the case of a non-possessory right, the only defence against repossession should be that there was no default (and not the amount owed or other details). In addition, it was observed that the secured creditor should be able to sell the encumbered assets at the market price in the place where the assets were located. Moreover, it was stated that it was essential to ensure that assets would be converted into cash in a timely manner in order to avoid loss of value.

29. Attention was also called to the need to provide prompt and effective ways for a secured creditor to take possession of the encumbered assets following default in the case of a non-possessory security right. In other respects, however, it was not thought necessary to distinguish between possessory and non-possessory security rights. The view was expressed that the potential for abuse by secured creditors should also be considered. The example was given of agreements between debtors and secured creditors that in some jurisdictions were treated differently in the sense that pre-default agreements were void, while post-default agreements were valid and enforceable.

IX. INSOLVENCY

30. It was agreed that both secured transactions and insolvency regimes were concerned with debtor-creditor relationships and that both regimes exercised an important influence on corporate governance in the sense that they both had an interest in credit discipline and responsibility for debt. It was also agreed that there were also areas of tension between the two regimes, such as, for example, the different approaches to debt, to the extent that each regime upheld different rights and had different stakeholder constituencies.

31. It was stated that the insolvency viewpoint was not adverse to and should support a secured transactions regime that enabled the consensual “creation” of appropriately defined third-party security rights interests in property. The need was identified to clarify and to provide certainty in the classification of “quasi-security devices”, such as retention of title and financial leases. It was pointed out that the greater the range of property over which security might be taken, the greater the possibility of assessing the ability of a borrower to service a borrowing (which reduced over-indebtedness and consequent insolvency).

32. In addition, it was observed that an insolvency viewpoint also supported a notice-filing system that would be all embracing and provide a certain, efficient and cost-effective search base. It was said that a filing system provided an insolvency representative with certainty by facilitating the identification of encumbered assets, the secured obligation and the secured creditor. It would also assist an insolvency representative in determining validity and enforceability and in determining priority between competing security rights over the same property. Within the context of registration, however, two issues were mentioned as

requiring particular consideration. The first concerned whether a secured transaction or an insolvency regime should emphasize the need for filing by, for example, avoiding or otherwise rendering ineffective unregistered secured property rights for failure to file or otherwise perfect. It was mentioned that that approach was taken in some insolvency and secured transactions regimes. The second issue concerned the applicability to secured transactions, otherwise validly concluded, of provisions dealing with the avoidance of antecedent preferential and fraudulent transactions as found in most insolvency law regimes.

33. With regard to the actual impact of the commencement of an insolvency process upon secured creditors, it was suggested that it might be necessary to distinguish between liquidation and rescue processes. Under the former, an insolvency viewpoint would generally support the view that in a liquidation process there should be no lengthy or, indeed, any stay or suspension on enforcement of a security right. However, in relation to a rescue process, there should be a stay or suspension on enforcement of a security right, because of the possibility of enhanced value through rescue and of avoiding dismemberment of the estate. That should not, however, affect or threaten the substantive rights of secured creditors, but rather postpone the exercise of immediate enforcement rights. More difficult issues mentioned included binding a secured creditor to a rescue plan; abuse of a rescue process by debtors; post-insolvency commencement funding; and the possible creation of a “superpriority” that might affect holders of existing security rights. The need to coordinate enforcement and insolvency responses with the work of the Working Group on Insolvency Law was also emphasized.

X. CONFLICT OF LAWS

34. The discussion focused on the law that should govern the creation, publicity and priority of security rights over receivables and inventory. With respect to receivables, the appropriateness of the conflict rule contained in the United Nations Convention on the Assignment of Receivables in International Trade (leading to the application of the law of the grantor’s location) was confirmed. It was observed, however, that for certain categories of intangibles, such as bank deposits and securities accounts, a different approach might need to be taken.

35. With respect to the law applicable to security rights over tangible property, it was noted that there were two alternatives. The first alternative was the traditional rule, which subjected creation, publicity and priority issues to the law of the State in which tangible assets were located (*lex situs*). The second alternative was a two-fold rule according to which creation and publicity would be governed by the law of the location of the grantor but priority would be governed by the *lex situs*.

36. A number of concerns were raised with respect to the second alternative. One concern was that such a rule would run counter to the expectations of third parties that would expect the *lex situs* to apply to all property aspects of a security right in tangible property. Another concern was

that a two-fold rule might be difficult to apply if the legal system governing priority was based on publicity concepts that did not exist under the law of the location of the grantor. However, in support of such a bifurcated rule it was stated that departing from the traditional rule would have the benefit of applying the same law to the creation and publicity of a security right in both tangible and intangible property.

37. As to the law applicable to enforcement, it was suggested that most enforcement-related issues should be governed by the *lex situs*, since enforcement was necessary when the debtor did not voluntarily perform its obligations and the assistance of local authorities was required. It was also stated that enforcement might not be treated as a single issue but a series of issues. It was also observed that some of those issues might be subject to party autonomy (for example, disposition of an encumbered asset by agreement of the parties), while with respect to other issues that raised public policy issues an objective connecting factor might need to be used.

D. Note by the Secretariat on the draft legislative guide on secured transactions: comments by the European Bank for Reconstruction and Development, working paper submitted to the Working Group on Security Interests at its first session

(A/CN.9/WG.VI/WP.4) [Original: English]

1. At its thirty-fourth session, the United Nations Commission on International Trade Law (UNCITRAL) decided to entrust a working group with the mandate to develop “an efficient legal regime for security rights in goods involved in a commercial activity, including inventory, to identify the issues to be addressed, such as the form of the instrument, the exact scope of the assets that can serve as collateral ...”.¹ Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry and practice, the Commission recommended that a two- to three-day colloquium should be held.²

38. With respect to the law applicable to insolvency proceedings, it was stated that, in the case of assets located in the State where the main insolvency proceedings were opened, the widely accepted rule, providing for the application of the law of that State, should be adopted. As to the situation in which assets were located in another jurisdiction, it was stated that there was no generally accepted solution and the matter needed to be discussed with a view to providing guidance to States.

XI. TRANSITION

39. It was stated that the contents of any transition rules would depend on the circumstances prevailing in each State and that, therefore, no guidance could be provided to States. It was recognized, however, that the matter should be discussed since, in the absence of adequate transition rules, either parties might not be able to obtain the full benefits of new legislation or existing relationships might be disrupted.

ANNEX

COMMENTS BY THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

1. As part of its legal reform work undertaken in the last 10 years, secured transactions constitutes an area of particular importance to the European Bank for Reconstruction and Development (EBRD). When EBRD was founded in 1991 to participate in the reconstruction efforts in the former communist countries of Central and Eastern Europe, it was immediately clear that investments by the Bank and others in the region would be seriously impeded if the legal framework necessary to secure those investments was not in place. Such a framework could not be achieved by the simple enactment of a new law but required an entire re-thinking of the legal provisions applicable to security rights over property

and the effective implementation of such policy reform. The process started slowly and has intensified over the years. Every country in the region has since undertaken reform of the subject in one way or another.

2. EBRD has itself contributed to this process in many ways. For example, it has developed a template for reform. The EBRD Model Law for Secured Transactions was published in 1994 and the EBRD ten core principles for secured transactions law were published in 1998. In addition, EBRD has conducted an assessment of progress in the region. The EBRD regional survey of secured transactions laws was published for the first time in 1999 and has been regularly updated ever since. Moreover, EBRD has contributed to progress directly by providing technical assistance to a number of countries for the reform of secured transactions law and its implementation. It is thus of great interest to EBRD

¹Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 358.

²Ibid., para. 359.

to follow and participate in the new initiative of the United Nations Commission on International Trade Law (UNCITRAL) in this field. This initiative constitutes an opportunity to expand and develop the work that has been carried out in this field by EBRD, the Asian Development Bank (ADB), the International Bank for Reconstruction and Development (the World Bank) and other institutions working on international legal reform. UNCITRAL's work can have an immense impact on nations globally. Moreover, despite the non-binding nature of a legislative guide, as opposed to a convention, we believe that it can have more impact on law reformers throughout the world, as it would certainly be the most advanced and comprehensive document on secured transactions legal regimes to date.

3. EBRD sees its role as that of an active observer, providing examples of the issues faced in the legal reform process and the way they have been resolved in different jurisdictions of Central and Eastern Europe. EBRD would also stress the economic benefits to be derived from an efficient secured credit market, which should not be sacrificed to traditions and theoretical concepts. Practical problems in the area of secured transactions and the difficulties and economic inefficiencies of solving them under existing legislation (if it is possible at all) should be the trigger of any legislature to undertake reform in this field and thereby to refer to the future UNCITRAL legislative guide. It is practitioners who are often best placed to put forward the persuasive arguments needed to convince lawmakers that traditional rules and practices have to be changed if they are to serve modern economic needs.

4. Having read the first preliminary draft of the legislative guide, which is now before the Working Group, and having participated in the colloquium, we would like to emphasize certain issues that have featured in our work in transition countries.

(a) The guide should stimulate change

5. The objective of developing a legislative guide is that the resulting product should stimulate change. It would be disappointing if the guide were read and endorsed by those countries that already have an effective legal regime for secured transactions, but studiously ignored by those countries where there is a strong case for change. It is interesting to note that the guide is likely to be as relevant and useful for many developed countries as it will be for developing countries and countries with economies in transition. It would equally be disappointing if the need for compromise within the Working Group led to the reform policies being diluted to the extent that the message of the guide would no longer be clear or compelling.

6. Whereas it is inevitable that the guide takes the form of a relatively long document with a mine of detail, it is crucial that it should emphasize a set of recommendations that concentrate on the essential results that have to be obtained, with an indication (where appropriate) of alternative (yet effective) means by which those results may be achieved. We find, for example, that the basic requirements for the creation of the security interest and the elements that should be present in any given regime need to be spelled out very clearly. The guide cannot be limited to a presentation of the various options present in existing regimes as part of a "pick and choose" exercise. It is necessary to draw a distinction between those concepts or features of the system that are essential to the whole reform process (for example, the ability to encumber, without additional formalities, assets that are identified generally or are acquired in the future), and those that are of less importance and may be introduced or refined at a later stage, depending on the need and inclination within the country concerned. Conversely, the guide should not seek to impose solutions, even in matters of practical detail, where other approaches might be adopted (for example, extending the security to the proceeds of

sale of the encumbered asset; purchase-money security; the method of giving certainty to the date of the security agreement; and renewal of filing).

(b) The guide should not polarize common law systems and civil law systems

7. It is desirable that the guide, while acknowledging the division between civil law legal tradition and common law legal tradition, does not in practice "ostracize" some countries, leaving them feeling excluded from reform efforts and needs because of their seemingly "different" legal tradition. One principle that has guided the work of EBRD in this field has been to draw on many useful solutions that have developed in common law systems to accommodate modern financing techniques in a manner that is compatible with the civil law traditions underlying many Central and Eastern European legal systems. Our experience has confirmed our belief that legal tradition is no obstacle to reform in the field of secured transactions towards an economically efficient regime, provided that the determination to reform exists and that variations and accommodations can be made to acknowledge differences in institutions, style and accepted practice.

8. The guide's message must remain simple (but not simplistic) so that its substance may be readily understood by those contemplating reform. If the guide is too complex or obscure in style, or seems to be too heavily inspired by an existing system, which may not appeal as a model to all countries, then it will not be used. It must also be remembered that it is likely to be translated and used in many different legal reform contexts, hence the need for clarity and plain, unbiased language.

(c) The guide should emphasize the distinction between a formal and a functional approach

9. The need for a functional analysis of secured transactions is evident as noted throughout the guide with various justifications, but without any clear explanation. We consider that this is one of the most difficult issues, as well as one of the most controversial, and that it must be addressed openly. There are strongly held views for and against adopting a functional approach to security interests (which encompasses any transaction whose function is to provide security to one party for re-payment of an underlying obligation, regardless of the form and the legal technique adopted by the parties). Reform that entails adopting a functional approach also implies a major review of the law on obligations and property and some fundamental changes in the approach to legal and practical issues. Such reform cannot be a question of a relatively self-contained introduction of non-possessory security interests that would provide the market with a new type of security adapted to its needs. The objective becomes far more comprehensive and both the reform and its implementation will require more extensive preparation and resources. Reform makers need to understand this very clearly and balance carefully the advantages and disadvantages of adopting a fully functional approach. Based on our experience, we would suggest that a formal approach (encompassing only those transactions that are in the form required for the creation of security) could serve the economic objectives of secured transactions reform, while leaving considerable scope to encourage convergence, for example by introducing similar rules for quasi-security transactions on the questions of publicity, priority and enforcement.

10. The guide needs to be very clear on this point, in its terminology, in the definition of the key objectives and in the basic approach to security issues, rather than making an implicit assumption that a functional approach should be adopted, without proper explanation.

(d) The guide should remain open to the concept of a secured transactions regime encompassing movable and immovable property

11. Another implicit assumption, which is made in the guide, is the strict separation between movable and immovable assets. This separation, although it may make perfect sense in some legal regimes, may not always be appropriate. On the contrary, in some cases, there can be a very good case for a country to attempt to reform both areas at the same time and to submit security over movable and immovable assets to similar rules. The guide should leave this option open and should give general guidance as to how reform encompassing both movable and immovable assets may be successfully developed.

(e) The need for publicity of the security interest must be made absolutely clear

12. The guide should leave no doubt that a modern regime for secured transactions requires a system of publicity, which puts third parties on notice that a security interest over defined assets has been created by the debtor in favour of a creditor and which can also resolve priority issues. This should be reflected, in particular, in the key principles of the guide. Although the absence of publicity has not prevented some economies from developing a secured credit market, it is contradictory, in an open-market economy, to encourage greater use of assets as security and, at the same time, to allow the existence of that security to be concealed from other persons in the market. The principle of publicity is being slowly but steadily adopted throughout the region where EBRD operates. Difficult policy choices for the implementation of publicity have to be made, such as the legal effects of registration and the non-authentic nature of registered information, and these must be clearly presented in the guide, as the current draft accepts.

(f) The guide needs to take a clear stance on enforcement

13. Enforcement of a security interest tests the ultimate *raison d'être* of the security. If enforcement does not enable quick and effective realization of the encumbered assets and payment of the

secured creditor, the reliance on the security as a means to reduce credit risk is severely undermined. However, this may be the most difficult part of the reform because the enforcement regime will necessarily be closely interlocked with the existing rules on civil procedure on matters such as debt collection (enforcement of contracts) by judicial action, possessory actions, provisional measures over assets and enforcement over movable and immovable assets. Moreover, here, more than in any other area, the existence of institutions and their functioning (or not) will be key to the success of the reform. For example, the court system, its capacity, way of functioning and the risk of corruption, the existence and effectiveness of other professions that can play a key role in enforcement procedures, (especially when they are conducted privately, such as through judicial enforcement officers, notaries, other lawyers, auctioneers and other experts) will be key to the success of the reform.

14. Because of the importance of enforcement and the limitations on adopting a general prescriptive approach when so many external factors must be taken into account, it is essential to refer to the system's objectives in terms of timing and efficiency. In this connection, it is important to have regard to the realistic expectations of what can be achieved in a country, as opposed to imposing solutions that may work in some jurisdictions but not in others owing to the differences in procedural law and institutional framework.

15. Views are often polarized when discussions on enforcement focus on the involvement of the courts. The approach of allowing parties broad rights to resolve issues themselves and reserving the role of the courts as a fall-back position has much to commend it but often runs directly against entrenched traditions and perceptions of the court's role. In many countries, there is a strong expectation of court involvement. Where there are deficiencies in the way the court system operates, an inefficient court-dominated realization process may be seen as a lesser evil than a self-help regime where the courts are not capable of assuring adequate protection against abusive or wrongful actions by the creditor. The way towards workable solutions is most often found by a reasoned exploration of the different methods by which enforcement can be achieved, the potential economic impact of each method (and the resultant effect on the perception of security) and the different available means of ensuring a fair balance between the justifiable interests of debtor and creditor.

VI. TRANSPORT LAW

A. Report of the Working Group on Transport Law on the work of its ninth session

(New York, 15-26 April 2002) (A/CN.9/510)

[Original: English]

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I. INTRODUCTION

1. At its twenty-ninth session, in 1996,¹ the United Nations Commission on International Trade Law (UNCITRAL) considered a proposal to include in its work programme a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.²

2. At that session, the Commission had been informed that existing national laws and international conventions had left significant gaps regarding various issues. Those gaps constituted an obstacle to the free flow of goods and increased the cost of transactions. The growing use of electronic means of communication in the carriage of goods further aggravated the consequences of those fragmentary and disparate laws and also created the need for uniform provisions addressing the issues particular to the use of new technologies.³

3. At that session, the Commission also decided that the Secretariat should gather information, ideas and opinions as to the problems that arose in practice and possible solutions to those problems, so as to be able to present at a later stage a report to the Commission. It was agreed that such information gathering should be broadly based and should include, in addition to Governments, international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the International Association of Ports and Harbors, the International Chamber of Commerce (ICC), the International Chamber of Shipping, the International Federation of Freight Forwarders Associations, the International Maritime Committee (CMI) and the International Union of Marine Insurance.⁴

4. At its thirty-first session, in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the Secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information.

5. At the thirty-second session of the Commission, in 1999, it was reported on behalf of CMI that a CMI working group had been instructed to prepare a study on a broad range of issues in international transport law with the aim of identifying the areas where unification or harmonization was needed by the industries involved.⁵

6. At that session, it was also reported that the CMI working group had sent a questionnaire to all CMI member organizations covering a large number of legal systems. The intention of CMI, once the replies to the questionnaire had been received, was to create an international subcommittee to analyse the data and find a basis for further work towards harmonizing the law in the area of international transport of goods. The Commission had been assured that CMI would provide it with assistance in preparing a universally acceptable harmonizing instrument.⁶

7. At its thirty-third session, in 2000, the Commission had before it a report of the Secretary-General on possible future work in transport law (A/CN.9/476), which described the progress of the work carried out by CMI in cooperation with the Secretariat. It also heard an oral report on behalf of CMI. In cooperation with the Secretariat, the CMI working group had launched an investigation based on a questionnaire covering different legal systems addressed to the CMI member organizations. It was also noted that, at the same time, a number of round-table meetings had been held in order to discuss features of the future work with international organizations representing various industries. Those meetings showed the continued support for and interest of the industry in the project.

¹See *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17)*.

²*Ibid.*, para. 210.

³*Ibid.*

⁴*Ibid.*, para. 215.

⁵*Ibid.*, *Fifty-fourth Session, Supplement No. 17 (A/54/17)*, para. 413.

⁶*Ibid.*, para. 415.

8. In conjunction with the thirty-third session of the Commission, a transport law colloquium, organized jointly by the Secretariat and CMI, was held in New York on 6 July 2000. The purpose of the colloquium was to gather ideas and expert opinions on problems that arose in the international carriage of goods, in particular the carriage of goods by sea, identifying issues in transport law on which the Commission might wish to consider undertaking future work and, to the extent possible, suggesting possible solutions.

9. On the occasion of that colloquium, a majority of speakers acknowledged that existing national laws and international conventions left significant gaps regarding issues such as the functioning of a bill of lading and a sea waybill, the relationship of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provided financing to a party to a contract of carriage. There was general consensus that, with the changes wrought by the development of multimodalism and the use of electronic commerce, the transport law regime was in need of reform to regulate all transport contracts, whether applying to one or more modes of transport and whether the contract was made electronically or in writing. Some issues raised for consideration in any reform process included formulating more exact definitions of the roles, responsibilities, duties and rights of all parties involved and clearer definitions of when delivery was assumed to occur; rules for dealing with cases where it was not clear at which leg of the carriage cargo had been lost or damaged; identifying the terms or liability regime that should apply as well as the financial limits of liability; and the inclusion of provisions designed to prevent the fraudulent use of bills of lading.

10. At its thirty-fourth session, in 2001, the Commission had before it a report of the Secretary-General (A/CN.9/497) that had been prepared pursuant to the request by the Commission.⁷

11. That report summarized the considerations and suggestions that had resulted thus far from the discussions in the CMI International Subcommittee on Issues of Transport Law. The details of possible legislative solutions were not presented because they were currently being worked on by the Subcommittee. The purpose of the report was to enable the Commission to assess the thrust and scope of possible solutions and to decide how it wished to proceed. The issues described in the report that would have to be dealt with in the future instrument included the scope of application of the instrument; the period of responsibility of the carrier; the obligations of the carrier; the liability of the carrier; the obligations of the shipper; transport documents; freight; delivery to the consignee; right of control of parties interested in the cargo during carriage; transfer of rights in goods; the party that had the right to bring an action against the carrier; and time bar for actions against the carrier.

12. The report suggested that consultations conducted by the Secretariat pursuant to the mandate it received from the

Commission in 1996 indicated that work could usefully commence towards an international instrument, possibly having the nature of an international treaty, that would modernize the law of carriage, take into account the latest developments in technology, including electronic commerce, and eliminate legal difficulties in the international transport of goods by sea that were identified by the Commission. Considerations of possible legislative solutions by CMI were making good progress and it was expected that a preliminary text containing drafts of possible solutions for a future legislative instrument, with alternatives and comments, would be prepared by December 2001.

13. After discussion, the Commission decided to consider the project in one of its working groups (to be named the "Working Group on Transport Law"). It was expected that the Secretariat would prepare for the Working Group a preliminary working document containing drafts of possible solutions for a future legislative instrument, with alternatives and comments, which was under preparation by CMI.

14. As to the scope of work, the Commission, after some discussion, decided that the working document to be presented to the Working Group should include issues of liability. The Commission also decided that the considerations in the Working Group should initially cover port-to-port transport operations; however, the Working Group would be free to study the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations, and, depending on the results of those studies, recommend to the Commission an appropriate extension of the Working Group's mandate. It was stated that solutions embraced in the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991) should also be carefully taken into account. It was also agreed that the work would be carried out in close cooperation with interested intergovernmental organizations involved in work on transport law (such as the United Nations Conference on Trade and Development (UNCTAD), the Economic Commission for Europe (ECE) and other regional commissions of the United Nations, and the Organization of American States (OAS)), as well as international non-governmental organizations.

15. Working Group III (Transport law), composed of all States members of the Commission, held its ninth session in New York from 15 to 26 April 2002. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Burkina Faso, Canada, China, Colombia, Fiji, France, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Paraguay, Russian Federation, Singapore, Spain, Sweden, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

16. The session was also attended by observers from the following States: Angola, Australia, Belarus, Chile, Côte d'Ivoire, Cyprus, Denmark, Ecuador, Finland, Jordan, Netherlands, Peru, Philippines, Republic of Korea, Senegal, Switzerland, Tunisia and Venezuela.

⁷Ibid., *Fifty-fifth Session, Supplement No. 17 (A/55/17)*, para. 427.

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

(a) **United Nations system:** Economic Commission for Europe and United Nations Conference on Trade and Development;

(b) **Intergovernmental organizations:** Andean Community;

(c) **International non-governmental organizations invited by the Commission:** Ibero-American Maritime Law Institute, International Chamber of Shipping, International Federation of Freight Forwarders Associations, International Group of P&I Clubs, International Maritime Committee, International Multimodal Transport Association, International Union of Marine Insurance, Transportation Intermediaries Association, *Union internationale des avocats* and World Association of Former United Nations Interns and Fellows.

18. The Working Group elected the following officers:

Chairman: Rafael Illescas (Spain)

Rapporteur: Walter De Sá Leitão (Brazil)

19. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.III/WP.20);

(b) Note by the Secretariat on the preliminary draft instrument on the carriage of goods by sea (A/CN.9/WG.III/WP.21);

(c) Note by the Secretariat on the preliminary draft instrument on the carriage of goods by sea: comments by the Economic Commission for Europe and the United Nations Conference on Trade and Development (A/CN.9/WG.III/WP.21/Add.1).

20. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a draft instrument on the carriage of goods by sea.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS

21. The Working Group undertook a preliminary review of the provisions of the draft instrument contained in the annex to the note by the Secretariat (A/CN.9/WG.III/WP.21). In so doing, the Working Group took into account the comments presented by ECE and UNCTAD, which were reproduced in annexes I and II to an addendum to the note by the Secretariat (A/CN.9/WG.III/WP.21/Add.1). The Working Group brought to the attention of the Commission that it had proceeded on the provisional working assumption that the scope of the draft instrument would cover door-to-door transport operations (see para. 32 below). The Commission was invited to review that working assumption. In the absence of sufficient time, the Working Group did not complete its consideration of the

draft instrument, which was left for finalization at its tenth session, scheduled to be held from 16 to 20 September 2002 in Vienna, subject to approval by the Commission. The Secretariat was requested to prepare revised provisions of the draft instrument based on the deliberations and decisions of the Working Group. The deliberations and conclusions of the Working Group are reflected in chapter III below.

III. PREPARATION OF A DRAFT INSTRUMENT ON TRANSPORT LAW

A. Preliminary considerations

22. The Working Group commenced its deliberations with respect to the preparation of a draft instrument on transport law (the "draft instrument"). There was general consensus that the purpose of its work was to end the multiplicity of the regimes of liability applying to carriage of goods by sea and also to adjust maritime transport law better to meet the needs and realities of international maritime transport practices. The Working Group gratefully acknowledged the work already undertaken by CMI in preparing the draft instrument and the commentary relating thereto. The view was expressed that the draft instrument should take into consideration international conventions currently in force that governed different modes of transport and that the draft instrument should seek to establish a balance between the interests of shippers and those of carriers.

23. The Working Group decided to commence its work by a broad exchange of views regarding the general policy reflected in the draft instrument, rather than focusing initially on an article-by-article analysis of the draft instrument. To assist in structuring the general discussion, it was agreed that seven themes should be examined, with reference being made in each case to the relevant provisions in the draft instrument. These were scope of application (draft article 3); electronic communication (draft articles 2, 8 and 12); liability of the carrier (draft articles 4-6); rights and obligations of parties to the contract of carriage (draft articles 7, 9 and 10); right of control (draft article 11); transfer of contractual rights (draft article 12); and judicial exercise of those rights emanating from the contract (draft articles 13 and 14). Upon the suggestion made by one delegation, the Working Group agreed that a further theme should be added regarding the freedom of contract (currently dealt with in draft article 17) for examination as part of the thematic analysis of the draft instrument.

24. It was generally felt at the outset that any new instrument should be drafted bearing in mind possible interactions between the new regime and other transport law conventions that might be applicable. It was also agreed that in preparing any new instrument governing aspects of maritime transport, the need to ensure safety and security should be a paramount consideration. A suggestion was made that the preparation of the draft instrument would be greatly assisted by the production of a table comparing the provisions of the draft instrument with other maritime texts, such as the United Nations Convention on the Carriage of

Goods by Sea, 1978 (also referred to in the present report as the “Hamburg Rules”), the International Convention for the Unification of Certain Rules of Law relating to Bills of Lading (Brussels, 1924, also referred to in the present report as the “Hague Rules”) and the Protocol to amend that convention (Brussels, 1968, also referred to in the present report as the “Hague-Visby Rules”), as well as other conventions selected among international instruments in force in the field of road, rail and air transport, such as the Convention on the Contract for the International Carriage of Goods by Road (Geneva, 1956, also known as the “CMR”), the Convention concerning International Carriage by Rail (Berne, 1980, also known as the “COTIF”), the Convention for the Unification of Certain Rules Relating to International Carriage by Air (Warsaw, 1929, also known as the “Warsaw Convention”) and the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways (Budapest, 2000, also known as the “CMNI”). That suggestion was adopted by the Working Group.

25. The Working Group noted with interest that UNCTAD was currently working on the preparation of a feasibility study on the establishment of a new multimodal transport convention, considering also its desirability, acceptability and practicability.

B. General discussion

1. Scope of application

(a) Possible application of the draft instrument to door-to-door transport

26. The Working Group devoted considerable attention to the issue of whether the period of responsibility of the carrier as dealt with in the draft instrument was to be restricted to port-to-port transport operations or whether, should the contract of carriage include also land carriage before or after (or before and after) the sea carriage, the draft instrument should also cover the entirety of the contract (door-to-door concept). The discussion was initiated by suggestions that, since a great and increasing number of contracts of carriage by sea, in particular in the liner trade of containerized cargo, included land carriage before and after the sea leg, it was desirable to make provision in the draft instrument for the relationship between the draft instrument and conventions governing inland transport, which were applicable in some countries. Draft article 4.2.1 (Carriage preceding or subsequent to sea carriage) in document A/CN.9/WG.III/WP.21, which was placed between square brackets, indicated the approach that was suggested to be followed. The draft article provided for a network system, but one as minimal as possible. The draft instrument was only displaced where a convention that constituted mandatory law for inland carriage was applicable to the inland leg of a door-to-door carriage and it was clear that the loss or damage in question occurred solely in the course of the inland carriage. This meant that, where the damage occurred during more than one leg of the door-to-door carriage or where it could not be ascertained where the loss or damage occurred, the draft instrument would apply to the whole door-to-door transit period.

27. Suggestions were made that the draft instrument should be restricted to port-to-port transport operations. One reason given was that the extension of the proposed maritime regime to door-to-door operations required consultations with representatives of other modes of transport, which had not occurred during the preparatory work that had led to the production of document A/CN.9/WG.III/WP.21. However, in response it was pointed out that, while such consultations would take place and while the working methods of the Commission and the Working Group gave ample opportunity for such consultations, the proposed door-to-door approach took account of the legitimate interests of land carriers in that the mandatory liability regimes of the treaties were preserved by the draft instrument.

28. A further argument against the extension to door-to-door operations was that the earlier attempt at preparing a multimodal legislative convention, namely the United Nations Convention on International Multimodal Transport of Goods (Geneva 1980), was not successful and that including multimodal transport in the draft instrument might compromise the acceptability of the new instrument. It was also stated the UNCTAD/ICC Rules for Multimodal Transport Documents provided a contractual solution that worked in practice, which reduced the need for a legislative regime. Furthermore, UNCTAD was preparing a study on the feasibility of an international multimodal regime and it would be advisable to await the results of that study before taking a decision in the context of the draft instrument. However, it was stated in response that the door-to-door approach put forward for consideration was not aimed at constituting a fully fledged multimodal regime but rather a maritime regime that took into account the reality that the maritime carriage of goods was frequently preceded or followed by land carriage. The draft instrument reflected that reality and was limited to resolving conflicts with mandatory treaties on land carriage. It was also suggested that limiting the draft instrument only to the sea leg might be regarded as not sufficiently useful a contribution to the harmonization of transport law and that the proposed door-to-door concept increased the attractiveness of the project.

29. It was also stated that extending the maritime regime to land carriage segments preceding or following the sea carriage might give rise to legal complexities in a situation where the regime of the carriage of goods by sea would govern one set of issues and the regime of the carriage of goods by land (to the extent it was mandatory) would govern other issues and that difficulties would arise in reconciling and interpreting such legal regimes. Moreover, the carriage of goods by land would be governed by different rules depending on whether or not the land carriage was part of the door-to-door transport operation involving a sea leg. In response it was argued that the minimal system along the lines of draft article 4.2.1 was workable and responded to the expectations of the parties and that the draft article established a good starting point for the discussion, during which the solutions could be further refined to avoid difficulties of interpretation. Moreover, in other modes of carriage, notably under the Warsaw Convention, the parties were free to deal contractually with the land carriage preceding or following the air carriage as permitted by the mandatory regime governing land carriage and that situation worked satisfactorily in practice.

30. Considerable support was expressed for the view that the legislative regime applicable to maritime export-import operations should not treat the maritime leg in isolation disregarding the broader door-to-door transport operation. The draft instrument should respond to the reality that, in particular, containerized traffic in the liner trade was usually structured as a door-to-door operation and that, in the light of technological developments, including electronic commerce, and the improvement of logistical facilities, the frequency of such operations would certainly increase in the future. Non-vessel-operating carriers (NVOs) were increasingly offering such door-to-door services and transport documents were issued covering door-to-door operation; it would thus be artificial to restrict the legislative treatment of the transport of containers to the port-to-port segment of carriage, because the containers were not checked at the beginning and the end of the sea leg but rather at the agreed point in the interior at the facilities of the customer. That reality was reflected in the definition of the “contract of carriage” in draft article 1, pursuant to which such a contract meant a contract under which the goods were carried “wholly or partly” by sea. The way in which the coverage of door-to-door operations was suggested to be approached was based on resolving conflicts between treaties and preventing the draft instrument from displacing mandatory provisions of conventions such as the Convention on the Contract for the International Carriage of Goods by Road and the Convention concerning International Carriage by Rail. While the concept as currently reflected in draft article 4.2.1 was in need of detailed consideration and refinement, the approach was widely supported because it responded to the expectations of the trading community. It was added that through the concept of a “performing party” (draft art. 1.17), which was yet to be considered by the Working Group, for example a road carrier that physically transported the goods, would become responsible to the cargo owner as a performing party and the draft instrument would have to resolve a conflict between the regime of the draft instrument and the mandatory regime governing the road carriage.

31. It was noted that land carriage could be subject not to a mandatory regime of an international treaty but to a non-unified national regime (either because the State in question was not party to a treaty or because the land carriage was not international and did not meet the conditions for the applicability of the treaty). While the current version of draft article 4.2.1, subparagraph (b), envisaged that the draft instrument would yield only to mandatory provisions of an international convention, it was said that it might be useful to consider the relationship between the draft instrument and provisions of a non-unified national law relating to inland carriage (alluded to in the last sentence of paragraph 50 of A/CN.9/WG.III/WP.21).

32. In discussing the issue, the Working Group was conscious of the mandate given to it by the Commission,^a in particular of the fact that the Commission had decided that the considerations in the Working Group should

initially cover port-to-port transport operations, but that the Working Group would be free to consider the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations, and depending on the results of those considerations recommend to the Commission an appropriate extension of the Working Group’s mandate. Bearing that in mind, the Working Group adopted the view that it would be desirable to include within the scope of the Working Group’s discussions also door-to-door operations and to deal with these operations by developing a regime that resolved any conflict between the draft instrument and provisions governing land carriage in cases where sea carriage was complemented by one or more land carriage segments. Consequently, the Working Group requested the Commission to approve the approach suggested by the Working Group. The Working Group considered that it would be useful for it to continue its discussions of the draft instrument under the provisional working assumption that it would cover door-to-door transport operations.

(b) *Internationality of the carriage*

33. The Working Group discussed the implications of the approach to internationality taken in draft article 3. In particular, a question was raised as to whether the provisions establishing the scope of application of the draft instrument should result in different solutions regarding the applicability of the draft instrument according to whether or not the transport segments preceding and following the maritime segment involved an element of internationality. It was generally considered that the draft instrument should apply as soon as an element of internationality characterized the overall contract of carriage, irrespective of whether or not certain segments of the carriage were purely domestic. To illustrate that point, it was stated that the draft instrument should apply to a transport initiating in Madrid and ending in Philadelphia, where the goods were carried by road from Madrid to Cádiz, by sea from Cádiz to New York, and by road from New York to Philadelphia. The draft instrument should apply equally to a transport between Berlin and Buffalo, where the goods were carried from Berlin to Rotterdam by train, then from Rotterdam to Montreal by sea, then from Montreal to Buffalo by road. In the context of that discussion, it was pointed out that, in preparing the draft instrument, particular attention would need to be given to the need for a clear solution regarding possible conflicts between the different legal regimes (whether of international or domestic origin) that might govern the different segments of the transport depending on the mode of transport being used. For example, to deal with the above-mentioned transport between Berlin and Buffalo, preference was generally expressed for the simpler, more broadly encompassing solution under which the draft instrument would govern the entire transport, irrespective of the fact that domestic segments were included. It was observed, however, that such a simple solution would differ from the more complex and more restrictive solution adopted in a recent revision of the Convention concerning International Carriage by Rail, under which transport segments ancillary to the rail segment would be covered by that Convention only where they were purely domestic.

^aIbid., Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 345.

34. With respect to the various factors listed in subparagraphs (a) to (e) of draft article 3.1 for determining the internationality of the carriage, support was generally expressed to adopting the broadest possible scope of application for the draft instrument. As a matter of drafting, it was pointed out that, consistent with the door-to-door approach favoured as a working assumption by the Working Group, the notions of “place of receipt” and “place of delivery” should be preferred to the notions of “port of loading” and “port of discharge”. In that connection, it was observed that the port of loading and the port of discharge as well as any intermediary port would not necessarily be known to the shipper. With respect to the substance of the provision, doubts were expressed as to whether the place of conclusion of the contract mentioned in subparagraph (d) should be regarded as relevant for determining the application of the draft instrument. It was widely held that, in modern transport practice, the place of conclusion of the contract was mostly irrelevant to the performance of the contract of carriage and, if electronic commerce was involved, that place might even be difficult or impossible to determine.

2. *Electronic communications* (draft articles 2, 8 and 12)

35. Considerable support was expressed in favour of the policy on which the treatment of electronic communications in draft articles 2, 8 and 12 was based. The attention of the Working Group was drawn to the need for reviewing the draft instrument with a view to ensuring consistency with the text of the UNCITRAL Model Law on Electronic Commerce, with respect to both substance and terminology.

36. The Working Group was generally in agreement with the establishment of a functional equivalence between existing transport documents such as negotiable or non-negotiable bills of lading and electronic communication systems put in place to replace such documents in an electronic environment. It was pointed out, however, that one purpose of the draft instrument was to establish stand-alone rules, on the basis of which the legal value of electronic communications exchanged as substitutes for paper-based documents would be directly recognized, without necessarily referring to the traditional concepts of paper-based transport documentation. In that respect, the draft instrument could be described as going beyond merely recognizing the functional equivalence between paper documents and their electronic counterparts. As an additional benefit expected from such an approach, the draft instrument would thus alleviate the inconvenience that might result from the current disparities between jurisdictions in the interpretation of a notion such as “bill of lading”, which could cover negotiable and non-negotiable documents.

37. As to the contents of the specific rules embodied in draft article 2, various suggestions were made. One suggestion was that a mechanism should be provided to identify with sufficient clarity the originator of the electronic record or records that would be used as a substitute for a bill of lading. Another suggestion was that the draft instrument

should establish requirements for the storage of electronic records in a manner that would preserve the integrity of their contents. More generally, it was suggested that the draft instrument should address the means through which the transferability function associated with negotiable bills of lading could be replicated in an electronic environment. It was stated that a mere reference to “adequate provisions” in the agreements to be concluded between the parties would not be sufficient to address the issue of negotiability, which might also need to be considered in factual situations where no prior agreement had been made between the parties with respect to electronic communications. In that connection, the view was expressed that the draft instrument should require agreements to use electronic communications to be made expressly by the parties. Yet another suggestion was that the draft instrument should provide rules to solve possible conflicts that might arise between the paper and the electronic version of transport documents issued for the purposes of the same contract of carriage, in particular if not all the originals of a paper bill of lading were surrendered prior to the issuance of an electronic version.

38. The Working Group took note of those various suggestions for continuation of the discussion regarding electronic communications at a later stage on the basis of the provisions contained in draft articles 2, 8 and 12.

3. *Liability (draft articles 4-6)*

(a) *Liability of the carrier and period of responsibility*

39. In keeping with its decision to restrict its consideration to a general examination of themes, the Working Group undertook a preliminary analysis of the general approaches taken in draft articles 4-6. It was generally agreed that the provisions as drafted were an essential component of the draft instrument and represented a basis upon which to found any discussion of the applicable regime for the obligations and liabilities of the carrier. It was pointed out that the provisions as drafted sought to maintain a number of important features that existed in international conventions and national laws currently in force. It was also generally agreed that draft articles 4-6 should be read together, particularly since the extent of the obligations and liabilities of the carrier dealt with in draft articles 5 and 6 respectively, depended on the time at which the period of responsibility of the carrier commenced and ended as set out in draft article 4. A view was expressed that draft articles 4-6 tended to reduce the liability of the carrier compared to articles 4 and 5 of the Hamburg Rules. Under that view, it was suggested that, at least for use in those countries that had ratified the Hamburg Rules, the provisions of articles 4-6 of the draft instrument might need to be reviewed to be brought in line with articles 4 and 5 of the Hamburg Rules.

40. Referring to the policy underlying draft article 4.1.1, it was observed that the draft provision seemed to be based on the principle that the carrier’s liability was linked to a concept of custody by the carrier of the goods (which was initiated by the receipt of goods and ended by their

delivery). A widely shared view was that, in any case, the concept of custody had prevailed in international instruments relating to other modes of transport and the same should occur in the context of the draft instrument. In that connection, some reservations were expressed with the approach taken in draft articles 4.1.2 and 4.1.3 according to which the precise moment of the receipt and delivery of goods was a matter of contractual arrangements between the parties or a matter to be decided upon by reference to customs or usages. The view was expressed that such contractual flexibility was in contradiction with modern transport conventions such as the Convention concerning International Carriage by Rail and the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways, that it introduced an element of uncertainty in the mandatory liability regime of the draft instrument and that it might even open some possibility of manipulation of the moment when the liability began and ended. It was argued that such a concept of contractual flexibility might undermine the aim of having the draft instrument cover door-to-door transport. However, support was expressed for opinions that the time and location of the delivery of the goods should be left to the carrier and the shipper (both of whom were commercial parties capable of assessing the risks and implications of their agreement on the matter). Such freedom of contract was necessary to reflect the fact that the moment when the custody of the goods began and ended depended on circumstances such as practices prevailing in different ports, characteristics of the vessel and the goods, the loading equipment and similar elements. It was said that there was nothing wrong with leaving the parties free to agree when the custody of the goods should begin and end, as long as the effective custody of the goods by the carrier and its liability for them were coextensive. It was noted that, also under article 4, rules 1 and 2, of the Hamburg Rules (under which the liability began when the goods were taken over at the port of loading and ended when they were delivered at the port of discharge), it was implicit that the carrier and the shipper had a degree of latitude in agreeing whether the taking over and delivery occurred, for instance, under the tackle of the ship or at some other point in the port. It was observed that the rules on liability should be analysed with respect to both the port-to-port option and the door-to-door option. In relation to draft article 4.2.1, some delegations expressed the view that they could not approve of extending the maritime regime to pre- and post-sea-carriage in the way it was proposed in the draft article. It was stated that there were also other options regarding the elements of a network system. The regime applicable to non-localized damages should be analysed in view of applicable regimes covering land transport.

(b) Mixed contracts of carriage and forwarding

41. Views were expressed regarding the possibility that the carrier and the shipper might expressly agree that the carrier, upon performing its contract obligations, would, as an agent, arrange for a connecting carriage (a possibility that was expressly addressed in draft article 4.3). Misgivings were expressed about that possibility as it was considered that it opened a way to subcontracting for a part of the carriage and excluding liability for that subsequent

carriage by stipulating that the carrier arranged for it as an agent. While sympathy was expressed for that view (in particular where standard printed contract conditions were used to shorten the period of liability without taking into account the concrete context in which the carrier's liability was to end and the carrier assumed the role of an agent), views were expressed that it was not reasonable for legislation to attempt to prevent parties from agreeing that one of the parties would act as an agent for the other if that was a considered and joint decision by the parties.

42. It was also observed that other transport conventions did not provide for a possibility of the carrier acting as an agent (or quasi freight forwarder) for the cargo owner, and that the draft instrument should not allow for such a possibility. However, in response it was noted that even if that possibility was not envisaged in the legislation, it was not excluded that the parties could agree to it, and that, in order to protect the interests of the parties, it was useful to clarify the practice and establish conditions designed to prevent abuse.

(c) Obligations of the carrier

43. In respect of draft article 5.4, strong support was expressed for imposing upon the carrier an obligation of due diligence that was continuous throughout the voyage by retaining the words that were currently in square brackets "and during" and "and keep". Among views that were expressed in favour of imposing such an obligation, it was pointed out that, with improved communication and tracking systems allowing a carrier to follow closely the voyage of a vessel, a continuing obligation of due diligence was appropriately adapted to modern business practices. However, it was suggested that the degree of diligence would or should depend on the context, to the effect that, for example, the duty of the carrier would be different depending on whether the vessel was at sea or in port. In addition, it was suggested that the content of such a duty of due diligence should be drafted so that account could be taken of evolving standards such as the International Management Code for the Safe Operation of Ships and for Pollution Prevention (1993, the "ISM Code") and evolving international standards that might be developed, in particular, by the International Maritime Organization. Notwithstanding the broad support for a continuing obligation of due diligence, a concern was raised that the extension of the carrier's obligation to exercise due diligence in respect of the whole voyage put a greater burden on carriers and could lead to the associated costs being passed on in the form of higher freights. Also, it was suggested that if door-to-door coverage was ultimately accepted, the inclusion of draft article 5.2.2 should be reviewed. It was recalled that draft article 5.2.2 was intended to make provision for FIO (free in and out) and FIOS (free in and out, stowed) clauses. Support was expressed for the inclusion of this draft article because it resolved current legal uncertainty as to whether the carrier under a FIO or FIOS clause only became liable once the cargo was loaded or stowed. Furthermore, it was said that, in view of the fact that, in some legal systems, adopting FIO(S) clauses meant that the mandatory harmonized regime governing the liability of the carrier did not apply, the benefit of dealing with FIO(S)

clauses in the draft instrument was that it would put beyond doubt the principle that the carrier owed an obligation of due diligence even where the parties had agreed on such a clause. Some concern was expressed that, in allowing contracting out, draft article 5.2.2 might undermine the principle of uniformity.

44. In respect of draft article 6.1.1 regarding the liability of the carrier, there was strong support for the view that the basis for liability should be the fault committed by the carrier rather than a strict liability. In respect of the exceptions to the liability as set out in article 6.1.2, it was noted that the exceptions to liability resulting from error in navigation or management of the ship (paragraph (a)) or from fire on the ship, unless caused by the fault or privity of the carrier (paragraph (b)) expressly created grounds for exoneration of the carrier by way of a deeming provision. A strong argument was made that, given that a central aim of the draft instrument was modernization, the exemption from liability for errors in navigation or management in the ship was out of date, particularly in light of other conventions dealing with other modes of carriage, which did not include such an exemption. However, in opposition to the suggested deletion of draft article 6.1.2, a view was that marine transport did raise unique concerns and that deletion of such an existing cause of exemption might have an economic impact on the parties. An argument for retention of the defence was made on the basis that it was not appropriate to compare sea with road, rail and air transport, notwithstanding technological advancements on vessel security and monitoring of vessels at sea. In respect of the exception relating to fire, some support was expressed for its retention, possibly in a form more closely based on the approach taken in the Hague-Visby Rules, namely that the fire be on the vessel unless caused by the actual fault or actual privity of the carrier. It was observed, however, that the circumstances where fire should be considered as a cause for exoneration of the carrier, that is, where it was the result of an action of the shipper or an inherent defect of the goods, was sufficiently covered under draft article 6.1.3 (iii) and (vi).

45. With respect to the relative exceptions to the liability of the carrier listed in draft article 6.1.3, the Working Group noted that the draft provision was based on the Hague Rules. There was no consensus on whether the exceptions should be treated as exonerations from liability or whether they should be presumptions only. Nor was a consensus achieved as to the specific elements of the list. Doubts were expressed, in particular, with respect to the acceptability of the new exceptions contained in subparagraphs (ix) and (x) of the draft provision, which might need to be further considered in light of the decisions to be made with respect to the possibility to determine by contract the beginning or the end of the period of responsibility of the carrier. It was agreed that the draft provision would need to be discussed extensively at a later stage.

46. With respect to draft article 6.1.4, some preference was expressed in favour of the second alternative wording, which was said to be more reflective of a balanced approach to the obligations of the carrier and the shipper.

47. The Working Group decided that the general discussion of the issues of liability should be reopened at a future session on the basis of draft articles 4-6 after more extensive consultations had taken place.

4. Rights and obligations of the parties to the contract of carriage (draft articles 7, 9 and 10)

(a) Obligations of the shipper (draft articles 7 and 10)

48. The Working Group proceeded to consider draft articles 7 and 10 dealing with obligations of the shipper and delivery to the consignee. It was observed that the prime obligation of the shipper was to pay freight with secondary obligations being to bring the cargo into the custody of the carrier and provide the carrier with goods in such a condition that they would withstand the intended carriage. The Working Group recognized that these obligations were reflected in many national laws and in business practices. It was further observed that the shipper was obliged to inform the carrier of the nature of the cargo and in particular whether the cargo was dangerous.

49. It was pointed out that draft articles 7 and 10 had been drafted with the aim of providing balanced rights and obligations as between the shipper and the carrier, which improved on the approach taken in the Hague-Visby Rules and expanded in scope upon the approach taken in the Hamburg Rules. It was observed that the draft text of article 7.5 imposed strict liability for failure on the part of the shipper to enable the carrier to carry the goods safely. There was general agreement that draft article 7 provided a basis for further debate. A suggestion was made that the shipper's obligation to deliver the goods ready for carriage should not be left entirely to the will of the parties as set out in draft article 7.1, particularly in view of the obligation of the carrier to provide information under draft article 7.2. It was stated that such an obligation was directly related to the safety and security of the vessel and thus should not be left entirely to party autonomy. A suggestion was made that in certain circumstances, for example where goods carried could be hazardous to the environment or a risk to third parties, the carrier or master of the vessel should be allowed to provide information on the goods to relevant bodies such as a port authority. It was questioned whether draft article 7.2, which dealt with an obligation of the carrier, was correctly located in chapter 7, given that this chapter dealt with obligations of the shipper.

50. The view was expressed that, as currently drafted, the obligations placed on the shipper might not be in total balance with those imposed upon the carrier. For example, draft article 7.6 only allowed a shipper to escape liability if it could show that the loss, damage or injury caused by the goods was caused by events that a diligent shipper could not avoid or the consequences of which a diligent shipper would be unable to prevent. By contrast, the corresponding liability provision in respect of the carrier set out in draft article 6.1.1 allowed the carrier to escape liability if it could show there had been no fault on its part. It was agreed that, whilst the obligations of the shipper and carrier should be properly balanced, this balance should be assessed from a

global perspective rather than by an article-by-article or obligation-by-obligation analysis. In that regard, it was noted that the carrier had the benefit of defences and limitations that were not available to the shipper.

51. The Working Group generally agreed that draft articles 7 and 10 provided a good basis for further discussion of the obligations of the shipper and were particularly important from the point of view of protecting the safety of vessels. However, it was noted that there was no distinction between ordinary and hazardous goods in the text, in contrast to some existing regimes regarding safety and security. In that respect, it was suggested that, notwithstanding that the current text had a different focus, the Working Group should further examine relevant conventions relating to safety of goods such as the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea of 1996. It was observed that in the context of draft article 7 it was not useful to make a distinction between dangerous and non-dangerous goods since goods that might generally be regarded as non-dangerous might, in concrete circumstances, cause damage to other goods.

(b) Freight (draft article 9)

52. It was observed that, based on international practices, draft article 9 dealt with a variety of issues, including time for the payment of freight, exceptions to the payment obligation and the right of retention of the goods by the carrier until such payment had been received. A question was raised regarding the meaning of “other charges incidental to the carriage of goods”, which were mentioned but not defined in draft article 9.3 (a). It was suggested that such a mention might make it necessary to specify in draft article 9.4 (a) that, where the transport document contained the statement “freight prepaid”, no payment for either freight or other charges was due. The Working Group expressed general support in favour of the structure of draft article 9 and of the policy on which it was based. The discussion focused on whether and to what extent the provisions of draft article 9 should be open to variation by agreement of the parties and on the scope of the right of retention.

53. With respect to the mandatory or non-mandatory nature of the provisions, the view was expressed that, in view of their possible impact on third parties, certain provisions contained in draft article 9 should not be open to variation by contract. For example, draft article 9.2 (b) was said to be declaratory in nature and not subject to contrary agreement. The opposing view was that draft article 9 would serve a more useful function if it offered a set of default rules applicable only in the absence of any specific provision in the contract of carriage. It was stated that even draft article 9.2 (b) could lead to unjustified results if no exception to it could be envisaged in any circumstances. It was thus suggested that the entire text of draft article 9 should be made subject to contrary agreement. At the close of the discussion, it was generally felt that, in reviewing the individual provisions of draft article 9 at a future session, the Working Group would need to decide, in connection

with each subparagraph, whether the provision should function as a default rule or not.

54. As to the right of retention, a question was raised as to whether draft article 9.5 limited the exercise of the right of retention to cases where the obligation to pay freight resulted from a corresponding obligation under applicable domestic law. It was suggested that the scope of the right of retention should be clarified or extended to avoid the possibility of such a limitation. It was stated in response that the application of draft article 9.4 (b) and draft article 9.5 (a) was not intended to be contingent upon a notion of liability; the right of retention was intended to arise directly from the failure by the consignee to pay freight if the consignee had been put on notice that such freight was due. It was widely felt, however, that the draft provisions, in particular the reference to the consignee being “liable for the payment of freight” might need to be further discussed.

5. Right of control (draft article 11)

55. The draft provision regarding the right of control was generally considered a welcome addition to traditional maritime transport instruments. The Working Group did not engage in a detailed discussion of the provisions of draft article 11 but expressed its confidence that the draft article would constitute a good basis for continuation of the discussion at a future session.

56. Among preliminary observations that were made to the text of draft article 11, a concern was expressed regarding the excessive complexity of the provision, particularly if it were to apply to door-to-door transport. While it was generally expected that the provision could be clarified and simplified in both structure and content at a further stage, it was pointed out that establishing basic rules on the right of control was essential in particular to the development of electronic communications. It was suggested that regulating the right of control should be consistent with the “right to dispose of the goods” or the right to modify the contract as regulated by other transport conventions such as the Convention on the Contract for the International Carriage of Goods by Road. Concerns were expressed in relation to the provision of a possibility to make a variation of the contract including, for example, a change of the place of delivery. The view was expressed that this provision imposed a greater burden on the carrier than existed under current regimes and that the right should be restricted to the holder of a transport document in the case of a negotiable transport document. It was stated that with regard to a non-negotiable document, the right should be confined to changing the name of the consignee as provided for under the CMI Uniform Rules for Sea Waybills. As to the operation of the provision, a question was raised regarding the meaning of the words “the controlling party shall indemnify the carrier” in draft article 11.3 (b). It was pointed out that the notion of indemnity inappropriately suggested that the controlling party might be exposed to liability. That notion should be replaced by that of “remuneration”, which was more in line with the rightful exercise of its right of control by the controlling party. Another question was raised as to the possible consequences of failure by the carrier to comply with the new instructions received from

the controlling party. It was suggested that, in the continuation of the discussion, the Working Group would need to decide whether such consequences should be regulated by the draft instrument or left to applicable domestic law.

6. *Transfer of contractual rights (draft article 12)*

57. The Working Group, which considered that a provision on the transfer of rights was useful in the context of the draft instrument, heard several observations relating to it. It was stated that draft articles 12.1.1 (iii) and 12.2.1 and 2 were difficult to interpret and were in need of clarification; as to the reference in draft article 12.3 to “the national law applicable to the contract of carriage” it was said that it was either unnecessary and could be deleted or it raised questions of conflicts of laws to which no answers were provided. As to draft article 12.2.2, some support was expressed for it; however, it was also said that it might open the way for the carrier, by using standard clauses in the contract of carriage, to extend liabilities from the shipper to the holder of the transport document. It was said that the last two sentences of draft article 12.3 might interfere with national provisions on form of transfers of contractual rights and that deleting them might be considered.

7. *Judicial exercise of rights emanating from the contract of carriage (draft articles 13 and 14) and jurisdiction*

(a) *Right of suit and time for suit (draft articles 13 and 14)*

58. It was suggested that in addition to dealing with the right of suit against the carrier (draft article 13.1) there should also be provisions on the carrier’s right of suit (e.g., against the shipper when the shipper failed to perform one of its obligations). It was noted that the concept of subrogation differed among national laws, which introduced an element of uncertainty into the provision.

59. It was said that draft article 13.1 was not sufficiently clear as to which were the parties entitled to sue. The question was raised as to whether a party who did not suffer a loss should be able to sue (as indicated in draft article 13.2); however, views were expressed that it was useful to clarify in the draft instrument that the holder of a negotiable transport document had procedural standing to sue, whether on its own account or on behalf of the party who suffered the loss. It was considered that draft article 13.2 gave rise to questions that needed to be clarified; for example, it was said that, when the party who sued did so on behalf of the party who suffered loss, only one party and not both should be able to sue. It was also observed that, if the holder who itself had not suffered any loss or damage sued and lost the case, that outcome would have to be binding also for the party who suffered the loss or damage. Since the last sentence of draft article 13.2 touched upon issues of national law that were difficult to clarify in the context of the draft article, it was suggested that it might be preferable to delete it.

60. As to draft article 14, it was suggested to refer therein also to the performing carrier (“performing party”) and the consignee. It was also suggested that in draft article 14.4 the 90-day period should be specified as a default rule that would apply unless the law of the State where the proceedings were instituted provided for a longer period. As to the one-year period indicated in draft article 14.1, several views were expressed that the period was adequate; legal certainty and ease of communications between the parties were mentioned as grounds for the acceptability of the time period; however, there were also views in favour of extending the time period to two years, which was the period specified in the Hamburg Rules. Another suggestion was made to provide for a two- to three-year period in case of wilful misconduct. The Working Group took no decision on the matter. As to draft article 14.2, a concern was expressed whether such a rule would be appropriate in door-to-door transport, especially where the period of responsibility had been contractually restricted in accordance with draft articles 4.1.2 and 4.1.3.

(b) *Jurisdiction*

61. It was noted that the draft instrument did not deal with issues of jurisdiction, the reason being, as indicated in the note by the Secretariat (A/CN.9/WG.III/WP.21, para. 24), that it seemed premature to formulate a provision on jurisdiction or arbitration at that early stage of the project before some conclusions were reached on substantive solutions). While some support was expressed for not including in the draft instrument such a provision on jurisdiction and arbitration, it was widely considered that such a provision would be useful and even, in the view of some, indispensable. While no conclusions were reached as regards the substance of such a provision, several suggestions were made as to its possible content: that the State of delivery of the goods should be one of those which would have jurisdiction; that arbitration should be addressed in the future provision; that the provisions should override a jurisdiction clause in the transport contract (except where the clause was agreed on after the loss or damage had occurred); that parties by express agreement might be able to decide on a jurisdiction of their choice; and that articles 21 and 22 of the Hamburg Rules were to serve as a model for the draft provision.

8. *Freedom of contract (draft article 17)*

62. It was observed that the resolution of the issues identified in the commentary to draft articles 3.3 and 3.4 (in respect of exclusion of charter-parties, contracts of affreightment, volume contracts and similar agreements) would have an impact on the practical effect of draft article 17, which set out the limits of contractual freedom. Several different positions were taken on the question of whether charter-parties and similar agreements should be covered by the draft instrument. A strong view taken in the Working Group was that the exclusion of charter-parties was appropriate as it reflected the traditional approach. It was noted however that draft article 3.3 went beyond the traditional approach in attempting to exclude also contracts of affreightment and similar agreements. It was suggested that

it would be appropriate for sophisticated parties to have freedom of contract to agree to the terms that might apply and, in particular, on the liability provisions that would apply as between themselves. It was thus suggested that the best approach would be that the draft instrument would not apply in principle to charter-parties but that parties to such agreements would be free to agree to its application as between themselves. Such an agreement to submit a charter-party to the draft instrument would not bind third parties that did not consent to be bound. Another suggestion was that the exclusion of charter-parties from the scope of the draft instrument should be drafted so as not to discriminate between carriers. It was further suggested that the exclusion of charter-parties should be drafted so as to make it clear that slot- and space-charter agreements were also excluded. After discussion, there was general agreement that charter-parties and similar type agreements such as slot-charter agreements and space-charter agreements should be excluded from the scope of the draft instrument.

63. The Working Group considered whether or not it was necessary to define expressly what was meant by the term “charter-party”. In that respect, it was noted that a definition was very important given that the exclusion in draft article 3.3.1 referred to charter-parties “or similar agreements”. It was said that without defining a charter-party it would be difficult to know what was meant by such “similar agreements”. Against the inclusion of a definition of charter-party it was noted that the term had not been defined in either the Hague, Hague-Visby or Hamburg Rules and that this had not caused any significant difficulties in practice. However, it was said that given the broader coverage of the draft instrument, a definition was needed. Following discussion, views were expressed in favour of the inclusion of a definition of charter-party for the sake of clarity. In this respect it was noted that the proposed definitions set out in paragraphs 39 and 41 of A/CN.9/WG.III/WP.21 could provide a useful starting point.

64. In respect of draft article 17.2 (a), which allowed the carrier and the performing party to exclude or limit liability for loss or damage to goods where the goods were live animals, there was wide support that this provision was appropriate. In support of the provision, it was argued that this was a traditional exception, with both the Hague and the Hague-Visby Rules excluding live animals from the definition of goods. It was noted that trade in live animals represented only a very small trade. However, a concern was raised against allowing the carrier to exclude or limit the liability for loss or damage to live animals. It was suggested that a better approach would be to simply exclude carriage of live animals altogether from the draft instrument rather than allowing exclusion of liability. Overall, bearing these concerns in mind, the Working Group generally agreed that the carriage of live animals should be exempt from the coverage of the draft instrument.

65. After considering the exclusion of charter-parties from the scope of application of the draft instrument, the Working Group considered in a preliminary fashion the phenomenon of individually negotiated transport agreements as opposed to transport contracts concluded on standard terms. It was stated that the practice of individualized transport agreements (in practice referred to by

expressions such as volume contracts or transport service contracts) had developed in different industries that shipped goods internationally and with shippers of different sizes. Such contracts typically resulted from careful negotiations which addressed matters such as the volume of goods to be transported (expressed in absolute or relative terms), the period over which the goods would be transported, various service terms, price, as well as liability issues. Such individually negotiated contracts varied in their focus, for example, in that some specifically dealt with liability issues while others did not pretend to modify the generally applicable liability regime.

66. It was suggested that such contractual arrangements should be considered by the Working Group with a view to giving them a treatment that was different from other transport contracts. Such contracts would include the following special features: they would be covered by the draft instrument but its provisions would not be mandatory with respect to them; the draft instrument, including the liability provisions, would apply fully except to the extent the parties specifically agreed otherwise; derogations from the otherwise mandatory regime would have to be individually negotiated and could not be established by standard terms; third parties, including the consignee (the holder of the bill of lading or the person entitled to take delivery of the goods on another basis) would be bound by such individually negotiated terms only if, and only to the extent that, they specifically agreed to them (for example, by becoming a party to the individually negotiated contract); such agreement by third persons would have to be specific and could not be expressed by standard terms; when such an individually negotiated contract was in the nature of a “framework contract” pursuant to which individual shipments were effected, the individual shipments would be subject to the terms of the framework contract, but if a separate contract document (such as a bill of lading or a sea waybill) entitling a third person to take delivery of the goods was issued, the terms of the framework contract would not be binding on the third person, except if the third party specifically agreed.

67. Suggestions were made that contracts receiving special treatment in the draft instrument (whether they were to be excluded from the scope of application of the draft instrument, such as charter parties, or to be able to agree specifically to deviate from one or more of the mandatory provisions) should be defined in the draft instrument. Broad support was expressed for defining those contracts under which parties would have the flexibility to agree specifically to deviate from one or more of the mandatory provisions. The definition of such contracts contained in paragraph 42 of the note by the Secretariat (A/CN.9/WG.III/WP.21, annex) was suggested as a basis for discussion. No firm view emerged as to the appropriateness of defining charter-parties.

68. In some countries, individually negotiated contracts (such as volume contracts or transport services contracts) were subject to regulatory regimes, which, for instance, required that those contracts should be filed with the regulatory agency that had some supervisory prerogatives. While such regulatory regimes had features that were irrelevant for the current discussion, some of them might

serve as an inspiration in finding an appropriate definition of such contracts for the draft instrument.

69. A concern was expressed that the so-called “individually negotiated contracts in liner trade” were difficult to define and could cover a broad range of contracts, which could open the door for widespread evasion of the draft instrument and thus dilute the strength of the new regime. It was further pointed out that a distinction should be made between those contracts and individual shipments made thereunder.

70. The Working Group took note of those views and proposals and, while not reaching any conclusions, agreed that it would be worthwhile to consider at a future session these individually negotiated contracts, their description or definition and their treatment in the draft instrument.

C. Consideration of draft articles

1. Draft article 1 (Definitions)

71. The text of draft article 1 as considered by the Working Group was as follows:

“For the purposes of this instrument:

“1.1 ‘Carrier’ means a person that enters into a contract of carriage with a shipper.

“1.2 ‘Consignee’ means a person entitled to take delivery of the goods under a contract of carriage or a transport document or electronic record.

“1.3 ‘Consignor’ means a person that delivers the goods to a carrier for carriage.

“1.4 ‘Container’ includes any type of container, transportable tank or flat, swapbody, or any similar unit load used to consolidate goods, and any equipment ancillary to such unit load.

“1.5 ‘Contract of carriage’ means a contract under which a carrier, against payment of freight, undertakes to carry goods wholly or partly by sea from one place to another.

“1.6 ‘Contract particulars’ means any information relating to the contract of carriage or to the goods (including terms, notations, signatures and endorsements) that appears in a transport document or an electronic record.

“1.7 ‘Controlling party’ means the person that pursuant to article 11.2 is entitled to exercise the right of control.

“1.8 ‘Electronic communication’ means communication by electronic, optical, or digital images or by similar means with the result that the information communicated is accessible so as to be usable for subsequent reference. Communication includes generation, storing, sending and receiving.

“1.9 ‘Electronic record’ means information in one or more messages issued by electronic communication pursuant to a contract of carriage by a carrier or a performing party that:

“(a) Evidences a carrier’s or a performing party’s receipt of goods under a contract of carriage; or

“(b) Evidences or contains a contract of carriage;

“or both.

“It includes information attached or otherwise linked to the electronic record contemporaneously with or subsequent to its issue by the carrier or a performing party.

“1.10 ‘Freight’ means the remuneration payable to a carrier for the carriage of goods under a contract of carriage.

“1.11 ‘Goods’ means the wares, merchandise, and articles of every kind whatsoever that a carrier or a performing party received for carriage and includes the packing and any equipment and container not supplied by or on behalf of a carrier or a performing party.

“1.12 ‘Holder’ means a person that:

“(a) Is for the time being in possession of a negotiable transport document or has the exclusive [access to] [control of] a negotiable electronic record, and

“(b) Either:

“(i) If the document is an order document, is identified in it as the shipper or the consignee, or is the person to whom the document is duly endorsed; or

“(ii) If the document is a blank endorsed order document or bearer document, is the bearer thereof; or

“(iii) If a negotiable electronic record is used, is pursuant to article 2.4 able to demonstrate that it has [access to] [control of] such record.

“1.13 ‘Negotiable electronic record’ means an electronic record:

“(i) That indicates, by statements such as ‘to order’, or ‘negotiable’, or other appropriate statements recognized as having the same effect by the law governing the record, that the goods have been consigned to the order of the shipper or to the order of the consignee, and is not explicitly stated as being ‘non-negotiable’ or ‘not negotiable’; and

“(ii) Is subject to rules of procedure as referred to in article 2.4, which include adequate provisions relating to the transfer of that record to a further holder and the manner in which the holder of that record is able to demonstrate that it is such holder.

“1.14 ‘Negotiable transport document’ means a transport document that indicates, by wording such as ‘to order’ or ‘negotiable’ or other appropriate wording

recognized as having the same effect by the law governing the document, that the goods have been consigned to the order of the shipper, to the order of the consignee, or to bearer, and is not explicitly stated as being 'non-negotiable' or 'not negotiable'.

"1.15 'Non-negotiable electronic record' means an electronic record that does not qualify as a negotiable electronic record.

"1.16 'Non-negotiable transport document' means a transport document that does not qualify as a negotiable transport document.

"1.17 'Performing party' means a person other than the carrier that physically performs [or fails to perform in whole or in part] any of the carrier's responsibilities under a contract of carriage for the carriage, handling, custody, or storage of the goods, to the extent that that person acts, either directly or indirectly, at the carrier's request or under the carrier's supervision or control, regardless of whether that person is a party to, identified in, or has legal responsibility under the contract of carriage. The term 'performing party' does not include any person who is retained by a shipper or consignee, or is an employee, agent, contractor, or subcontractor of a person (other than the carrier) who is retained by a shipper or consignee.

"1.18 'Right of control' has the meaning given in article 11.1.

"1.19 'Shipper' means a person that enters into a contract of carriage with a carrier.

"1.20 'Transport document' means a document issued pursuant to a contract of carriage by a carrier or a performing party that

"(a) Evidences a carrier's or a performing party's receipt of goods under a contract of carriage; or

"(b) Evidences or contains a contract of carriage; or both."

(a) General remarks

72. It was noted that the order in which definitions were presented in draft article 1 was based on the alphabetic order in the original English version of the document. It was generally agreed that the readability of the draft instrument would be improved if those definitions were arranged according to a more logical structure by first listing the various parties that might intervene in the contractual relationships covered by the draft instrument and then listing the technical terms used in the draft provisions. It was observed that particular attention would need to be given to those definitions which might influence the determination of the scope of application of the draft instrument.

(b) Definition of "carrier" (draft article 1.1)

73. It was recalled that the definition of "carrier" in the draft instrument followed the same principle as laid down

in the Hague-Visby Rules and the Hamburg Rules, under which the carrier was a contractual person. A carrier might have entered into the contract either on its own behalf and in its own name or through an employee or agent acting on its behalf and in its name. A carrier would typically perform all of its functions through such persons (see A/CN.9/WG.III/WP.21, annex, para. 2). However, a concern was expressed that the definition of "carrier" did not make sufficient reference to the parties on whose behalf a contract of carriage was made. It was stated that the position of freight forwarders under the draft instrument was not entirely clear, as these parties were arguably covered by the definition of carrier (see A/CN.9/WG.III/WP.21/Add.1, annex II, para. 11). Another concern was expressed that, as currently drafted, the definition of "carrier" might not make it sufficiently clear that it was intended to cover both natural and legal "persons".

74. While it was generally agreed that the draft definition of "carrier" constituted an acceptable basis for continuation of the discussion, some felt that further explanations would need to be given in the course of the preparation of the draft instrument as to the reasons for which a simpler definition of "carrier" had been proposed, in contrast with the more complex but perhaps also more precise definitions contained in existing maritime transport conventions.

(c) Definition of "consignee" (draft article 1.2)

75. It was recalled that the definition of "consignee" was based on the definition contained in article 1, rule 4, of the Hamburg Rules, with added reference to the contract of carriage or the transport document on the basis of which the consignee became entitled to take delivery of the goods. It was explained that the additional reference was intended to exclude a person who was entitled to take delivery of the goods on some other basis than the contract of carriage, for example, the true owner of stolen goods (see A/CN.9/WG.III/WP.21, annex, para. 3). A question was raised as to whether the draft definition was to be interpreted as making it impossible for the consignee as defined to delegate the exercise of its right to take delivery of the goods to another person. Another question was raised as to the reasons for which specific mention was made of the contract of transport, the transport document and the electronic record. It was questioned whether it was appropriate to place the contract of carriage (which was presumably the only source of the consignee's entitlement) on the same level as the transport document or its electronic equivalent. Support was expressed for deleting the reference to "a transport document or electronic record". It was stated in response that the need to identify various possible sources of the consignee's entitlement to take delivery of the goods came from the fact that, in certain circumstances or in certain legal systems, the right evidenced by the transport document might be different from the right evidenced by the original contract of carriage, although the transport document would always be issued for the execution of the contract of carriage. In the context of that discussion, a concern was expressed that the reference to the transport document might be misunderstood as covering also documents such as warehouse receipts. With a view to avoiding misunderstanding as to the origin of the consignee's entitlement to

take delivery, it was suggested that the definition might be redrafted along the following lines: “‘Consignee’ means a person entitled to take delivery of the goods under a contract of carriage, which may be expressed by way of a transport document or electronic record”. Another suggestion was that a reference to the controlling party might need to be introduced in the definition of “consignee”.

76. The Working Group took note of those questions, concerns and suggestions for continuation of the discussion at a later stage.

(d) Definition of “consignor” (draft article 1.3)

77. It was recalled that the definition of “consignor” might include the shipper, the person referred to in article 7.7 or somebody else who on their behalf or on their request actually delivered the goods to the carrier or to the performing party (see A/CN.9/WG.III/WP.21, annex, para. 4). The definition of “consignor” was also intended to include the person who actually delivered the goods to the carrier in cases where such person was a person other than the “free on board” (f.o.b.) seller or the agent, not being the shipper, who nevertheless was mentioned as the shipper in the transport document. That person who actually delivered the goods had no liabilities under draft article 7.7 or under draft article 11.5. Its only right was to obtain a receipt pursuant to draft article 8.1 from the carrier or performing party to whom it actually delivered the goods (see A/CN.9/WG.III/WP.21, annex, paras. 118 and 119).

78. Wide support was expressed in favour of introducing in the draft instrument a definition of “consignor” based on the draft provision. A suggestion that mention should be made that the consignor was acting as an agent of the shipper was objected to on the grounds that the consignor, although presumably acting on behalf of the shipper, would not necessarily act as an agent. The consignor might be acting on the basis of its own obligations, for example pursuant to the contract of sale. Support was expressed for the introduction of a mention that the consignor delivered the goods “on behalf” of the shipper.

79. As to the delivery of the goods “to a carrier for carriage”, a suggestion was made that additional language should be introduced to clarify that the consignor should deliver the goods to the “actual” or “performing” carrier. That suggestion was supported, although the view was expressed that the words “a carrier” sufficiently addressed the possibility that a performing party might intervene in addition to the original carrier.

80. A view was expressed that, in possibly revising the current definition of “consignor”, the Working Group might consider the text of paragraph 5 of article 1 of the United Nations Convention on International Multimodal Transport of Goods (1980). The Working Group took note of that view.

(e) Definition of “container” (draft article 1.4)

81. Various views were expressed regarding the draft definition. One view was that the text was too broadly

worded to constitute a workable definition. In particular, the use of the word “includes” made it an open-ended definition that might encompass packaging techniques that would not meet the criteria generally expected to be met by sea-going containers, particularly if transportation as deck cargo was involved. It was suggested that the definition should be limited to “containers designed for transport at sea”. As a matter of drafting, the view was expressed that the opening words “‘Container’ includes any type of container” introduced an element of circularity that was unacceptable in a formal definition. Yet another view was that a specific definition of “container” was useless since containers as any other type of packaging should be covered by the definition of “goods” under draft article 1.11.

82. With a view to alleviating some of the concerns that had been expressed with respect to a broad definition of “container”, it was pointed out that the draft provision had been introduced not as a general and theoretical definition but exclusively for the purposes of the provisions where the notion of “container” was used in the draft instrument, namely the provisions on deck cargo (draft article 6.6), the provisions regarding liability, which also referred to such notions as “package” and “shipping unit” (draft article 6.7), and the provisions on evidence, which dealt with the special case where goods were delivered to the carrier in a closed container (draft article 8.3). While support was expressed for the view that it might be necessary to consider exclusively containers designed for sea transport in the context of the provision on deck cargo, it was felt by a number of delegations that a broader definition might be acceptable in the context of draft articles 6.7 and 8.3. The Secretariat was requested to prepare a revised definition, with possible variants reflecting the above-mentioned views and concerns, for consideration at a future session.

*(f) Definition of “contract of carriage”
(draft article 1.5)*

83. The view was expressed that the definition was too simplistic and might require a more detailed consideration of the various obligations of the carrier, namely to receive delivery of the goods, to carry them from one place to another and to deliver them at the place of destination. It was also suggested that the definition of the contract of carriage should not only mention the carrier but also the other party involved, namely the shipper. As a matter of drafting, it was suggested that the definition of the contract of carriage should not directly refer to the “carrier” but more generally to a “person” (who would become a carrier by virtue of the contract).

84. Another view was that defining the contract of carriage as a contract where the carrier “undertakes” to carry the goods might conflict with the approach taken in draft article 4.3.1, under which the contract of carriage might result in a situation where the carrier would “arrange” for the goods to be carried by another carrier. It was stated that the definition contained in draft article 1.5 was preferable in that respect since it avoided any ambiguity as to the respective roles of a carrier and a freight forwarder. It was pointed out in response that there was no contradiction between defining, on the one hand, the contract of

carriage as one where the carrier “undertakes” an obligation, and establishing, on the other hand, that in addition to the initial contract of carriage another contract may be concluded between the initial carrier and a freight forwarder.

85. The discussion focused on the use of the words “wholly or partly”, which had been included to cover carriage preceding or subsequent to carriage by sea if such carriage was covered by the same contract. It was proposed by delegations that favoured limiting the scope of the draft instrument to port-to-port transport that those words should be deleted or placed between square brackets. It was pointed out that keeping those words was more in line with the provisional working assumption made by the Working Group that the draft instrument should be prepared with door-to-door transport in mind. In addition, it was pointed out that if the words “wholly or partly” were deleted, the scope of the draft instrument would be limited to contracts involving exclusively sea transport. Thus, even the sea segment of a contract of carriage involving also transportation by other means would be excluded from the scope of the draft instrument. However, it was generally felt that such a limitation of the sphere of application of the draft instrument would be excessive. After discussion, it was decided that the words “wholly or partly” would be maintained in the draft provision. With a view to facilitating further discussion regarding the possible implications of the draft instrument in the context of door-to-door transport, it was also agreed that the words “wholly or partly” should be identified by adequate typographical means as one element of the draft instrument that might require particular consideration in line with the final decision to be made regarding the scope of the draft instrument.

(g) *Definition of “contract particulars”*
(draft article 1.6)

86. It was questioned whether the definition of “contract particulars” was necessary given that draft article 8.2 broadly included the features of contract particulars. It was suggested that article 1.6 operated merely as the element of an index rather than as a formal definition. The Working Group acknowledged that draft article 1.6 introduced a new term that had a close and direct relevance to draft article 8.2 and a suggestion was made to postpone consideration of that definition until draft article 8.2 had been considered. That postponement was agreed to, but it was noted that the definition might contain contradictions when read together with draft article 1.20, which required that a transport document should evidence or contain a contract of carriage. By contrast the definition of contract particulars referred to any information “relating to the contract of carriage”. It was suggested that the text should indicate more clearly what that phrase referred to. In that respect, it was suggested that when the Working Group considered draft articles 1.9 and 1.20 it should consider whether the requirement that an electronic communication or a transport document evidenced a contract of carriage was really necessary. It was suggested that it would be more relevant for the transport document or electronic record to evidence receipt of the goods. It was also noted that draft article 1.7 when read with draft article 8.2 failed to include a reference to

the shipper, notwithstanding draft article 7.7, which referred to a shipper as identified in the contract particulars. The Working Group agreed that those concerns should be considered in redrafting the definition.

(h) *Definition of “controlling party”*
(draft article 1.7)

87. The Working Group took note that the definition of “controlling party” was listed merely as an index reference rather than as a comprehensive definition. It took note that the term was referred to in draft article 11.2 and the term “right to control” was referred to in draft article 1.18. It was suggested that definitions that were used in the draft instrument should be self-contained definitions and not merely index references. However, it was observed that the index referencing was a useful drafting method to shorten the substantive provisions. Noting the concerns that were expressed, the Working Group agreed that the definition should be retained for further discussion.

(i) *Definition of “electronic communication”*
(draft article 1.8) and “electronic record”
(draft article 1.9)

88. The Working Group heard that the provisions had been drafted taking account of the work of the UNCITRAL Working Group on Electronic Commerce. It was noted that the draft definitions differed from the terms used in the UNCITRAL Model Law on Electronic Commerce by referring to “electronic communications” rather than “data message” and by including a reference to “digital images”. The Working Group agreed that whilst it was not mandatory to preserve at any cost a term used in existing UNCITRAL texts, it was important to consider the reasons for making such changes and examine the implications of such changes vis-à-vis the UNCITRAL Model Law on Electronic Commerce. The Working Group also heard that the draft instrument had been drafted in recognition of the language used in the UNCITRAL Model Law on Electronic Commerce and the Model Law on Electronic Signatures, but it might be necessary to adjust the language of those texts to suit the specific structure of the draft instrument. While it was observed that the use of digital imaging was increasingly relied on in marine transport (a reason for which the draft expressly referred to that term), it was widely felt that further consideration would need to be given to the reasons for which the central notion of “data message” might not be used in the draft instrument. In particular, it was questioned whether the need to introduce a reference to digital imaging (which was already implicitly covered by the broad definition of “data message” in the UNCITRAL Model Law on Electronic Commerce) would justify doing away with such an essential notion. A concern was expressed that the reference in draft article 1.9 to information that was attached “or otherwise linked” could be too broad and undermine the contractual relationship between the carrier and consignee because it could allow the carrier to include additional contractual terms after the electronic record had been issued. Another concern was expressed that the reference in the definition of “electronic record” to “one or more messages” implied that there could be several messages constituting an electronic record and

that it could be problematic to identify them. It was suggested that a small expert group could be convened to examine provisions relating to electronic commerce in more detail.

(j) *Definition of “freight” (draft article 1.10)*

89. A concern was expressed that the definition of freight was incomplete in that it failed to state the person who was liable to pay the freight. However, it was agreed that the role of the definition was simply to describe what freight was and that issues relating to the freight, namely to whom it should be paid and by whom, could be dealt with elsewhere.

(k) *Definition of “goods” (draft article 1.11)*

90. A concern was expressed that the reference in the definition of “goods” that a carrier or a performing party “received for carriage” rather than “undertakes to carry” might mean that the definition failed to cover cases where there was a failure by the carrier to receive the goods or load cargo on board a vessel. It was said that the current reference only to receipt of goods was too narrow. Alternatively, it was suggested that the definition could be simplified by removing any reference to receipt of the goods. It was decided that the Secretariat should prepare two alternative texts taking account of each of those approaches.

(l) *Definition of “holder” (draft article 1.12)*

91. The suggestion was made that the term “for the time being” was unnecessary. Support was expressed for maintaining a requirement that the holder should be in “lawful” possession of a negotiable transport document. It was suggested that the definition should reflect the simple and widely understood distinction between negotiable documents “to order”, bearer documents and non-negotiable documents naming the consignee.

(m) *Definition of “negotiable electronic record” (draft article 1.13) and “non-negotiable electronic record” (draft article 1.15)*

92. The Working Group accepted the definitions as a sound basis for further discussions.

(n) *Definition of “negotiable transport document” (draft article 1.14)*

93. It was suggested that there should be a clearer explanation of the differences between negotiability and non-negotiability. It was noted that the question as to what constituted a document of title differed between jurisdictions. It was suggested that there was a need for more precision in understanding core terms such as “negotiable” in order to provide for appropriate rules on negotiable electronic records. In response it was noted that whilst it was important to be more precise in that area, particularly because it was a new area and was affected by national law, the Working Group should keep in mind that it could not regulate all consequences.

(o) *Definition of “non-negotiable transport document” (draft article 1.16)*

94. Although a suggestion was made that the definition was not necessary and should be deleted, the Working Group agreed to retain the definition for further consideration.

(p) *Definition of “performing party” (draft article 1.17)*

95. It was noted that in preparing the draft definition of “performing party” different views expressed during the consultation process were taken into account. Some favoured including any party that performed any of the carrier’s responsibilities under a contract of carriage if that party was working, directly or indirectly, for the carrier. Others advocated excluding the “performing party” definition entirely. The relatively restrictive definition in the current text was presented as a compromise (for further comments about the definition of the performing carrier (“performing party”), see A/CN.9/WG.III/WP.21, annex, paras. 14-21).

96. It was suggested that the concept of the performing carrier (“performing party”) should be deleted and that the contractual carrier (who should be the only person to respond to the claimant) should have the right of recourse against performing parties. It was added that the channelling of liability to a party (in this case the contracting party) would be preferable and that such channelling of liability worked in practice, as demonstrated for example by the International Convention on Civil Liability for Oil Pollution Damage, 1969.

97. Another suggestion was to restrict further the notion of the performing party by excluding entities that handled and stored goods (such as operators of transport terminals) and include in the definition only true carriers.

98. It was also suggested that the restriction of the definition by using the concept of “physically performs” was arbitrary and would cause problems in practice (e.g., it would be difficult to establish with one limitation period who was the person to be sued and might cause difficulties of interpretation in applying draft articles 4.2.1, 4.3 and 5.2.2). The definition of the “actual carrier” in article 1, rule 2, of the Hamburg Rules was suggested to be preferable.

99. However, wide support was expressed for the presence of the notion in the draft instrument; its concept was also widely supported, including the use of the term “physically performs” as a way to limit the categories of persons to be included within the definition. It was considered that the notion of performing party was useful since it provided a meaningful protection to the claimant (it was in particular beneficial to the consignee to be able to hold the last performing carrier liable for the goods). It was indicated that the protection to the performing party as contained in draft articles 6.10 as well as 6.3.1 (also known in some legal systems as a “Himalaya clause”) was an essential part of the role of “performing party” in the draft instrument.

100. It was also suggested that all of the options for the definition of “performing party” contained in the draft text and commentary should be retained for the time being.

101. It was stated that, while the definition should not be broadened, it would be useful to have some clarification as to how the persons that fell outside the definition of performing party would be treated as regards matters such as any right of suit against them and any liability limits and defences applicable to them.

102. It was suggested to replace “under a contract of carriage” with an expression such as “in the context of transport operations” or “in performing the transport operations” to indicate more clearly the relation of the performing party to the “contract of carriage”. It was added in more general terms that the performing party was not a party to the contract of carriage between the shipper and the contracting carrier and that the drafting of the definition should be reviewed to make that clear. In that connection, the question was raised as to whether it was necessary to address any obligations that the performing party was carrying out and that were not obligations assumed by the contracting carrier.

103. It was noted (without suggesting that the definition of “performing party” should necessarily be narrowed) that the Working Group would have to consider the possibility that a performing party (such as a warehouse operator) would be located in a State that was not a party to the convention being prepared. It was also observed that, to the extent operators of transport terminals would be performing parties, the Working Group would have to take into account a possible conflict between the draft instrument and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991).

104. Suggestions were made to simplify and shorten the drafting of the definition. It was suggested to delete the words “regardless of whether that person is a party to, identified in, or has legal responsibility under the contract of carriage” as unclear and as adding nothing substantial to the definition. The presence of the last sentence of the definition was supported because it clarified the defined concept. The Working Group considered that the words “[or fails to perform in whole or in part]” should be deleted.

*(q) Definition of “right of control”
(draft article 1.18)*

105. It was noted that this was more a cross-reference than a definition. It was proposed that article 1.18 could therefore be deleted. However, it was agreed to retain the definition for further consideration at a later stage.

(r) Definition of “shipper” (draft article 1.19)

106. The Working Group noted that the definition mirrored the definition of “carrier” in draft article 1.1. The shipper was a contractual party who might have entered into the contract either on its own behalf and in its own

name or through an employee or agent acting on its behalf and in its name. A shipper would typically perform all of its functions through such persons. The shipper might be the same person as the consignee, as was the case in many f.o.b. sales (see A/CN.9/WG.III/WP.21, annex, para. 22).

107. Bearing in mind the concerns expressed in the context of the discussion of draft article 1.1, it was generally agreed that the draft definition of “shipper” constituted an acceptable basis for continuation of the discussion at a future session.

*(s) Definition of “transport document”
(draft article 1.20)*

108. It was recalled that the definition of “transport document” should be read as preliminary to those of “negotiable transport document” and “non-negotiable transport document” in draft articles 1.14 and 1.16. Paragraph (a) would include a bill of lading issued to, and still in the possession of, a charterer (which did not evidence or contain a contract of carriage but functioned only as a receipt) and some types of receipt issued before carriage or during transshipment. Paragraph (b) would include a negotiable bill of lading when operating as such and a non-negotiable waybill (see A/CN.9/WG.III/WP.21, annex, para. 23).

109. The definition of “transport document” was generally supported by the Working Group on the basis that the two central functions of a transport document, namely that of evidencing receipt of the goods and that of evidencing the contract of carriage, were appropriately encompassed by the definition. It was observed that the third traditional function of a bill of lading, namely that of representing the goods, was not touched upon by the definition. A question was raised regarding the omission of any reference in that definition to negotiability particularly in light of draft articles 1.14 and 1.16, which respectively defined “negotiable transport document” and “non-negotiable transport document”. In response, it was suggested that the definition of “transport document” was intended to be generic and to encompass both negotiable and non-negotiable transport documents so a reference to negotiability or to the function of the bill of lading as representing the goods was not required in that present definition.

110. In response to a question that was raised regarding the possibility that a transport document might “contain” a contract of carriage, it was pointed out that the words “evidences or contains a contract of carriage” in paragraph (b) were designed to accommodate different approaches in national laws to the question of whether a transport document might evidence or contain a contract of carriage. In response to a question on whether paragraphs (a) and (b) represented alternative or cumulative functions, it was noted that the definition applied where the requirements in either (a) or (b) were satisfied or where the requirements in both paragraphs were met. Notwithstanding the above comments, which were thought to require further consideration in the preparation of a revised version of the definition of “transport document”, the Working Group agreed to the retention of the text of draft article 1.20 as a sound basis for discussion of the remainder of the provisions contained in the draft instrument.

2. Draft article 5 (*Obligations of the carrier*)

111. Having completed its consideration of the draft definitions, the Working Group engaged in a reading of the provisions of the draft instrument concerning the obligations of the parties to the contract of carriage.

112. The text of draft article 5 as discussed by the Working Group was as follows:

“5.1 The carrier shall, subject to the provisions of this instrument and in accordance with the terms of the contract of carriage, carry the goods to the place of destination and deliver them to the consignee.

“5.2.1 The carrier shall during the period of its responsibility as defined in article 4.1, and subject to article 4.2, properly and carefully load, handle, stow, carry, keep, care for and discharge the goods.

“5.2.2 The parties may agree that certain of the functions referred to in article 5.2.1 shall be performed by or on behalf of the shipper, the controlling party or the consignee. Such an agreement must be referred to in the contract particulars.

“5.3 Notwithstanding the provisions of articles 5.1, 5.2 and 5.4, the carrier may decline to load, or may unload, destroy, or render goods harmless or take such other measures as are reasonable if goods are, or reasonably appear likely during its period of responsibility to become, a danger to persons or property or an illegal or unacceptable danger to the environment.

“5.4 The carrier is bound, before, at the beginning of, [and during] the voyage by sea, to exercise due diligence to:

“(a) Make [and keep] the ship seaworthy;

“(b) Properly man, equip and supply the ship;

“(c) Make [and keep] the holds and all other parts of the ship in which the goods are carried, including containers where supplied by the carrier, in or upon which the goods are carried fit and safe for their reception, carriage and preservation.

“5.5 Notwithstanding the provisions of articles 5.1, 5.2 and 5.4, the carrier in the case of carriage by sea [or by inland waterway] may sacrifice goods when the sacrifice is reasonably made for the common safety or for the purpose of preserving other property involved in the common adventure.”

(a) Paragraph 5.1

113. It was recognized that draft article 5.1 set out the basic obligation of the carrier to carry the goods to the place of destination and deliver them to the consignee. There was general agreement that the text as currently drafted, appropriately described some of the principal obligations of the carrier and was a sound basis on which to commence discussions. However, several suggestions were made for possible improvements of the text. One suggestion was that the obligation of the carrier should be more

fully expressed by including a reference requiring the carrier to deliver the goods in the same condition that they were in at the time that they were handed over to the carrier. It was said that, if that additional reference were to be included, the relationship between draft article 5.1 and draft article 6.1 (which dealt with the liability of the carrier) might require further examination. The suggestion was objected to on the grounds that, in some circumstances, goods would change character during the course of carriage due to their inherent nature, which might alter as time passed. Examples were given, such as circumstances involving partial evaporation of the goods or processing of the goods while at sea. It was stated in response that the natural consequences of the passing of time should not serve as a pretext to exonerate the carrier from any obligation to preserve the initial condition of the goods. In the context of that discussion, it was pointed out that listing some but not all of the carrier's additional obligations among the primary obligation expressed in draft article 5.1 was unsatisfactory. It was also suggested that, in revising draft article 5, further attention might need to be given to the relevant provisions of the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways.

114. Another suggestion was that the draft article, which was said to set out an incomplete description of the carrier's obligations, should also mention the requirement that the carrier should take charge of the goods. In that respect, it was suggested that, in more fully describing the carrier's obligations under draft article 5.1, reference might need to be made to draft article 4.1, which established the period of responsibility of the carrier.

115. Yet another suggestion was that the provision, whilst respecting to some extent the contractual freedom of the parties, should not leave the description of the obligations of the carrier entirely to contractual freedom, thus allowing the obligations of the carrier to be defined in adhesion contracts unfavourable to the shipper. It was pointed out that, under some existing national laws, the fundamental obligations of the carrier were set out in mandatory legislation that would not allow any deviation through contractual agreement. Reference was made to the comment in paragraph 59 of the annex to document A/CN.9/WG.III/WP.21, which stated that the provisions of the draft instrument should “make clear that the terms of the contract do not stand alone”. It was suggested that that point should be more clearly expressed in the draft provision. A widely shared view was that the extent to which the obligations of the carrier could be displaced through contractual agreement might need to be further considered in the context of draft article 17.

116. Notwithstanding the concerns and suggestions expressed in the course of the discussion, the Working Group provisionally agreed to retain the text of article 5.1 as drafted. It was widely thought that the above-mentioned concerns and drafting suggestions should be revisited at a later stage.

(b) Paragraph 5.2.1

117. An explanation was sought as to the relationship between draft article 5.2.1 and draft article 6.1, which dealt

with the basis of liability of the carrier. In particular, concern was expressed as to the use of the words “properly and carefully”. Furthermore, it was suggested that the carrier’s obligation to carry and deliver the goods was already set out in draft article 5.1. It was also suggested that, if the provision were to apply to door-to-door transportation, it might need to be redrafted accordingly, since the current text appeared to use maritime transport terminology by its reference to loading, handling, stowing, carrying, keeping, caring for and discharging the goods. A concern was also expressed as to the extension of the corresponding requirement to the entire duration of the door-to-door transportation through the reference to draft article 4.1. Regarding the use of the words “properly and carefully”, a widely shared view was that such wording, which originated in the Hague Rules and had enjoyed the benefit of extensive interpretation through case law worldwide, should be preserved in the draft instrument and possibly extended (together with the remainder of the provisions contained in draft article 5, with the exception of draft article 5.4) to the non-maritime segments of door-to-door transportation.

118. With respect to the duration of the period during which the carrier was responsible under draft article 5, the view was expressed that the reference to “the period defined in article 4.1” should be replaced by a reference to the period running from the time that the goods were taken over by the carrier until the time of their effective delivery. Making that period “subject to article 4.2” was said to be irrelevant. It was explained that the words “subject to article 4.2” had been intended as, and should be replaced by, a reference to article 4.3. It was widely felt that, although the Working Group had not taken a final decision on the scope of the application of the draft instrument, further attention would need to be given as to how the draft instrument would interplay with other unimodal transport conventions.

119. Notwithstanding that there was some support for omitting draft article 5.2.1, the Working Group provisionally agreed to retain the draft article given the extensive experience with analogous provisions in existing conventions such as article 3, rule 2, of the Hague Rules. It was also agreed that further study of the draft article should be undertaken to assess the interplay and the consistency between draft article 5.2.1 and draft article 6, as well as the effect of the various possible definitions of the period during which the obligation in draft article 5.2.1 would apply. The Secretariat was requested to prepare a revised draft, with possible alternative wordings reflecting the views and concerns expressed.

(c) Paragraph 5.2.2

120. It was noted that draft article 5.2.2 was designed to accommodate the practice of FIO (free in and out) and FIOS (free in and out, stowed) clauses, which were used in bulk cargo charter-party trade, but were rare in liner trade. It was observed that the reason for agreeing on FIO(S) clauses was usually that the cargo owner could perform the operations at a lower price (e.g., because of volume rebate given by the stevedore company); alternatively, such

clauses were agreed where the cargo owner was in a better position to undertake certain operations (e.g., because of its particular experience with loading and stowing certain type of cargo). Those reasons might also be combined. It was said that in particular when FIO(S) clauses were agreed for the second reason it was reasonable that they should in some way diminish the carrier’s liability for those operations. However, it was responded that the circumstances in which shippers participated in the loading operations differed, depending on circumstances such as the size of the company, the type of cargo, circumstances in the port and the technology used in safekeeping the goods, and that it was inconceivable that a treaty should in a general way allow the carrier to be relieved of its liability for loading and unloading when such clauses were used.

121. It was observed that, even if cargo was loaded by the shipper in the context of an FIO(S) clause, it was much less likely that the consignee would perform unloading operations (in such a case the effect of the clause, which covered both loading and unloading operations, was that unloading was done by the carrier or someone else on behalf of the cargo owner). That possibility (which was envisaged in the text by the words “or on behalf of the shipper, the controlling party of the consignee”) was criticized in that the carrier should not be able to perform an operation “on behalf” of the cargo owner and be able to diminish its liability for it.

122. It was stated that under some legal systems the clause in current practice only affected the question as to who was to bear the costs of operations and in principle did not diminish the liability of the carrier. The overriding obligation of the carrier to keep the ship and other cargo safe was said to be in line with that approach.

123. The view was expressed that FIO(S) clauses might be appropriate for maritime (port-to-port) carriage but had no place in the global transport service of door-to-door transport contracts where it would be agreed that loading and unloading operations in an intermediary port should be performed by the cargo owner and that the agreement would shift the risk of those operations on the cargo owner in the midst of the service. It was thus suggested that the draft provision should be deleted. That view received considerable support and it was considered that the impact of those clauses on door-to-door operations needed to be evaluated.

124. According to others, however, the clauses should be recognized as dividing the responsibilities and risks between the shipper and the carrier and as a consequence the clause should exonerate the carrier to the extent that the shipper undertook to carry out those obligations. Contractual freedom in that respect was desirable and had the beneficial effect of allowing the parties to carry out their business at the lowest possible costs by placing the obligations of loading and unloading on the persons that were best placed to carry them out.

125. It was noted that the draft provision referred in a broad manner to the obligations of article 5.2.1, which included also carrying, keeping and caring for goods. Wide support was expressed for the suggestion that the carrier

should not be able to delegate contractually to the shipper such a broad array of obligations arising from the transport contract.

126. It was noted that pursuant to the current draft provisions an FIO(S) clause did not need to be expressly agreed or specifically negotiated, which raised public policy concerns. It was stated in response that, to the extent the manner of agreeing on such a clause was unclear, it should be clarified that they should be expressly agreed upon and also that a transfer to third persons had to be by express consent (but it was added that such a clarification did not mean that the clause did not transfer the liability for those operations to the cargo owner).

127. Different views were expressed as to what should be the appropriate rule for the draft instrument. There was general agreement with the proposition that even if the parties agreed on a FIO(S) clause, the draft instrument continued to apply. Support was expressed for the suggestion that the clause did not only affect the question of the costs of loading and unloading operations but also that thereby the carrier's responsibility for those operations was contractually diminished (otherwise the contractual freedom in this area was not apt to achieve optimum commercial benefits). Considerable support, however, was given to the suggestion that the clause should only affect the question as to who should bear the costs of loading and unloading operations and that the application of the clause should not diminish the carrier's liability for those operations. No final conclusion was reached on this point, but it was accepted that the point needed to be clarified in the draft instrument. After discussion it was decided that the provision should be placed between square brackets as an indication that the concept had to be reconsidered by the Working Group including as to how it related to the provisions on the liability of the carrier. It was suggested that written information about the practice of FIO(S) clauses should be prepared for a future session of the Working Group to assist it in its considerations.

(d) Paragraph 5.3

128. The attention of the Working Group was drawn to the existence of rules regarding the transport of dangerous goods under other unimodal transport conventions such as those on international carriage of goods by rail, road and inland waterways. In the context of door-to-door transportation, the interplay between the draft instrument and those conventions would need to be further studied.

129. With respect to the substance of draft article 5.3, support was expressed in favour of the principles on which the provision was based. A widely shared view was that a distinction might need to be drawn in the draft article according to whether or not the carrier had been informed about the nature of the goods. It was suggested that the scope of the provision might need to be restricted to circumstances where a specific danger resulted from the transport of certain goods or the carrier had not been informed of the dangerous nature of the goods. However, other delegations expressed the contrary view that regardless of knowledge, for safety reasons, the carrier should have a

right to destroy the goods if necessary. Another suggestion was that the provision should deal with the issue of the possible compensation owed by the shipper to the carrier for the additional costs involved in the handling of the goods in the circumstances envisaged under draft article 5.3. Yet another suggestion was that the text of the draft article would need to indicate more clearly its relationship with the carrier's obligations to maintain the vessel as seaworthy under draft article 5.4. It was stated that the text of draft article 5.3 would also need to include safeguards against unjustified actions by the carrier. A concern was expressed that, as presently written, the draft provision might be misleading, especially in view of the reference to draft article 5.3 included in draft article 6.1.3 (x) providing for exclusions of liability of the carrier. It was stated that a difficulty arose because the combined draft provisions attempted to deal at the same time with the right of the carrier to destroy the goods (without distinction according to whether or not the carrier knew of the dangerous nature of the goods) and with the obligations and liabilities of the shipper. It was stated that those issues were better dealt with in article 13 of the Hamburg Rules.

130. After discussion, the Working Group generally agreed that the text of draft article 5.3 required further improvement. As an alternative to the current text of the provision, the Secretariat was requested to prepare a variant based on the principles expressed in article 13 of the Hamburg Rules regarding the powers of the carrier in case of emergency arising in the transport of dangerous goods. It was also agreed that the issue of compensation that might be owed to the carrier or the shipper in such circumstances might need to be further discussed in the context of draft article 7.5.

(e) Paragraph 5.4

131. The Working Group recalled its preliminary discussion regarding draft article 5.4 (see para. 43 above) and confirmed its broad support for imposing on the carrier an obligation of due diligence that was continuous throughout the voyage by retaining the words that were currently between square brackets "and during" and "and keep". However, a concern was reiterated that the extension of the carrier's obligation to exercise due diligence in respect of the whole voyage put a greater burden on carriers and could lead to the associated costs being passed on in the form of higher freights.

132. It was observed that the wording of draft article 5.4 was inspired by the Hague Rules and its retention would preserve the benefit of extensive experience and a body of case law regarding the interpretation of that provision in maritime transport. It was pointed out, however, that the text of draft article 5.4 made it unsuitable for other modes of transport.

133. It was suggested that improvements would need to be introduced in the text to clarify the allocation of the burden of proof regarding the carrier's obligation of due diligence. In particular, a question was raised as to whether the shipper, in addition to bearing the burden of proof as to the cause of loss or damage to the goods under draft

article 6.1.3, would also have to prove failure by the carrier to exercise due diligence under draft article 5.4.

134. Another question was raised as to the duration of the period of responsibility of the carrier under draft article 5.4, which was imposed on the carrier “before” the voyage by sea, without specifying a point in time for the beginning and the end of the period. It was suggested that the obligation of due diligence of the carrier should not come to an end at the time of arrival of the ship at the port of its destination but at least until the goods had been discharged. To that effect, it was suggested that the words “and keep” should not be retained in subparagraphs (a) and (c). Instead, a sentence should be added at the end of draft article 5.4 along the following lines: “The obligations set out above must be fulfilled throughout the period during which the goods are on board the ship and during discharge of the goods from the ship.”

135. Another suggestion was made that wording along the following lines should be added to accommodate the specific needs arising from the transport of chilled and frozen products: “Following delivery of goods which have been carried under controlled temperatures (whether in containers, or otherwise), the carrier must, if requested so to do by any of the persons referred to in article 13.1, make available within 14 days of being so requested copies of such documentary evidence and or electronically stored information (such as recording charts or downloaded electronically stored data) which it has relating to the temperatures at which the goods have been carried”.

136. After discussion, the Working Group agreed that the current text of draft article 5.4 constituted a workable basis for continuation of its deliberations. The Working Group took note of the various suggestions that had been expressed in respect of the draft provision. It was generally agreed that the draft provision would need to be further considered in light of similar or comparable provisions in other unimodal transport conventions.

(f) Paragraph 5.5

137. Questions were raised as to the need and purpose of draft article 5.5, including its relationship with chapter 15, which dealt with general average.

138. It was stated that draft chapter 15 referred to the adjustment of general average and to the applicability of contractual rules dealing with details for such adjustment, whereas draft article 5.5 expressed a general principle of law, which, on the one hand expressed the rule generally recognized in legal systems that the sacrifice of property of others was justified in certain circumstances and, on the other hand provided a juridical basis for general average as dealt with in draft chapter 15. It was argued that the expression of that principle, notwithstanding possible drafting improvements, was useful since it might facilitate the operation of the York-Antwerp Rules (1994) on general average. It was further stated that draft article 5.5 provided an exception (in addition to the one stated in draft article 5.3) to the duty of care as specified in the other provisions of draft chapter 5. Various statements were made

that draft article 5.5 was consistent with the promotion of safety at sea.

139. However, strong objections were raised against the draft article, as regards its overall approach, the principles it expressed, as well as to its drafting. Some of those criticizing the draft provision considered that it should be deleted, while others were of the view that the Working Group should improve the wording of the draft provision and retain it, whether in its present place or by connecting it with draft article 15.

140. It was considered that draft article 5.5 established a new power, which so far had not been expressed in legal texts of a similar nature, without clarifying and circumscribing the limits of the power. It was considered that general average was a traditional and well-established legal concept and that it was inappropriate to add to it a sweeping legal provision such as the one in draft article 5.5. Moreover, draft article 5.5 went beyond the traditional concept of general average (in particular because it was not restricted by the notion of peril endangering the common adventure at sea), was unjustifiably favourable to the carrier and also that draft article 15 (which was closely based on article 24 of the Hamburg Rules) was sufficient to deal with the situations where the carrier had to sacrifice goods for the common safety of a common maritime adventure.

141. By way of explanation it was said that if the sacrifice of goods was caused by unseaworthiness of the vessel and if a causal link was established between the unseaworthiness and the need for sacrifice, the carrier would be liable. However, it was said in reply that the draft article placed the cargo owner in a difficult position given the liability provision in draft article 6.1.3 (according to which the carrier was presumed not to be at fault for loss or damage to goods); in particular the burden of proof that the cargo owner had to discharge was difficult.

142. It was noted that the draft article did not refer to the preservation of the vessel or the cargo from a common peril, which was an essential element of a general average situation. Such incomplete treatment of the right to sacrifice goods was said to be undesirable and might lead to unpredictable consequences. It was also not clear, as a matter of drafting, what the relationship was between the draft article and draft article 15. Moreover, it was reported that the York-Antwerp Rules (1994) were under consideration for a possible revision, which was said to be a further reason against including untested legislative provisions in the draft instrument. It was said that, as a matter of drafting approach, it was preferable to state positively duties of care of the carrier (and combine those duties with presumptions of non-liability) and that it was less desirable to state positively a right to disregard a duty of care. In any case, if any general principles were to be required regarding general average, it was said to be preferable to deal with them in the context of draft article 15.

143. After considering the differing views, it was noted that the Working Group was divided between those who favoured the elimination of draft article 5.5 and those who preferred it to be kept. Those which favoured keeping the

provision considered that it was in need of further study and clarification (as the discussion had indicated). As an indication that the Working Group was not in a position to decide whether to keep the draft provision and an indication that further consideration of its substance and drafting was necessary, the Working Group decided to place the draft article between square brackets.

3. Draft article 7 (*Obligations of the shipper*)

144. The text of draft article 7 as discussed by the Working Group was as follows:

“7.1 Subject to the provisions of the contract of carriage, the shipper shall deliver the goods ready for carriage and in such condition that they will withstand the intended carriage, including their loading, handling, stowage, lashing and securing and discharge, and that they will not cause injury or damage. In the event the goods are delivered in or on a container or trailer packed by the shipper, the shipper must stow, lash and secure the goods in or on the container or trailer in such a way that the goods will withstand the intended carriage, including loading, handling and discharge of the container or trailer, and that they will not cause injury or damage.

“7.2 The carrier shall provide to the shipper, on its request, such information as is within the carrier’s knowledge and instructions that are reasonably necessary or of importance to the shipper in order to comply with its obligations under article 7.1.

“7.3 The shipper shall provide to the carrier the information, instructions and documents that are reasonably necessary for:

“(a) The handling and carriage of the goods, including precautions to be taken by the carrier or a performing party;

“(b) Compliance with rules, regulations and other requirements of authorities in connection with the intended carriage, including filings, applications and licences relating to the goods;

“(c) The compilation of the contract particulars and the issuance of the transport documents or electronic records, including the particulars referred to in article 8.2.1(b) and (c), the name of the party to be identified as the shipper in the contract particulars and the name of the consignee or order, unless the shipper may reasonably assume that such information is already known to the carrier.

“7.4 The information, instructions and documents that the shipper and the carrier provide to each other under articles 7.2 and 7.3 must be given in a timely manner and be accurate and complete.

“7.5 The shipper and the carrier are liable to each other, the consignee and the controlling party for any loss or damage caused by either party’s failure to comply with its respective obligations under articles 7.2, 7.3, and 7.4.

“7.6 The shipper is liable to the carrier for any loss, damage or injury caused by the goods and for a breach of its obligations under article 7.1, unless the shipper proves that such loss or damage was caused by events or through circumstances that a diligent shipper could not avoid or the consequences of which a diligent shipper was unable to prevent.

“7.7 If a person identified as ‘shipper’ in the contract particulars, although not the shipper as defined in article 1.19, accepts the transport document or electronic record, then such person is (a) subject to the responsibilities and liabilities imposed on the shipper under this chapter and under article 11.5; and (b) entitled to the shipper’s rights and immunities provided by this chapter and by chapter 13.

“7.8 The shipper is responsible for the acts and omissions of any person to which it has delegated the performance of any of its responsibilities under this chapter, including its sub-contractors, employees, agents and any other persons who act, either directly or indirectly, at its request, or under its supervision or control, as if such acts or omissions were its own. Responsibility is imposed on the shipper under this provision only when the act or omission of the person concerned is within the scope of that person’s contract, employment or agency”.

(a) Paragraph 7.1

145. Notwithstanding the statement made in paragraph 112 of the annex to the note by the Secretariat (A/CN.9/WG.III/WP.21) that the “basic obligation of the shipper is to deliver the goods to the carrier in accordance with the contract of carriage”, it was suggested that, in fact, the basic obligation of the shipper was to pay the freight. Some delegations took the view that payment of freight was a primary obligation of the shipper with other obligations being ancillary to that one. However, an alternative view was that, even if the payment of freight was the most important obligation of the shipper, that matter was already dealt with in article 9 of the draft instrument. It was suggested that, to reflect more clearly the importance of the shipper’s obligation to ensure that the goods, when delivered to the carrier, were in a condition to withstand carriage, the word “and” should be removed from the statement of the shipper’s obligation in the first sentence of draft article 7.1. Wide support was expressed in favour of that suggestion.

146. Another suggestion was made that, as currently drafted, the obligation of the shipper to deliver the goods in a condition ready for carriage was subject to the provisions of the contract of carriage and that if the intention was that that should be a mandatory obligation then the opening words of draft article 7.1 (“Subject to the provisions of the contract of carriage”) should be deleted. It was observed that, as presently drafted, the provision could allow the parties to agree to change the obligation set out in draft article 7.1. It was stated that any such change should only apply as between the parties to the contract of carriage and that it should not apply to third parties. It was also stated

that subjecting the shipper's obligation to deliver the goods to the provisions of the contract of carriage could open a possibility for abuse by a carrier who might seek to include more onerous clauses. It was also said that there appeared to be an imbalance between the carrier's obligation of care in respect of the goods as set out in draft article 5.2.1 and the obligations of the shipper in respect of the goods. It was pointed out that the obligation of the shipper in relation to the condition and packaging of goods was set out in far more detail than the corresponding obligation of the carrier and that that could cause confusion and also result in evidentiary problems. It was suggested that greater balance could be achieved by relying on the approach taken in articles 12, 13 and 17 of the Hamburg Rules. Support was expressed in favour of that suggestion. In opposition to that suggestion, it was said that the obligations of the shipper in draft article 7.1 and those of the carrier in draft article 5 were different types of obligations and were correctly drafted in slightly different levels of detail.

147. It was suggested that the second sentence in draft article 7.1 should be deleted given that the definition of "goods" in draft article 1.11 also included "any equipment and container". However, the suggestion was objected to on the grounds that the inclusion of the second sentence was necessary to put beyond doubt that the shipper's obligation extended to the proper stowage of the cargo in containers or trailers and to address the general concern that security issues should be given more prominent status. Examples were given of situations, particularly in the ferry industry, where the securing of the cargo in trailers on board ferry vessels was particularly important. In view of that concern, it was agreed that the second sentence should be retained. However, the Working Group noted that the relationships between draft articles 7.1 and 1.11 might need to be further reviewed at a later stage to avoid any possible inconsistency.

148. After discussion, the Working Group agreed to delete the word "and" from the second line in draft article 7.1 and to place the phrase "Subject to the provisions of the contract of carriage" in square brackets pending further consultations and discussions on the scope of the obligation of the carrier and the extent to which it was subject to freedom of contract. The suggestion to prepare alternative wording based on articles 12, 13 and 17 of the Hamburg Rules was noted by the Working Group. In addition, it was noted that the provision might need to be reviewed for consistency in terminology in the six official languages.

(b) Paragraph 7.2

149. The view was expressed that draft article 7.2 was inappropriate, since it introduced a subjective element into the mutual duties and obligations between the shipper and the carrier and since it constituted an additional burden upon the carrier, which might lead to unnecessary litigation. In addition, it was stated that draft article 7, which dealt with the obligations of the shipper, should not be used to establish an obligation of the carrier. It was thus suggested that the draft provision should be deleted and that the issue of information and instructions to be provided by the carrier to the shipper should be dealt with on a case-by-case basis relying on existing trade practices.

150. However, the widely prevailing view was that draft article 7.2 should be maintained since it provided an appropriate balance between the duties of the shipper (as dealt with in draft chapter 7 and elsewhere) and the duties of the carrier to provide the shipper with the necessary information enabling the shipper to fulfil its duties. It was observed that, even if the duty such as the one in draft article 7.2 was not stated expressly, it existed as a principle anyway, as it was essentially dictated by the mutual duty of the contract parties to cooperate in good faith. In that connection it was stated that the draft instrument should contain a provision (included in other UNCITRAL texts such as article 7 of the United Nations Convention on Contracts for the International Sale of Goods) to the effect that in the interpretation of the instrument regard was to be had to the observance of good faith. Nevertheless, it was widely considered that in this particular context it was beneficial to give expression to the general duty of good faith by a provision along the lines of draft article 7.2.

151. As to the drafting of the provision, it was said that it was necessary to make sure that it was clear in all language versions that the qualifying concept "reasonably necessary" referred to both "information" and "instructions". Some doubts were expressed as to whether the draft provision, which focused on the duties of the carrier, was properly placed in the chapter covering the obligations of the shipper. However, it was considered that, in view of the close link between draft article 7.2 and the other provisions of draft chapter 7, the placing of the draft provision was not necessarily inappropriate. It was suggested that in view of the link between the carrier's duty under draft article 7.2 and the shipper's duties under draft chapter 7, it must follow that the shipper was not liable for non-fulfilment of its duties if the carrier did not provide properly requested information and instructions and that it might be desirable to clarify that understanding. It was observed that article 7 of the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways required a written form for information to be given in a similar context and that the question of form in draft article 7.2 might also be considered.

152. Subject to the expressed observations, the Working Group decided to retain the draft provision with a view to considering its details at a future session.

(c) Paragraph 7.3

153. Wide support was expressed for the formulation of draft article 7.3, which set out the requirement that the shipper should provide to the carrier certain information, instructions and documents. The view was expressed that the reference in paragraph (c) to "the name of the party to be identified as the shipper in the contract particulars" could create problems in practice when such information was contained in, for example, a bill of lading, with the name of the documentary shipper being different from the name of the contractual shipper. It was suggested that the words "contract particulars" should be replaced by the words "transport document". In response, it was observed that the definition of "contract particulars" already referred to any information that appeared in "a transport document".

On that basis, the text of draft article 7.3 was approved as a sound basis for continuation of the discussion at a later stage.

(d) Paragraph 7.4

154. It was stated that draft article 7.4, which involved a mutual obligation on the shipper and carrier to provide information, instructions and documents in a timely manner and that they should be accurate and complete, was an appropriate starting point for further discussions. The Working Group agreed that the text should be retained for further consideration.

(e) Paragraph 7.5

155. It was observed that draft article 7.5 imposed on both the shipper and the carrier strict liability to each other, to the consignee or to the controlling party for any loss or damage caused by either party's failure to provide the information required to be provided under draft articles 7.2, 7.3 or 7.4. It was said that that provision was important given that, in modern times, actual physical inspection of goods was rare and therefore the exchange of information relating to goods between shippers and carriers was of paramount importance to the success of carriage operations.

156. However, concerns were expressed with the current text of draft article 7.5. One concern was that the type of liability established by draft article 7.5 was inappropriate given that the obligations set out in draft articles 7.2, 7.3 and 7.4 were not absolute and involved subjective judgments. For example, paragraph 7.3 referred to the shipper providing information that was "reasonably necessary". Imposing strict liability for failure to comply with what was described as a flexible and imprecise obligation seemed excessive to some delegations. It was suggested that, in certain circumstances, a shipper might have a number of reasons for not providing the relevant information, for example where the shipper reasonably believed that the carrier was already in possession of the relevant information. Furthermore, it was stated that an approach based on strict liability might be inappropriate, for example where a shipper had failed to provide relevant particulars under article 8.2.1 (b) or (c) to be included in the transport document before receipt of the goods by the carrier (as required under article 8.2.1). In such a case, the effect of draft article 7.5 would be to make the shipper strictly liable for failing to comply with its obligation under article 7.4 to provide information "in a timely manner". It was stated that, as currently drafted, the provision was ambiguous and that it was not clear what its effect would be either as to liability to a consignee or a controlling party or as to whether a carrier would be liable to a consignee for the shipper's failure to provide adequate particulars and vice versa. It was suggested that a revised draft of the provision might need to differentiate between contractual liability to the other parties involved and extra-contractual liability to third parties.

157. Another concern was that the provision did not accommodate the situation where both the shipper and the carrier were concurrently liable by allowing for shared

liability in such situations. As well, it was suggested that the provision was ambiguous in that it was not clear what was meant by "loss or damage" in draft article 7.5 as compared, for example, to the phrase used in draft article 7.6, which referred to "loss, damage or injury". It was suggested that the Working Group should examine that question to better delimit what loss or damage was being referred to. More generally, it was suggested that the obligation imposed by draft article 7.5 should be further examined in detail to clarify its multiple implications.

158. It was concluded that draft article 7.5 should be placed between square brackets, pending its re-examination in the light of the above-mentioned concerns and suggestions. The Secretariat was requested to prepare a revised draft, with possible alternative texts to take account of the suggestions made. At the close of the discussion, the Working Group generally agreed that in revising the draft provision, due consideration should be given to the fact that the information referred to in draft article 7.5 might be communicated by way of electronic messages, that is, fed into an electronic communication system and replicated with or without change in the transmission process.

(f) Paragraph 7.6

159. It was observed that draft article 7.6 held the shipper liable for damage caused by the goods (and for non-fulfilment of its obligations under article 7.1) based on fault, with the burden of proof upon the shipper to show that the loss or damage was caused by events or through circumstances that a diligent shipper could not avoid or the consequences of which a diligent shipper was unable to prevent. It was recognized that draft article 7.6 reversed the approach taken in both article 4, rule 6, of the Hague-Visby Rules and article 13 of the Hamburg Rules, where strict liability applied for damage caused by dangerous goods. It was suggested that the commentary set out in paragraph 116 of the note by the Secretariat (A/CN.9/WG.III/WP.21, annex) did not sufficiently justify the shift from the existing law set out under draft article 7.6.

160. One delegation considered that the reference to the standard of liability being that of the "diligent shipper" was too ambiguous. It was stated in response that that represented an appropriately flexible standard, which should be understandable in all legal systems. The view was expressed that the burden of proof placed on the shipper according to draft article 7.6 was heavier than that placed on the carrier under draft article 6.1. It was observed that draft article 7.6 imposed a heavy burden of proof on the shipper, particularly in so far as it related to proving that the loss, damage or injury caused by the goods was caused by events that could not be avoided or prevented by a diligent shipper. It was suggested that the higher standard of proof should only apply in respect of the breach of obligations under article 7.1. In response, it was stated that the stricter standard was appropriate as it sent a proper message to shippers as to the paramount importance of safety at sea.

161. Given that the carrier had the benefit of exemptions and limitations that were not available to the shipper, it was suggested that the following text should be included in

draft article 7.6: "A shipper is not responsible for loss or damage sustained by a carrier or a ship from any cause without the act, fault or neglect of the shipper, its agents or its servants". It was suggested that such a text was intended to replace the existing text of draft article 7.6 but that it should be placed in square brackets to indicate that the question of determining upon whom the burden of proof should fall was still outstanding and would be subject to further discussions. It was also suggested that neither that proposal nor the current text of draft article 7.6 adequately addressed the situation of contributory negligence where a carrier failed to comply with its obligations under draft article 7.2 and this contributed to the shipper's failure to comply with draft article 7.6. It was generally felt that the text needed to take account of that matter.

162. Broad support was expressed in favour of the suggested language. However, several comments were made in respect of the proposed text. It was suggested that the scope of responsibility of the shipper in draft article 7.6 needed to be examined from several different situations: first, where damage was done to the vessel by the goods themselves; second, where the goods caused damage to the crew on board the vessel; and, third, where the goods damaged other goods on board the vessel. It was stated that the proposed text might assist in better dealing with those three categories of damages. It was also stated that the proposed text might be better suited to dealing with shipper responsibilities vis-à-vis third parties, which were not covered by the current text of draft article 7.6. Another comment on the proposal was that it was largely based on both the Hague Rules and article 12 of the Hamburg Rules and that such an approach based on liability for fault represented an improved formulation on the text set out in draft article 7.6. A further comment was that the reference to "ship" in the draft proposal might need to be reconsidered in the event that the draft instrument would apply to door-to-door transport rather than merely on a port-to-port basis. In the context of door-to-door transport, the text would need to be reviewed against the background of other unimodal conventions. Yet another comment was that the reference to third parties in the proposal was too broad and given that the issue was dealt with by other regimes regarding safety, such as the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea, it would be better to restrict the proposal to the shipper and carrier.

163. The view was expressed that the main difficulty arising under draft article 7.6 was that the distinction between ordinary and dangerous goods, which existed in other maritime conventions, had been removed from the draft instrument. It was suggested that the distinction should be included in the draft instrument so that the shipper would have strict liability for damage to the vessel caused by dangerous goods. However, a concern was expressed that it was important to assess the impact of including a clause with respect to dangerous goods particularly in respect of additional costs that might arise for cargo interests. There was no unanimity in the Working Group regarding the question of whether to include a specific rule dealing with dangerous cargo and the matter was left open for further consideration.

(g) Paragraph 7.7

164. There was general support for the text of draft article 7.7 as a useful attempt to deal with the position of the f.o.b. seller who, although not being the shipper, was nevertheless mentioned as the shipper in the transport document. However a concern was raised as to the use of the phrase "accepts the transport document". In that respect it was suggested that acceptance should be understood as the act or manner by which the documentary shipper became a holder of the bill of lading. It was said that the phrase should also be considered in the context of a situation when a non-negotiable transport document or non-negotiable electronic record was issued. Another concern was expressed as to whether all the liabilities and responsibilities that were imposed upon the shipper should also be imposed on the f.o.b. seller. In response to that concern, it was stated that, given that the named shipper (as the first holder of the bill of lading) acted as the shipper with all the rights of the shipper, then it was logical that it should also assume all the obligations of the shipper. It was generally accepted that that issue should be considered a matter for further consideration. It was suggested that the draft provision should be expanded to deal with the situation where no shipper was named in the transport document with a suggestion that in such cases a presumption could apply that the person delivering the cargo was the shipper. A further concern was that the provision needed to distinguish more clearly between the shipper and the shipper named in the transport document. In that context, it was suggested that further attention should be given to determining whether the liability of the "person" identified in draft article 7.7 should be joint or joint and several with that of the shipper, or whether it should be exclusive of the liability of the shipper. It was agreed that further deliberation was needed in respect of the various views, concerns and suggestions mentioned above.

(h) Paragraph 7.8

165. It was stated that draft article 7.8 set out a classic principle that the shipper was responsible for the acts or omissions of its subcontractors, employees or agent and that that responsibility was properly limited to acts or omissions that fell within the scope of the person's contract, employment or agency. However, strong concerns were expressed that the provision as drafted imposed too broad a responsibility for the shipper in respect of the acts or omissions of persons to whom it had delegated its responsibilities. It was suggested that the provision was too burdensome when compared to similar provisions in respect of the carrier. It was also suggested that draft article 7.8 should be further refined with reference to draft article 5.2.2 which, inter alia, allowed a carrier to act on behalf of the shipper. It was noted that there was a possibility that the carrier could attribute fault on its part to the shipper by virtue of draft article 7.8. It was agreed that that issue should be further examined.

166. It was further agreed that the proposal for alternative language made in respect of draft article 7.6 (see above, para. 161) should be further examined and that the reference to agents and servants of the shipper in the proposal

might be deleted, as the matter might be dealt with in draft article 7.8.

167. A suggestion was made that the position of the shipper with respect to the activities of its subcontractors, employees or agents should be in line with the position of carriers in respect of such persons. In that respect, it was suggested that the language in draft article 7.8 should be more closely aligned with the language used in draft article 6.3.2. In opposition to that suggestion, it was said that, although the Working Group was seeking to maintain a fair balance between the shipper and the carrier, it should not necessarily use the exact same wording when describing both parties' responsibilities. In fact it was suggested that the circumstances under which a shipper should be liable for the actions of a third party pursuant to draft article 7.8 should be considered from a different angle than the circumstances under which a carrier should be liable for acts of third parties under draft article 6.3.2.

168. As a matter of drafting, it was suggested that the draft article should be examined in all languages to ensure that consistent terms were used to describe matters such as "responsibilities" or "obligations" of the shipper.

169. The Working Group agreed that draft article 7.8 was a basis on which to continue discussions whilst keeping in mind the various concerns that had been expressed as to its current wording. At the close of the discussion, it was suggested that draft article 7.8 should be narrowed so as to apply only to shipper obligations that were delegable rather than those obligations that were non-delegable.

170. It was agreed that the text in draft article 7.8 should be retained along with the proposal set out above at paragraph 161 as an alternative for the current text of draft article 7.6 so that both texts could be considered again at a future session of the Working Group.

4. Draft article 9 (Freight)

171. The text of draft article 9 as discussed by the Working Group was as follows:

"9.1 (a) Freight is earned upon delivery of the goods to the consignee at the time and location mentioned in article 4.1.3, unless the parties have agreed that the freight is earned, wholly or partly, at an earlier point in time.

"(b) Unless otherwise agreed, no freight becomes due for any goods that are lost before the freight for those goods is earned.

"9.2 (a) Freight is payable when it is earned, unless the parties have agreed that the freight is payable, wholly or partly, at an earlier or later point in time.

"(b) If subsequent to the moment at which the freight has been earned the goods are lost, damaged or otherwise not delivered to the consignee in accordance with the provisions of the contract of carriage, freight remains payable irrespective of the cause of such loss, damage or failure in delivery.

"(c) Unless otherwise agreed, payment of freight is not subject to set-off, deduction or discount on the grounds of any counterclaim that the shipper or consignee may have against the carrier, [the indebtedness or the amount of which has not yet been agreed or established].

"9.3 (a) Unless otherwise agreed, the shipper is liable to pay the freight and other charges incidental to the carriage of the goods.

"(b) If the contract of carriage provides that the liability of the shipper or any other person identified in the contract particulars as the shipper will cease, wholly or partly, upon a certain event or after a certain point of time, such cessation is not valid:

"(i) With respect to any liability under chapter 7 of the shipper or a person mentioned in article 7.7; or

"(ii) With respect to any amounts payable to the carrier under the contract of carriage, except to the extent that the carrier has adequate security pursuant to article 9.5 or otherwise for the payment of such amounts;

"(iii) To the extent that it conflicts with the provisions of article 12.4.

"9.4 (a) If the contract particulars in a transport document or an electronic record contain the statement "freight prepaid" or a statement of a similar nature, then neither the holder nor the consignee is liable for the payment of the freight. This provision does not apply if the holder or the consignee is also the shipper.

"(b) If the contract particulars in a transport document or an electronic record contain the statement "freight collect" or a statement of similar nature, such a statement puts the consignee on notice that it may be liable for the payment of the freight.

"9.5 (a) [Notwithstanding any agreement to the contrary,] if and to the extent that under national law applicable to the contract of carriage the consignee is liable for the payments referred to below, the carrier is entitled to retain the goods until payment of:

"(i) Freight, deadfreight, demurrage, damages for detention and all other reimbursable costs incurred by the carrier in relation to the goods;

"(ii) Any damages due to the carrier under the contract of carriage;

"(iii) Any contribution in general average due to the carrier relating to the goods has been effected, or adequate security for such payment has been provided.

"(b) If the payment as referred to in paragraph 7 of this article is not, or is not fully, effected, the carrier is entitled to sell the goods (according to the procedure, if any, as provided for in the applicable national law) and to satisfy the amounts payable to it (including the costs of such recourse) from the proceeds of such sale. Any balance remaining from the proceeds of such sale shall be made available to the consignee."

(a) Paragraph 9.1

172. By way of general comment it was said that neither the Hague nor the Hamburg regimes contained provisions on freight and that it was questionable whether the draft instrument would benefit from dealing with the issue. If there should be provisions on freight, they should be balanced and, for example, appropriately deal with the situation where the goods were delivered in a totally damaged condition (in which case, according to the current draft, full freight was payable). However, in response it was noted that, in the case of damaged goods, the freight already paid or owed formed part of the claim for damages. Further reservations as to the inclusion of freight provisions were based on the fact that practices varied widely between different trades, a situation that would be further complicated by the fact that the draft instrument might apply to door-to-door carriage.

173. However, wide support was expressed for the inclusion of provisions relating to freight that respected the principle of the freedom of contract, on the basis that such provisions would assist in the unification of this area of maritime law in particular in light of the fact that national legislation in a number of jurisdictions took differing approaches on the payment of freight. It was said that if the draft instrument was to apply on a door-to-door basis, then provisions relating to freight that applied in existing unimodal conventions would need to be considered.

174. The Working Group undertook a discussion as to what was meant by the term “earned upon delivery”. It was said that that meant that the claim existed at the time of the delivery. It was suggested that the provision should more clearly distinguish between when a claim arose and when it was earned. Further explanation was sought as to what was meant by the term “earned” in the context of draft article 9.1. In response, it was suggested that the term “earned” referred to when a debt accrued although it may be actually payable at some later date. The view was expressed that the distinction was borne out by the fact that draft article 9.1 dealt with the question of when freight was earned, whereas draft article 9.2 dealt with when freight was payable. Concerns as to the clarity of the provision were however maintained. It was also suggested that draft article 9.1 required that the carrier could not claim freight for the transport until the transportation of the goods had been carried out but that this was subject to contrary party agreement. It was suggested that while the time for when freight became payable should be non-mandatory, the question of whether or not the claim for freight came into existence should not be open to contractual negotiation. Overall there were differences of opinion in the Working Group as to what was meant by the terms “earned” and “due”. It was agreed that further clarity should be sought in any future drafts of the provision. There was general agreement that the principle of freedom of contract should apply to determining when the payment of freight was earned as well as when the payment of freight became due. As well, it was suggested that the provision should expressly state that the amount of freight should be established by agreement between the parties.

175. As to the provision that freight was earned upon delivery of the goods, it was considered that if a shipper

failed to hand over goods to the carrier as agreed, the carrier should still be entitled to receive at least part of the freight. However, it was stated in reply that freedom of contract offered sufficient flexibility to address such issues.

176. In respect of paragraph (b) of draft article 9.1, it was suggested that the provision was drafted too broadly. In that respect, it was said that simply stating that no freight was due for any goods that were lost before the freight for the goods was earned, was too broad. It was suggested that the operation of this provision needed to be clarified with reference to different causes for non-delivery, such as when the carrier was responsible, when nobody was responsible (force majeure) and when the shipper was responsible.

177. It was noted that there existed rules, practices and regulations, including rules elaborated at regional levels, the example was given of the *Comisión Centroamericana de Transporte Marítimo*, which dealt with issues such as, the currency of freight, the effects of devaluation or appreciation of the currency, as well as the carrier's right to inspect goods and correct the amount of freight if the basis for calculating it was found to be inaccurate. It was suggested that the draft instrument should not interfere with any current or future arrangements of that nature.

(b) Paragraph 9.2

178. By way of analysis of the structure of draft article 9.2, it was observed that draft article 9 established a distinction between the conditions under which the obligation to pay freight came into existence (which were dealt with in draft article 9.1) and the circumstances under which freight became payable (which were dealt with under draft article 9.2).

179. A concern was expressed as to the interplay and the possible inconsistency between paragraphs 9.1 (a) and 9.2 (b). Assuming that, under draft article 9.1 (a), freight was earned upon delivery of the goods, a question was raised as to the circumstances under paragraph 9.2 (c) where, subsequent to delivery, the goods would be “lost, damaged, or otherwise not delivered”. In response, it was explained that paragraph 9.2 (b) was intended to address only the situation where the freight had been stipulated payable in advance, a situation that would probably be the most commonly found in practice in view of the general inclusion of clauses on the time when freight was earned in transport documents. With a view to alleviating the above-mentioned concern, a proposal was made that draft article 9.2 (b) should be redrafted along the following lines: “Where freight is earned before delivery of the goods, the loss, damage and/or non-delivery of the goods to the consignee does not render the earned freight non-payable, irrespective of the causes of such loss, damage and/or failure in delivery”.

180. It was observed that, should the draft instrument govern non-maritime transport in the context of door-to-door contracts of carriage, particular attention would need to be given to the interaction and possible conflict between the maritime regime under which freight remained payable

even if the goods were lost and other unimodal transport regimes such as that established by the Convention on the Contract for the International Carriage of Goods by Road, where the carrier had an obligation to refund freight if the goods were lost.

181. More generally, the view was expressed that establishing an international regime where freight remained payable even if the goods were lost, while consistent with a number of existing national laws, might be regarded by some as unfair and difficult to justify in a uniform international instrument. It was stated that no attempt should be made towards providing a uniform solution regarding that matter, which should be left to national laws. It was observed, however, that the policy under which freight remained payable even if the goods were lost was not unfavourable to the shipper. If the goods were lost, the amount of freight would be added to the value of the goods for the purposes of calculating compensation under draft article 6.2. If freight were included, the amount of compensation would therefore be calculated on the basis of a higher value.

182. With respect to paragraph 9.2 (c), a question was raised regarding the reasons for which the draft provision established the general prohibition of set-off as a default rule. It was stated that such a policy might run counter to the general law of obligations in certain countries. The contrary view was that the policy reflected in paragraph 9.2 (c) was satisfactory in that it insisted on the need for the parties to agree mutually on the set-off, thus preventing unilateral set-off by the shipper. That policy was said to be in line with the general principle on which draft article 9 was based that party autonomy should prevail in respect of freight. With a view to reconciling the two positions, wide support was expressed for including in the draft provision the words currently between square brackets (“the indebtedness or the amount of which has not yet been agreed or established”).

183. After discussion, it was provisionally agreed that, for continuation of the discussion at a later stage, the draft article should be restructured, with paragraphs 9.1 (a) and 9.2 (a) being combined in a single provision, paragraph 9.1 (b) standing alone and paragraphs 9.2 (b) and 9.2 (c) also being combined. It was also provisionally agreed that appropriate clarification should be introduced to limit the application of paragraph 9.2 (b) and (c) to cases where specific agreement had been concluded between the parties.

(c) Paragraph 9.3

184. It was noted that draft article 9.3 (a) provided a fallback, non-mandatory rule in case the transport contract did not settle the question who was the debtor for the freight and other incidental charges.

185. It was observed that the draft instrument provided no explanation as to what was covered by the term “charges incidental to the carriage of the goods” and that the term might be understood as covering a rather broad category of claims that might include, for instance, demurrage

(damages for detaining the ship beyond the time contractually allowed for operations such as loading or unloading), other damages for detention, general average contributions and other reimbursable costs incurred by the carrier. It was considered in reply that the charges, being limited to those “incidental to the carriage of the goods”, would cover only those that the carrier was justified to claim from the shipper; for example, where the shipper had the free use of the carrier’s container but it would use the container beyond the agreed period, the shipper would be liable for the cost of using the container beyond the period of free use. The carrier might also have to incur costs in relation to the goods when, for example, they were refused entry by the customs authority and the carrier had costs therewith; it was suggested, however, that such costs more properly fell within draft article 7.6, in particular in its proposed revised version (see para. 161 above). The Working Group took note of those statements and did not take any decision as to whether further clarification of the term was needed.

186. As to draft article 9.3 (b), it was noted that it addressed situations, relevant in particular to trade under charter-parties (which were not to be covered by the draft instrument), where the charterer, having paid part of the freight in advance or having transferred to a shipper the right to have goods carried, wished to be relieved of any other obligations relating to the carriage. In such a situation the parties would include in the charter-party a clause (in practice often referred to as a “cesser clause”) to the effect that the charterer’s liability for freight would cease on shipment of the cargo; that meant that the carrier was to claim freight from the cargo owner or shipper and could for that purpose rely on the security interest (or lien) in the cargo.

187. As to the relevance of draft article 9.3 (b) to transport contracts governed by the draft instrument, it was noted that, normally, the shipper’s liability would not cease upon events such as the shipment of the cargo or the transfer of the bill of lading (and, to that extent, the draft provision was not needed). However, should the parties include in the transport contract governed by the draft instrument a clause with the effect of a cesser clause (which it was recognized would not be frequent in practice) or should a cesser clause become part of the bill of lading because the terms and conditions in the charter-party would be incorporated in it by reference (and the cesser clause would indeed operate to terminate the shipper’s liability for freight and other incidental claims, which was not necessarily the case because of the way such incorporated cesser clauses were interpreted by courts), draft article 9.3 (b) would ensure that the shipper would remain bound to the carrier as specified in subparagraphs (i), (ii) and (iii). It was noted that the draft provision was mandatory, that is, that it overrode the agreement of the parties.

188. Some support was expressed for the draft provision, since it ensured that the carrier’s claim for freight was not left unpaid. However, considerable opposition and criticism were voiced against it. It was said to be unjustified that the provision was mandatory in an area where there was no need to protect a weaker party and, more generally, where freedom of contract should not be restricted, since the parties might have valid reasons to regulate by contract how the obligations of the shipper were to be dealt with. It was

also said that the provision was too broadly worded in that subparagraph (b)(ii) covered “any amounts” payable to the carrier, irrespective of the extent to which a cesser clause had freed the shipper from its payment obligation. Moreover, by referring to any liability under chapter 7 (which covered a broad array of obligations of the shipper beyond the payment of freight), the provision was out of place in draft article 9 on freight. It was also said that it should be carefully studied whether the mandatory provision should extend to all those obligations.

189. The Working Group took note of the criticism of draft article 9.3 (b) and decided to postpone its decision on the matter until the issue, including the practical context in which the provision was to operate, was further studied.

190. In the absence of sufficient time, the Working Group did not complete its reading of draft article 9. It was agreed that the remaining paragraphs of draft article 9 and the remainder of the provisions of the draft instrument would be considered by the Working Group at its tenth session.

A/CN.9/WG.III/WP.21

B. Note by the Secretariat on the preliminary draft instrument on the carriage of goods by sea, working paper submitted to the Working Group on Transport Law at its ninth session

(A/CN.9/WG.III/WP.21 and Add.1) [Original: English]

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INTRODUCTION

1. At its twenty-ninth session, in 1996,¹ the United Nations Commission on International Trade Law (UNCITRAL) considered a proposal to include in its work programme a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.²

2. At that session, the Commission had been informed that existing national laws and international conventions had left significant gaps regarding issues such as the functioning of bills of lading and sea waybills, the relation of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provided financing to a party to the contract of carriage. Some States had provisions on those issues, but the fact that those provisions were disparate and that many States lacked them constituted an obstacle to the free flow of goods and increased the cost of transactions. The growing use of electronic means of communication in the carriage of goods further aggravated the consequences of those fragmentary and disparate laws and

¹See *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17)*.

²*Ibid.*, para. 210.

also created the need for uniform provisions addressing the issues particular to the use of new technologies.³

3. It was then suggested that the Secretariat should be requested to solicit views and suggestions on those difficulties, not only from Governments but in particular from the relevant intergovernmental and non-governmental organizations representing the various interests in the international carriage of goods by sea. It was stated that an analysis of those views and suggestions would enable the Secretariat to present, at a future session, a report that would allow the Commission to take an informed decision as to the desirable course of action.

4. Several reservations were expressed with regard to that suggestion.⁴ One reservation was that the issues to be covered were numerous and complex, which would strain the limited resources of the Secretariat. Priority should instead be given to other topics that were, or were about to be, put on the agenda of the Commission. Furthermore, it was said that the continued coexistence of different treaties governing the liability in the carriage of goods by sea and the slow process of adherence to the United Nations Convention on the Carriage of Goods by Sea, 1978 (the Hamburg Rules), made it unlikely that adding a new treaty to the existing ones would lead to greater harmony of laws. Indeed, there was some danger that the disharmony of laws would increase.⁵

5. In addition, it was said that any work that would include the reconsideration of the liability regime was likely to discourage States from adhering to the Hamburg Rules, which would be an unfortunate result. It was stressed that, if an investigation were to be carried out, it should not cover the liability regime. It was, however, stated in reply that the review of the liability regime was not the main objective of the suggested work; rather, what was necessary was to provide modern solutions to the issues that either were not adequately dealt with or were not dealt with at all in treaties.

6. Having regard to those differing views, the Commission did not include the consideration of the suggested issues on its agenda at that stage. Nevertheless, it decided that the Secretariat should be the focal point for gathering information, ideas and opinions as to the problems that arose in practice and possible solutions to those problems. It was also agreed that such information gathering should be broadly based and should include, in addition to Governments, the international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the International Association of Ports and Harbors, the International Chamber of Commerce (ICC), the International Chamber of Shipping (ICS), the International Federation of Freight Forwarders Associations (FIATA), the International Maritime Committee (CMI) and the International Union of Marine Insurance (IUMI).⁶

7. At its thirty-first session, in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the Secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information. It was stated that that analysis would allow the Commission to take an informed decision as to the desirable course of action.⁷ Strong support was expressed at that session for the exploratory work being undertaken by CMI and the Secretariat. The Commission expressed its appreciation to CMI for its willingness to embark on that important and far-reaching project, for which few or no precedents existed at the international level.⁸

8. At the thirty-second session of the Commission, in 1999, it was reported on behalf of CMI that a CMI working group had been instructed to prepare a study on a broad range of issues in international transport law with the aim of identifying the areas where unification or harmonization was needed by the industries involved.⁹ In undertaking the study, it had been realized that the industries involved were extremely interested in pursuing the project and had offered their technical and legal knowledge to assist in that endeavour. Based on that favourable reaction and the preliminary findings of the CMI working group, it appeared that further harmonization in the field of transport law would greatly benefit international trade. The CMI working group had found a number of issues that had not been covered by the current unifying instruments. Some of those issues were regulated by national laws that were not internationally harmonized. Evaluated in the context of electronic commerce, that lack of harmonization became even more significant. It was reported that the CMI working group had identified numerous interfaces between the different types of contracts involved in international trade and transport of goods (such as sales contracts, contracts of carriage, insurance contracts, letters of credit, freight forwarding contracts and a number of other ancillary contracts). The CMI working group intended to clarify the nature and function of those interfaces and to collect and analyse the rules currently governing them. That exercise would at a later stage include a re-evaluation of principles of liability to determine their compatibility with a broader area of rules on the carriage of goods.

9. At that session, it was also reported that the CMI working group had sent a questionnaire to all CMI member organizations covering a large number of legal systems. The intention of CMI, once the replies to the questionnaire had been received, was to create an international subcommittee to analyse the data and find a basis for further work towards harmonizing the law in the area of international transport of goods. The Commission had been assured that CMI would provide it with assistance in preparing a universally acceptable harmonizing instrument.¹⁰

10. Also at that session, the Commission expressed its appreciation to CMI for having acted upon its request for

³Ibid.

⁴Ibid., paras. 212-214.

⁵Ibid., para. 213.

⁶Ibid., para. 215.

⁷Ibid., *Fifty-third Session, Supplement No. 17 (A/53/17)*, para. 264.

⁸Ibid., para. 266.

⁹Ibid., *Fifty-fourth Session, Supplement No. 17 (A/54/17)*, para. 413.

¹⁰Ibid., para. 415.

cooperation and requested the Secretariat to continue to cooperate with CMI in gathering and analysing information. The Commission was looking forward to receiving a report at a future session presenting the results of the study with proposals for future work.¹¹

11. At its thirty-third session, in 2000, the Commission had before it a report of the Secretary-General on possible future work in transport law (A/CN.9/476), which described the progress of the work carried out by CMI in cooperation with the Secretariat. It also heard an oral report on behalf of CMI. In cooperation with the Secretariat, the CMI working group had launched an investigation based on a questionnaire covering different legal systems addressed to the CMI member organizations. It was also noted that, at the same time, a number of round-table meetings had been held in order to discuss features of the future work with international organizations representing various industries. Those meetings showed the continued support for and interest of the industry in the project.

12. It was reported that, pursuant to the receipt of replies to the questionnaire, CMI had created an international subcommittee with a view to analysing the information and finding a basis for further work towards harmonizing the law in the area of international transport of goods. It was also reported that the enthusiasm encountered so far in the industry and the provisional findings about the areas of law that needed further harmonization made it likely that the project would be eventually transformed into a universally acceptable harmonizing instrument.

13. In the course of the discussions in the CMI subcommittee, it had been noted that although bills of lading were still used, especially where a negotiable document was required, the actual carriage of goods by sea sometimes represented only a relatively short leg of an international transport of goods. In the container trade, even a port-to-port bill of lading would involve receipt and delivery at some point not directly connected with the loading on to, or discharge from, the ocean vessel. Moreover, in most situations it was not possible to take delivery alongside the vessel. Furthermore, where different modes of transport were used, there were often gaps between mandatory regimes applying to the various transport modes involved. It had been proposed, therefore, that in developing an internationally harmonized regime covering the relationships between the parties to the contract of carriage for the full duration of the carrier's custody of the cargo, issues that arose in connection with activities that were integral to the carriage agreed to by the parties and that took place before loading and after discharge should also be considered, as well as issues that arose under shipments where more than one mode of transport was contemplated. It was noted that the emphasis of the work, as originally conceived, had been on the review of areas of law governing the transport of goods that had not previously been covered by international agreements. However, it had been increasingly felt that the current broad-based project should be extended to include an updated liability regime that would complement the terms of the proposed harmonizing instrument.

14. Several statements were made in the Commission to the effect that the time had come for active pursuit of harmonization in the area of the carriage of goods by sea, that increasing disharmony in the area of international carriage of goods was a source of concern and that it was necessary to provide a certain legal basis to modern contract and transport practices. It was also observed that the carriage of goods by sea was increasingly part of a warehouse-to-warehouse operation and that factor should be borne in mind in conceiving future solutions. Approval was expressed for a concept of work that would extend beyond liability issues and would deal with the contract of carriage so as to facilitate the export-import operation, which included the relationship between the seller and the buyer (and possible subsequent buyers) as well as the relationship between the parties to the commercial transaction and providers of financing. It was recognized that such a broad approach would involve some re-examination of the rules governing the liability for loss of or damage to goods.

15. In the context of the thirty-third session of the Commission, in 2000, a transport law colloquium, organized jointly by the Secretariat and CMI, was held in New York on 6 July 2000. The purpose of the colloquium was to gather ideas and expert opinions on problems that arose in the international carriage of goods, in particular the carriage of goods by sea, identifying issues in transport law on which the Commission might wish to consider undertaking future work and, to the extent possible, suggesting possible solutions. It allowed a broad range of interested organizations and representatives of both carrier and shipper industry bodies to provide their views on possible areas where transport law was in need of reform.

16. A majority of speakers acknowledged that existing national laws and international conventions left significant gaps regarding issues such as the functioning of a bill of lading and a sea waybill, the relationship of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provided financing to a party to a contract of carriage. There was general consensus that, with the changes wrought by the development of multimodalism and the use of electronic commerce, the transport law regime was in need of reform to regulate all transport contracts, whether applying to one or more modes of transport and whether the contract was made electronically or in writing. Some issues raised for consideration in any reform process included formulating more exact definitions of the roles, responsibilities, duties and rights of all parties involved and clearer definitions of when delivery was assumed to occur; rules for dealing with cases where it was not clear at which leg of the carriage cargo had been lost or damaged; identifying the terms or liability regime that should apply as well as the financial limits of liability; and the inclusion of provisions designed to prevent the fraudulent use of bills of lading.

17. At that session, the Commission welcomed the fruitful cooperation between CMI and the Secretariat. Several statements were made to the effect that it was necessary throughout the preparatory work to involve other interested organizations, including those representing the interests of cargo owners. The Commission requested the Secretariat to

¹¹Ibid., para. 418.

continue to cooperate actively with CMI with a view to presenting, at the next session of the Commission, a report identifying issues in transport law on which the Commission might undertake future work.

18. It was noted with appreciation that a CMI International Subcommittee, in which all maritime law association members of CMI were invited to participate, had met four times during 2000 to consider the scope and possible substantive solutions for a future instrument on transport law. A number of other non-governmental organizations participated as observers in those meetings, including the Baltic and International Maritime Council, FIATA, ICC, ICS, the International Group of P&I Clubs and IUMI. The tasks of the Subcommittee, as laid down by CMI in consultation with the Secretariat, had been to consider in what areas of transport law that were not at present governed by international liability regimes greater international uniformity might be achieved; to prepare an outline of an instrument designed to bring about uniformity of transport law; and then to draft provisions to be incorporated into the proposed instrument, including provisions relating to liability. In addition, the Subcommittee was to consider how the instrument might accommodate other forms of carriage associated with carriage by sea. The draft outline instrument and a paper on door-to-door issues were discussed at a major CMI international conference held in Singapore from 12 to 16 February 2001. It was reported that, pursuant to the discussion at the conference, the Subcommittee would continue its work with a view to identifying solutions that were likely to attract agreement among the industries involved in the international carriage of goods by sea.

19. At its thirty-fourth session, in 2001, the Commission had before it a report of the Secretary-General (A/CN.9/497) that had been prepared pursuant to the request by the Commission.¹²

20. The report that was before the Commission summarized the considerations and suggestions that had resulted thus far from the discussions in the CMI International Subcommittee. The details of possible legislative solutions were not presented because they were currently being worked on by the Subcommittee. The purpose of the report was to enable the Commission to assess the thrust and scope of possible solutions and to decide on how it wished to proceed. The issues described in the report that would have to be dealt with in the future instrument included the scope of application of the instrument; the period of responsibility of the carrier; the obligations of the carrier; the liability of the carrier; the obligations of the shipper; transport documents; freight; delivery to the consignee; right of control of parties interested in the cargo during carriage; transfer of rights in goods; the party that had the right to bring an action against the carrier; and time bar for actions against the carrier.

21. The report suggested that consultations that the Secretariat had been conducting pursuant to the mandate it received from the Commission in 1996 indicated that work

could usefully commence towards an international instrument, possibly having the nature of an international treaty, that would modernize the law of carriage, take into account the latest developments in technology, including electronic commerce, and eliminate legal difficulties in the international transport of goods by sea that were identified by the Commission. Considerations of possible legislative solutions by CMI were making good progress and it was expected that a preliminary text containing drafts of possible solutions for a future legislative instrument, with alternatives and comments, would be prepared by December 2001.

22. After discussion, the Commission decided to consider the project in one of its working groups (to be named the "Working Group on Transport Law"). It was expected that the Secretariat would prepare for the Working Group a preliminary working document containing drafts of possible solutions for a future legislative instrument, with alternatives and comments, which was under preparation by CMI.

23. As to the scope of the work, the Commission, after some discussion, decided that the working document to be presented to the Working Group should include issues of liability. The Commission also decided that the considerations in the Working Group should initially cover port-to-port transport operations; however, the Working Group would be free to study the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations, and, depending on the results of those studies, recommend to the Commission an appropriate extension of the Working Group's mandate. It was stated that solutions embraced in the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991) should also be carefully taken into account. It was also agreed that the work would be carried out in close cooperation with interested intergovernmental organizations involved in work on transport law (such as the United Nations Conference on Trade and Development (UNCTAD), the Economic Commission for Europe (ECE) and other regional commissions of the United Nations and the Organization of American States (OAS)), as well as international non-governmental organizations.

24. The annex to the present note contains the possible draft solutions to be discussed at the meeting of the Working Group on Transport Law to be held in New York from 15 to 26 April 2002. It deals with all the issues the Commission had suggested the draft instrument should deal with. However, it does not deal with the issue of jurisdiction or arbitration, as it seems premature to consider those topics before some conclusions have been reached on the substantive solutions. It also takes into account the needs of electronic commerce, namely, the need to remove obstacles to electronic transactions. Indeed, it purports to apply to all contracts of carriage, including those concluded electronically. To reach that goal, the draft instrument is medium neutral as well as technology neutral. This means that it can be adapted to all types of systems, not only those based on a registry. It is drafted to suit systems operating in a closed environment (such as an Intranet), as well as those operating in an open environment (such as the Internet).

¹²Ibid., *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, paras. 319-345.

ANNEX

DRAFT INSTRUMENT ON TRANSPORT LAW

1. Throughout the present paper, the expression “Hamburg Rules” refers to the 1978 United Nations Convention on the Carriage of Goods by Sea; the expression “Hague Rules” refers to the 1924 International Convention for the Unification of Certain Rules of Law relating to Bills of Lading; and the expression “Hague-Visby Rules” refers to the Hague Rules as Amended by the Brussels Protocol of 23 February 1968.

1. DEFINITIONS

1. For the purposes of this instrument:

1.1 “Carrier” means a person that enters into a contract of carriage with a shipper.

2. This definition follows the same principle as laid down in the Hague-Visby Rules and the Hague Rules: the carrier is a contractual person. A carrier may have entered into the contract either on its own behalf and in its own name or through an employee or agent acting on its behalf and in its name. A carrier will typically perform all of its functions through such persons.

1.2 “Consignee” means a person entitled to take delivery of the goods under a contract of carriage or a transport document or electronic record.

3. This definition excludes a person who is entitled to take delivery of the goods on some other basis than the contract of carriage, for example, the true owner of stolen goods.

1.3 “Consignor” means a person that delivers the goods to a carrier for carriage.

4. A consignor may include the shipper, the person referred to in article 7.7 or somebody else who on their behalf or on their request actually delivers the goods to the carrier or to the performing party. See also the commentary to article 7.7.

1.4 “Container” includes any type of container, transportable tank or flat, swapbody, or any similar unit load used to consolidate goods, and any equipment ancillary to such unit load.

1.5 “Contract of carriage” means a contract under which a carrier, against payment of freight, undertakes to carry goods wholly or partly by sea from one place to another.

5. This definition includes carriage preceding or subsequent to carriage by sea if such carriage is covered by the same contract.

1.6 “Contract particulars” means any information relating to the contract of carriage or to the goods (including terms, notations, signatures and endorsements) that appears in a transport document or an electronic record.

1.7 Controlling party means the person that pursuant to article 11.2 is entitled to exercise the right of control.

1.8 “Electronic communication” means communication by electronic, optical, or digital images or by similar means with the result that the information communicated is accessible so as to be usable for subsequent reference. Communication includes generation, storing, sending and receiving.

1.9 “Electronic record” means information in one or more messages issued by electronic communication pursuant to a contract of carriage by a carrier or a performing party that:

(a) Evidences a carrier’s or a performing party’s receipt of goods under a contract of carriage; or

(b) Evidences or contains a contract of carriage;

or both.

It includes information attached or otherwise linked to the electronic record contemporaneously with or subsequent to its issue by the carrier or a performing party.

6. This definition should cover every type of system actual and future. It follows as much as possible the content of the definition of a transport document. It is apt to include information added after its issuance, for example, under article 11.2 (c)(iii). This will also cover an electronic signature logically associated with an electronic record as well as an electronic endorsement that could also be attached or otherwise logically associated with the electronic record.

1.10 “Freight” means the remuneration payable to a carrier for the carriage of goods under a contract of carriage.

1.11 “Goods” means the wares, merchandise and articles of every kind whatsoever that a carrier or a performing party received for carriage and includes the packing and any equipment and container not supplied by or on behalf of a carrier or a performing party.

7. This provision covers substantially the definitions of “goods” in the Hague-Visby Rules and Hamburg Rules. Carriage of goods on deck is dealt with in article 6.6 and live animals in article 17.2 (a).

1.12 “Holder” means a person that:

(a) Is for the time being in possession of a negotiable transport document or has the exclusive [access to] [control of] a negotiable electronic record; and

(b) Either:

(i) If the document is an order document, is identified in it as the shipper or the consignee, or is the person to whom the document is duly endorsed; or

(ii) If the document is a blank endorsed order document or bearer document, is the bearer thereof; or

(iii) If a negotiable electronic record is used, is pursuant to article 2.4 able to demonstrate that it has [access to] [control of] such record.

8. This definition may include the shipper, the consignee and any possible intermediate holder. An agent of any of these persons acting in its own name may be a holder. It may be considered whether paragraph (a) should require a holder to be in “lawful” possession of a negotiable transport document. Using the term “lawful” without specifying what is meant by “lawful” possession could, however, invite reference to national law, thus undermining uniformity. Specifying what is meant by “lawful” possession would greatly expand the scope of the draft instrument. In any event, paragraph (b)(i) largely addresses the underlying concern for order documents. For bearer documents, it was thought that there is no real problem in practice that needs to be addressed here. If a practical problem did exist, it would not concern bearer documents in a wrongdoer’s hands (a problem for

which other remedies exist) but documents in the hands of a good faith purchaser who claims through a wrongdoer. It is thought that such a good faith purchaser deserves protection and that those who choose to use bearer documents should recognize such risks.

9. It is believed that paragraph (b)(iii) adequately covers not only register-based systems but also systems using portable document format (PDF) in conjunction with other technology, systems giving access to the carrier database through a password or other security arrangement and other systems.

10. The words between brackets are meant as alternatives between which a choice has to be made in the light of ongoing developments. "Access" may have too technical a connotation and "control" a too legal one.

1.13 "Negotiable electronic record" means an electronic record:

- (i) That indicates, by statements such as "to order", or "negotiable", or other appropriate statements recognized as having the same effect by the law governing the record, that the goods have been consigned to the order of the shipper or to the order of the consignee, and is not explicitly stated as being "non-negotiable" or "not negotiable"; and
- (ii) Is subject to rules of procedure as referred to in article 2.4, which include adequate provisions relating to the transfer of that record to a further holder and the manner in which the holder of that record is able to demonstrate that it is such holder.

11. The words "referred to" ensure that the parties can simply incorporate by reference a rule book applicable to their systems, if any, rather than include the full text of the applicable procedures.

1.14 "Negotiable transport document" means a transport document that indicates, by wording such as "to order" or "negotiable" or other appropriate wording recognized as having the same effect by the law governing the document, that the goods have been consigned to the order of the shipper, to the order of the consignee, or to bearer, and is not explicitly stated as being "non-negotiable" or "not negotiable".

12. The purpose of this definition is to give indications for identifying a negotiable transport document by scrutinizing its face. Further indications already appear in the definition of "transport document" in article 1.20 below. The rules as to delivery under such a document appear in article 10.3.2. The rules as to transfer of such a document appear in article 12.1. Both of these rely on the definition of "holder" which appears in article 1.12.

13. The use of the word "negotiable" has been much discussed and it is undoubtedly true that in some countries the use of the word is not technically correct when applied to a bill of lading. One may consider to use the word "transferable" as being more neutral. The draft instrument uses the expression "negotiable" on the grounds that even if in some legal systems it is inaccurate, it is well understood internationally (as evidenced by the use of the word "non-negotiable" in article VI of the Hague Rules), and that a change of nomenclature might encourage a belief that a change of substance was intended.

1.15 Non-negotiable electronic record means an electronic record that does not qualify as a negotiable electronic record.

1.16 "Non-negotiable transport document" means a transport document that does not qualify as a negotiable transport document.

1.17 "Performing party" means a person other than the carrier that physically performs [or fails to perform in whole or in part] any of the carrier's responsibilities under a contract of carriage for the carriage, handling, custody or storage of the goods, to the extent that that person acts, either directly or indirectly, at the carrier's request or under the carrier's supervision or control, regardless of whether that person is a party to, identified in, or has legal responsibility under the contract of carriage. The term "performing party" does not include any person who is retained by a shipper or consignee, or is an employee, agent, contractor, or subcontractor of a person (other than the carrier) who is retained by a shipper or consignee.

14. There is a broad range of views on the "performing party" definition. At one end of the range, some favour including any party that performs any of the carrier's responsibilities under a contract of carriage if that party is working, directly or indirectly, for the carrier. It is felt that such a broad definition would bring into the draft instrument's coverage any person that could plausibly be a defendant in a tort, bailment or other non-contractual action when cargo was lost or damaged. It would thus achieve greater uniformity by reducing the number of actions that could be brought outside of the instrument. Such a broad definition might be drafted with the following language at the start of the first sentence: "A person that performs, undertakes to perform, or procures to be performed any of a contracting carrier's responsibilities under a contract of carriage, to the extent that . . .".

15. At the other end of the range, some advocate excluding the "performing party" definition entirely. In their view, such a definition is unnecessary because the defined "performing party" should be irrelevant under the draft instrument's substantive rules. It is argued that the draft instrument should govern relations only between the shipper and the carrier and that it should not govern relations between the shipper and those that are engaged, either directly or indirectly, by the carrier.

16. Between these two views at either end of the spectrum, any number of intermediate positions are possible. The two views that in discussion have been referred to most often are the relatively restrictive definition represented by the current text and a relatively inclusive definition that might be drafted with the following language at the start of the first sentence: "A person other than the carrier that performs or undertakes to perform any of the carrier's responsibilities under a contract of carriage for the carriage, handling, custody or storage of the goods, to the extent that . . .".

17. Both of these intermediate positions limit the "performing party" definition to those that are involved in the carrier's core responsibilities—carriage, handling, custody or storage of the goods. Thus, ocean carriers, inland carriers, stevedores, and terminal operators, for example, would be included under either "performing party" definition. In contrast, a security company that guards a container yard, an intermediary responsible only for preparing documents on the carrier's behalf and a shipyard that repairs a vessel (thus ensuring seaworthiness) on the carrier's behalf would not be included under either definition.

18. The difference between these two definitions is in the treatment of intermediate contractors. A basic hypothetical example may well illustrate the distinction. If, for instance, the non-vessel operating carrier (NVO) contracts to carry goods from a port in one country (Rotterdam, for example) to an inland city in another country (Ottawa, for example), it thus qualifies as the "carrier". Suppose that the NVO then contracts with an ocean carrier for the carriage from Rotterdam to a Canadian port and with a trucking company for the inland carriage. If the ocean carrier arranges to have the goods carried on a vessel belonging to a different ocean carrier that has been time chartered to the first ocean carrier and to

have that vessel loaded and unloaded by independent stevedores, then both ocean carriers and both stevedores are performing parties under the relatively inclusive definition, but only the second ocean carrier and the stevedores are performing parties under the relatively restrictive definition represented by the current text. Although the first ocean carrier “undertakes to perform” the ocean carriage, it does not “physically” perform the ocean carriage. Similarly, if the trucking company subcontracts with an independent driver that owns its own truck to carry the goods from the Canadian port to Ottawa, both the trucking company and the truck’s owner-driver are performing parties under the relatively inclusive definition, but only the truck’s owner-driver is a performing party under the relatively restrictive definition. Although the trucking company “undertakes to perform” the inland carriage, it does not “physically” perform the inland carriage.

19. All of the possibilities discussed here assume a functional definition, depending on whether a person is performing some of the carrier’s duties under the contract of carriage, without regard for any contractual formalities. Under the relatively restrictive definition represented by the current text, several separate contracts may intervene between the carrier and a performing party. Under the relatively inclusive definition, the class of “performing parties” would include not only the carrier’s immediate subcontractors but also the entire line of subsidiary persons that perform the contract (i.e., the subcontractor’s subcontractors, that party’s subcontractors, and so on down the line to the party that physically performs the carrier’s duties).

20. The second sentence of the definition clarifies that “performing parties” are only those that work, directly or indirectly, for the contracting carrier. If the consignor or consignee has an employee or agent performing a task that would otherwise be the carrier’s responsibility under the contract of carriage, that employee or agent would not thereby become a “performing party.”

21. The phrase “or fails to perform in whole or in part” is bracketed, as the Working Group may decide that it is not necessary. It may indeed be argued that a person that fails to perform a task that it was obligated to perform is already covered by the phrase “a person . . . that physically performs”. Conversely, it may be argued that a person that fails to perform a task does not “physically perform” and that the bracketed language is necessary to ensure that a person is treated as a “performing party” whether it performs its duties perfectly, performs its duties poorly, or fails to perform its duties at all.

1.18 “Right of control” has the meaning given in article 11.1.

1.19 “Shipper” means a person that enters into a contract of carriage with a carrier.

22. This definition mirrors the definition of “carrier”. The shipper is a contractual person who may have entered into the contract either on its own behalf and in its own name or through an employee or agent acting on its behalf and in its name. A shipper will typically perform all of its functions through such persons. The shipper may be the same person as the consignee, as is the case in many f.o.b. (“free on board”) sales. See also the commentary to article 7.7.

1.20 “Transport document” means a document issued pursuant to a contract of carriage by a carrier or a performing party that:

(a) Evidences a carrier’s or a performing party’s receipt of goods under a contract of carriage; or

(b) Evidences or contains a contract of carriage;

or both.

23. This definition should be read as preliminary to those of “negotiable transport document” and “non-negotiable transport document” in articles 1.14 and 1.16. Paragraph (a) would include a bill of lading issued to, and still in the possession of, a charterer, which does not evidence or contain a contract of carriage but functions only as a receipt, and some types of receipt issued before carriage or during trans-shipment. Paragraph (b) would include a bill of lading when operating as such, and a waybill.

2. ELECTRONIC COMMUNICATION

2.1 Anything that is to be in or on a transport document in pursuance of this instrument may be recorded or communicated by using electronic communication instead of by means of the transport document, provided the issuance and subsequent use of an electronic record is with the express or implied consent of the carrier and the shipper.

24. This provision lays down the general principle of equivalence between electronic and paper communication for the purpose of this draft instrument. Further, the emphasis is on the consent of the parties to communicate electronically.

25. It is felt that it is not necessary to mention the subsequent holder as well. By accepting the transfer of an electronic record a holder agrees to use electronic procedures; otherwise it could not become a holder.

2.2.1 If a negotiable transport document has been issued and the carrier and the holder agree to replace that document by a negotiable electronic record:

(a) The holder shall surrender the negotiable transport document, or all of them if more than one has been issued, to the carrier; and

(b) The carrier shall issue to the holder a negotiable electronic record that includes a statement that it is issued in substitution for the negotiable transport document;

whereupon the negotiable transport document ceases to have any effect or validity.

2.2.2 If a negotiable electronic record has been issued and the carrier and the holder agree to replace that electronic record by a negotiable transport document:

(a) The carrier shall issue to the holder, in substitution for that electronic record, a negotiable transport document that includes a statement that it is issued in substitution for the negotiable electronic record; and

(b) Upon such substitution, the electronic record ceases to have any effect or validity.

26. It is expected that for a certain period there is a need for a provision dealing with a switch between a paper document and its electronic equivalent and vice versa. This article sets out a substitution rule and provides that in the case of such substitution no concurrent documents could be in circulation.

2.3 The notices and confirmation referred to in articles 6.9.1, 6.9.2, 6.9.3, 8.2.1 (b) and (c), 10.2 and 10.4.2, the declaration in article 14.3 and the agreement as to weight in article 8.3.1 (c) may be made using electronic communication, provided the use of such means is with the express or implied consent of the party by whom it is communicated and of the party to whom it is communicated. Otherwise, it must be made in writing.

27. This article provides that all communications specifically provided for in this draft instrument may be made electronically provided that the parties to the communication so agree.

2.4 The use of a negotiable electronic record is subject to rules of procedure agreed between the carrier and the shipper or the holder mentioned in article 2.2.1. The rules of procedure shall be referred to in the contract particulars and shall include adequate provisions relating to:

- (a) The transfer of that record to a further holder;
- (b) The manner in which the holder of that record is able to demonstrate that it is such holder; and
- (c) The way in which confirmation is given that:
 - (i) Delivery to the consignee has been effected; or
 - (ii) Pursuant to articles 2.2.2 or 10.3.2 (i)(b), the negotiable electronic record has ceased to have any effect or validity.

28. In order to achieve equivalence between a paper negotiable document and an electronic negotiable record, the agreed rules governing the use of such a record have to include provisions relating to the typical “document of title” functions of the record. In paragraph (a) it is specified that the rules have to provide for “electronic endorsements” and in paragraph (b) that they have to provide for the electronic equivalency of the identification function of a paper document of title. (See also the definition of “holder” under article 1.13). In paragraph (c) it is provided that the manner in which it is confirmed that a record is exhausted has to be indicated in the agreed rules as well.

29. The words “referred to” in this provision ensure that the parties could simply incorporate by reference the agreed rules applicable to their systems rather than include the full text of the applicable procedures.

3. SCOPE OF APPLICATION

3.1 Subject to article 3.3.1, the provisions of this instrument apply to all contracts of carriage in which the place of receipt and the place of delivery are in different States if:

- (a) The place of receipt [or port of loading] specified either in the contract of carriage or in the contract particulars is located in a contracting State; or
- (b) The place of delivery [or port of discharge] specified either in the contract of carriage or in the contract particulars is located in a contracting State; or
- (c) [The actual place of delivery is one of the optional places of delivery specified either in the contract of carriage or in the contract particulars and is located in a contracting State; or]
- (d) [The contract of carriage is entered into in a contracting State or the contract particulars state that the transport document or electronic record is issued in a contracting State; or]
- (e) The contract of carriage provides that the provisions of this instrument, or the law of any State giving effect to them, are to govern the contract.

30. Historically, the application of transport conventions has been tied to the issuance of a particular type of transport document, such as a bill of lading. Over time, bills of lading have been increasingly replaced by other, often non-negotiable, documents. Moreover, with the growth of electronic commerce it may be anticipated that traditional documents, perhaps even the electronic records as defined in this draft instrument, will also become less relevant. The scope of application of this draft instrument has therefore been defined without reference to whether a transport document (of any type) is, or is to be, issued.

31. Views are divided as to whether the port of loading should be included in paragraph (a) as a place that invokes the application of the draft instrument. For port-to-port shipments, it is agreed that the port of loading should trigger the application of the draft instrument, but the port of loading would already be included as the place of receipt. For door-to-door shipments when the port of loading and the place of receipt are in the same State, it would also be unnecessary to mention both. For door-to-door shipments when the port of loading and the place of receipt are in different States, some object that the identity of the port of loading is an essentially random factor having no necessary connection with the overall (i.e., door-to-door) performance of the contract and that it should therefore not be included in paragraph (a). Nevertheless, it could also be argued that the identity of the port of loading is not a random factor when it is “specified either in the contract of carriage or in the contract particulars”. On the contrary, the identity of the port of loading is an essential aspect of a predominately maritime contract and should be included in a predominately maritime convention. Furthermore, including the port of loading in paragraph (a) would broaden the scope of application of the draft instrument and produce greater uniformity.

32. The debate on paragraph (b) as to whether the port of discharge should be included mirrors the debate on paragraph (a) concerning the inclusion of the port of loading.

33. Views are divided as to whether paragraph (c) should be included. Some object that it might be uncertain when the goods were received by the carrier whether the draft instrument would apply or not. Views are also divided as to whether paragraph (d) should be included. Paragraph (d) may give rise to some uncertainty as to where the contract of carriage was entered into or the electronic record issued.

34. Paragraph (e) is in accord with the provisions of article X of the Hague-Visby Rules, but concern has been expressed that paragraph (e) might have unintended consequences. Some fear that a charter-party, for example, might have a choice-of-law clause calling for the law of a country that had ratified the draft instrument and that this might have the effect not only of subjecting the charter-party to this draft instrument but also of invalidating specific clauses in the charter-party that were inconsistent with the draft instrument, notwithstanding the parties’ express agreement to those inconsistent terms. It is agreed that this result would be undesirable, but doubt has been expressed that this result would be likely under the current language in paragraph (e).

35. It has also been questioned how the courts would apply the reference to “the law of any State giving effect to them” in paragraph (e) if a State had enacted a national law based on the draft instrument that did not fully conform to the draft instrument.

3.2 The provisions of this instrument apply without regard to the nationality of the ship, the carrier, the performing parties, the shipper, the consignee or any other interested parties.

36. In order to avoid any doubt, this provision lists certain factors that might otherwise have been thought relevant but that are instead explicitly made irrelevant for determining the application of this draft instrument.

3.3.1 The provisions of this instrument do not apply to charter-parties, [contracts of affreightment, volume contracts or similar agreements].

37. The wide applicability of this draft instrument under article 3.1 implies that certain exceptions should be made. Some contracts may qualify as “contracts of carriage” for which it is neither necessary nor desirable to apply mandatory law. Moreover, some provisions of this draft instrument may be less suitable

for application to certain contracts of carriage. Charter-parties, for example, have long been excluded from mandatory law. Wide-spread support exists for similarly excluding contracts of affreightment, volume contracts, towage contracts and similar agreements. But opinions are divided as to whether the term “charter-parties” should be defined and as to the extent to which other similar contracts should also be excluded.

38. Efforts to define charter-parties have led to discussions for a long time. The lack of a definition in prior conventions has not caused great difficulties in practice and some argue that it might be risky to attempt a definition at a time when commercial practices are changing rapidly. Others feel that a definition is necessary because the charter-party exclusion is assuming increased importance in the draft instrument.

39. If it is ultimately concluded that a definition is necessary, something along the following lines might be suitable: “contracts for the [use] [disposal] [provision] of a ship, or part thereof, to be employed in the carriage of goods, whether on time or voyage basis, such as a charter-party, or a slot or space charter.” The three bracketed terms, “[use] [disposal] [provision]” are meant as alternatives. One of the three should be chosen.

40. The issue as to the exclusion of other similar contracts is unresolved. Although there is general support for the proposition that some contracts similar to charter-parties should receive the same treatment as charter-parties, it remains unclear how far the exclusion should be extended. Towage contracts were first mentioned fairly late in the consultation process and thus they are mentioned only here in the commentary rather than in the draft text.

41. One suggestion is to extend charter-party treatment to modern equivalents of the charter-party, such as slot charters and space charters, but to recognize a different sort of freedom of contract for negotiated contracts between sophisticated parties that less closely resemble traditional charter-parties, such as contracts of affreightment and volume contracts. The suggestion has been made that contracts of affreightment and volume contracts should be subject to the draft instrument as a default rule, but that the parties to those contracts should have the freedom to derogate from the terms of the draft instrument. Such derogations, however, would only be binding on the immediate parties to the contract. Transport documents issued under those contracts would still need to comply with the terms of the draft instrument when they are passed to a third party who is not bound by the original parties’ agreement.

42. If it is ultimately concluded that a definition of these additional terms is necessary, something along the following lines might be suitable: “A volume contract is a written contract between one or more shippers and one or more carriers in which the shipper or shippers agree to provide a certain volume or portion of cargo over a fixed period of time and the carrier or carriers agree to a certain freight rate or rate schedule and service level. A towage contract is a contract for the towing or pushing of floating objects, whether on time or voyage basis.”

43. Some consider that it would be valuable to stress that in cases in which the draft instrument does not apply as a matter of law it would still be open to the parties to incorporate the terms of the draft instrument into their agreement as a matter of contract. This contractual incorporation could be done in whole (incorporating the entire draft instrument) or in part (incorporating selected provisions of the draft instrument).

3.3.2 Notwithstanding the provisions of article 3.3.1, if a negotiable transport document or a negotiable electronic record is issued pursuant to a charter-party, [contract of affreightment, volume contract or similar agreement], then the

provisions of this instrument apply to the contract evidenced by or contained in that document or that electronic record from the time when and to the extent that the document or the electronic record governs the relations between the carrier and a holder other than the charterer.

44. Whether the bracketed language is included in this provision will turn on whether similar bracketed language is included in article 3.3.1. If the bracketed language is included, then the reference to the “charterer” at the end of the article will need to be redrafted. Including volume contracts in this provision may make article 3.4 unnecessary.

3.4 If a contract provides for the future carriage of goods in a series of shipments, the provisions of this instrument apply to each shipment to the extent that articles 3.1, 3.2 and 3.3 so specify.

45. This provision may need to be revised or deleted in light of the resolution of the issue discussed in the commentary to article 3.3.1.

4. PERIOD OF RESPONSIBILITY

4.1.1 Subject to the provisions of article 4.3, the responsibility of the carrier for the goods under this instrument covers the period from the time when the carrier or a performing party has received the goods for carriage until the time when the goods are delivered to the consignee.

4.1.2 The time and location of receipt of the goods is the time and location agreed in the contract of carriage or, failing any specific provision relating to the receipt of the goods in such contract, the time and location that is in accordance with the customs, practices or usages in the trade. In the absence of any such provisions in the contract of carriage or of such customs, practices or usages, the time and location of receipt of the goods is when and where the carrier or a performing party actually takes custody of the goods.

46. Because of their legal consequences, it is considered important that the beginning and the end of the period of responsibility of the carrier should be specified as precisely as possible.

47. The provision emphasizes that receipt is primarily a contractual matter. As an example, if it is agreed that the carrier will receive a cargo of oil “when passing ship’s manifolds”, then the responsibility of the carrier for the oil starts at such place and point in time. Of course, often the agreed place and time of delivery of the goods to the carrier and their actual taking into custody will coincide. But they may differ, in which case the agreed time and place prevails. When no express or implied agreement has been made about the time and place of receipt, but certain customs, practices or usages of the trade, including those at the place of receipt, exist, then such customs, practices or usages apply. If no agreement, customs, practices or usages are applicable a general fall-back provision applies. In such case, the actual taking of the goods into the custody of the carrier is the relevant time and place of receipt.

4.1.3 The time and location of delivery of the goods is the time and location agreed in the contract of carriage, or, failing any specific provision relating to the delivery of the goods in such contract, the time and location that is in accordance with the customs, practices or usages in the trade. In the absence of any such specific provision in the contract of carriage or of such customs, practices or usages, the time and location of delivery is that of the discharge or unloading of the goods from the final vessel or vehicle in which they are carried under the contract of carriage.

48. Articles 4.1.2 and 4.1.3 together secure that when “tackle-to-tackle” transport is agreed (as will often be the case in bulk trades), the responsibility of the carrier does not extend beyond tackle.

4.1.4 If the carrier is required to hand over the goods at the place of delivery to an authority or other third party to whom, pursuant to law or regulation applicable at the place of delivery, the goods must be handed over and from whom the consignee may collect them, such handing over will be regarded as a delivery of the goods by the carrier to the consignee under article 4.1.3.

[4.2.1 Carriage preceding or subsequent to sea carriage

Where a claim or dispute arises out of loss of or damage to goods or delay occurring solely during either of the following periods:

(a) From the time of receipt of the goods by the carrier or a performing party to the time of their loading on to the vessel;

(b) From the time of their discharge from the vessel to the time of their delivery to the consignee;

and, at the time of such loss, damage or delay, there are provisions of an international convention that:

- (i) According to their terms apply to all or any of the carrier’s activities under the contract of carriage during that period, [irrespective of whether the issuance of any particular document is needed in order to make such international convention applicable]; and
- (ii) Make specific provisions for carrier’s liability, limitation of liability, or time for suit; and
- (iii) Cannot be departed from by private contract either at all or to the detriment of the shipper;

such provisions, to the extent that they are mandatory as indicated in (iii) above, prevail over the provisions of this instrument.]

[4.2.2 Article 4.2.1 applies regardless of the national law otherwise applicable to the contract of carriage.]

49. The great majority of contracts of carriage by sea include land carriage, whether occurring before or after the sea leg or both. It is necessary therefore to make provision for the relationship between this draft instrument and conventions governing inland transport that may apply in some (particularly European) countries. This article deals with that problem, and provides for a network system, but one as minimal as possible. The draft instrument is only displaced where a convention that constitutes mandatory law for inland carriage is applicable to the inland leg of a contract for carriage by sea and it is clear that the loss or damage in question occurred solely in the course of the inland carriage. This means that where the damage occurred during more than one leg of the carriage, or where it cannot be proved where the loss or damage occurred, this draft instrument will prevail during the whole door-to-door transit period.

50. The draft instrument leaves it open for countries adhering to it to exclude it wholly or in part from the inland carriage by giving any future international convention mandatory status, whether for a particular mode of inland transport or for the inland part of any contract for carriage by sea that includes such transport. It could also be argued that provisions of the national law of a contracting State relating to inland carriage should prevail over

the corresponding provisions of this draft instrument, but this would further restrict the uniform applicability of the draft instrument.

51. The essence of such a network system is that the provisions mandatorily applicable to inland transport apply directly to the contractual relationship between the carrier on the one hand and the shipper or consignee on the other. If the inland transport has been subcontracted by the carrier, they apply to the relation between carrier and subcarrier also. But in respect of the first relationship the provisions of this draft instrument may supplement the provisions mandatorily applicable to the inland transport; whereas as between carrier and subcarrier the inland provisions are alone relevant (supplemented as necessary by any applicable national law). If a cargo claim is directed by a third party against a performing party by virtue of the provisions of article 6.3.1, that party is liable to the claimant in the same way as the carrier, that is to say, under the provisions of this draft instrument, subject to mandatory provisions governing the inland leg of the transport.

52. It should also be noted that the proposed limited network system only applies to provisions directly relating to the liability of the carrier, including limitation and time for suit. Provisions in other conventions that may indirectly affect liability, such as jurisdiction provisions, should not be affected. Also, many other legal provisions mandatorily applicable to inland transport are not supposed to be replaced by this draft instrument because they are directed specifically to inland transport rather than to a contract involving carriage by sea. Two examples may be given. The first is the requirements of the 1956 Convention on the Contract for the International Carriage of Goods by Road relating to the consignment note. These may apply between the carrier and the subcarrier, but their application to the main contract of carriage regulated by this draft instrument would be inconsistent with the document (or electronic record) required by this draft instrument for the whole journey. The second example is the provisions of that Convention relating to the right to give instructions to the carrier (arts. 12-14). These again can only be applied to the relation between the carrier and the sub-carrier (in which relation the carrier is the “sender”): for the main contract of carriage, chapter 11 of this draft instrument must apply.

53. For the limited network system to apply, the damage must have occurred during the pre-carriage or on-carriage. In this respect a choice can be made between the place where the damage is caused, where it occurs and where it is detected. The time of detection is often after delivery and, thus, would not produce a balanced result. The place where the damage is caused may be before the voyage begins, for example, in the case of damage caused by the shipper having the cargo badly stowed in a container. The most serious objection against using the place where the damage is caused is that the question of proper causation according to the applicable law has to be resolved before it can be determined whether the provisions of this draft instrument or of another convention are applicable. The place where a damage has occurred is a factual matter, is usually relatively easy to establish and may be expected to produce fair results. Therefore, the place of occurrence is suggested as the proper choice within the scope of the network system and article 4.2.1 so provides.

54. It is intended that article 4.2.2 should make article 4.2.1 mandatory whatever law governs the contract of carriage (as under article 7.2 of the Rome Convention on the Law Applicable to Contractual Obligations). As an example may be taken a contract of carriage from Singapore to Antwerp, Belgium, under which the goods are to be shipped through a Dutch port of discharge, Rotterdam, and carried thence by land. The contract is governed by Singaporean law, whether by express choice of the parties or by operation of other principles of the conflict of laws.

Before a court in a country adhering to this draft instrument, Singapore law would be displaced to the extent that mandatory provisions of an international convention governing road haulage, also adopted by that country, are applicable to the inland leg of the journey.

55. The bracketed language in article 4.2.1 (i) reflects the situation under the 1980 Convention concerning International Carriage by Rail, where the applicability of the Convention is tied to the issue of a rail waybill.

4.3 Mixed contracts of carriage and forwarding

4.3.1 The parties may expressly agree in the contract of carriage that in respect of a specified part or parts of the transport of the goods the carrier, acting as agent, will arrange carriage by another carrier or carriers.

4.3.2 In such event the carrier shall exercise due diligence in selecting the other carrier, conclude a contract with such other carrier on usual and normal terms, and do everything that is reasonably required to enable such other carrier to perform duly under its contract.

56. This is the first of several articles in which it is provided that the parties may “expressly agree” on some issues. This phrase implies something beyond a pre-printed clause in the standard terms and conditions in the fine print on the back of a transport document (or the electronic equivalent). Rather, there should be some indication that the issue was the subject of discussion between the parties and that each party in fact agreed to it. At the very least, a term that has been “expressly agreed” (both under this article and under other articles in which the same phrase is employed) should be stated separately on the transport document or electronic record. For example, declarations of higher value for the purpose of avoiding package limitations of current conventions are customarily indicated in a separate box on the face of the bill of lading. Similar treatment would be appropriate in this context.

57. These mixed contracts are a common feature in the liner trade. However, their legal character is not always well understood and, in practice, many create ambiguities. They may refer to “connecting carrier” arrangements. Such arrangements may apply where a carrier is able to carry out only part of the voyage with a vessel under its own control and has agreed with the shipper to take care that the other part(s) are carried out by other carrier(s) with whom it may have an arrangement to do so. Occasionally the connecting carrier may be an inland carrier.

58. Article 4.3.1 is intended to make clear that this type of contract is perfectly legitimate. If a transport document or an electronic record is issued, the mixed character must be reflected in such document or record, so as to protect third parties relying on the contents of such documents or records. Article 4.3.2 puts some basic obligations on the carrier, when acting in its capacity as agent, and is meant to protect the shipper and/or the consignee.

5. OBLIGATIONS OF THE CARRIER

5.1 The carrier shall, subject to the provisions of this instrument and in accordance with the terms of the contract of carriage, carry the goods to the place of destination and deliver them to the consignee.

59. This provision states the basic obligation of the carrier. The reference to the provisions of this instrument makes clear that the terms of the contract do not stand alone.

5.2.1 The carrier shall during the period of its responsibility as defined in article 4.1, and subject to article 4.2, properly and carefully load, handle, stow, carry, keep, care for and discharge the goods.

5.2.2 The parties may agree that certain of the functions referred to in article 5.2.1 shall be performed by or on behalf of the shipper, the controlling party or the consignee. Such an agreement must be referred to in the contract particulars.

5.3 Notwithstanding the provisions of articles 5.1, 5.2 and 5.4, the carrier may decline to load, or may unload, destroy or render goods harmless or take such other measures as are reasonable if goods are, or reasonably appear likely during its period of responsibility to become, a danger to persons or property or an illegal or unacceptable danger to the environment.

5.4 The carrier is bound, before, at the beginning of [and during] the voyage by sea, to exercise due diligence to:

(a) Make [and keep] the ship seaworthy;

(b) Properly man, equip and supply the ship;

(c) Make [and keep] the holds and all other parts of the ship in which the goods are carried, including containers where supplied by the carrier, in or upon which the goods are carried fit and safe for their reception, carriage and preservation.

5.5 Notwithstanding the provisions of articles 5.1, 5.2 and 5.4, the carrier in the case of carriage by sea [or by inland waterway] may sacrifice goods when the sacrifice is reasonably made for the common safety or for the purpose of preserving other property involved in the common adventure.

60. The above provisions state the obligations of the carrier as positive duties and are similar in effect to articles II and III, rule 1, of the Hague and Hague-Visby Rules. A body of opinion exists that the general liability regime of article 6.1 below makes a positive provision such as this unnecessary, but the majority view has favoured the retention of such a provision. It spells out not only the carrier's obligations with regard to the carriage, but also those with respect to the ship, which are consistent with its public law obligations regarding safety and the preservation of the environment. Including such a provision would also preserve the benefit of much existing case law.

61. As regards article 5.4 the words in square brackets “and during” “and keep”, if inserted, would make the seaworthiness duty continuous throughout the voyage, which is not so under the Hague and Hague-Visby Rules. The change has received support on the basis that it would seem somewhat out of tune with the International Management Code for the Safe Operation of Ships and for Pollution Prevention and safe shipping requirements for the law to be stated otherwise. Some think however that if the ship becomes unseaworthy during the voyage, the duty to put matters right may, depending on the circumstances, be part of the duty to care for the goods, already contained in article 5.2.1; this is particularly so if the defence of nautical fault is abolished (as to which see below). It is also said that a continuing duty may impose harsh and sometimes impracticable duties on the carrier while at sea and hence significantly broaden its responsibilities and that it would also require the generating of new case law to work out its meaning and implications.

62. As regards containers, the wide definition in article 1.4 should be borne in mind.

63. Article 5.2.2 is intended to make provision for FIO(S) (free in and out and free in and out, stowed) clauses and the like, which are rare in the liner trade but common in the charter-party trade. The applicability of this draft instrument to negotiable transport documents issued under a charter-party makes this provision desirable.

64. The provision as to sacrifice in article 5.5 is confined to sea (or water) transport because the notion of sacrifice for the preservation of the common adventure is a maritime one, linking with general average. The opinion has been expressed that it is not necessary to deal with this point in the draft instrument.

65. There has been a proposal for a specific provision requiring carriers in refrigerated trades to make available temperature data on request. It was thought that this was too specific for a general instrument such as this. If it were to be thought appropriate it might be considered in connection with article 6.9.4.

6. LIABILITY OF THE CARRIER

6.1 Basis of liability

6.1.1 The carrier is liable for loss resulting from loss of or damage to the goods, as well as from delay in delivery, if the occurrence that caused the loss, damage or delay took place during the period of the carrier's responsibility as defined in article 4, unless the carrier proves that neither its fault nor that of any person referred to in article 6.3.2 (a) caused or contributed to the loss, damage or delay.

66. This provision constitutes the basic rule of liability. The overall result is similar to that of article 5.1 of the Hamburg Rules and the technique to that of article IV, rule 2 (q) of the Hague Rules. The actual wording is however not the same as either.

67. The Hamburg Rules require that the carrier prove that it, its servants or agents took all measures that could reasonably be required to avoid the occurrence and its consequences. Article IV, rule 2 (q), of the Hague Rules requires that the carrier show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage. This article refers to the fault of the carrier itself or that of persons performing its functions, the latter being incorporated by the reference to article 6.3.

68. The question of the carrier's liability for delay is provided for and commented on under article 6.4.

6.1.2 [Notwithstanding the provisions of article 6.1.1 the carrier is not responsible for loss, damage or delay arising or resulting from:

(a) Act, neglect or default of the master, mariner, pilot or other servants of the carrier in the navigation or in the management of the ship;

(b) Fire on the ship, unless caused by the fault or privity of the carrier.]

69. These are the first two of the carrier's traditional exceptions, as provided in the Hague and Hague-Visby Rules. There is considerable opposition to the retention of either. As regards paragraph (a) there is little support for the "management" element, which is simply productive of disputes as to the difference between management of the ship and the carrier's normal duties as to care and carriage of the goods. The general exception is however justified by some on the basis that, should it be removed, there would be a considerable change to the existing position regarding spreading of the risks of sea carriage, which would of course have an impact on the insurance position. It would not be possible to retain this exception as part of the modified "presumption" regime which is set out in article 6.1.3 below, since it is a direct exoneration for negligence: it must either be an exoneration or be deleted. The exception is therefore preserved here in its original form to make the position clear.

70. There is also a view that even if this exception is removed, an exception should remain for "act, neglect or default of a

compulsory pilot in the navigation of the ship", on the ground that this covers a situation in which the carrier can justifiably feel aggrieved at being expected to answer. Such an exception would most naturally be a genuine exoneration. It could alternatively be included under the presumption regime set out below, though since by its wording it relates to loss caused not by the negligence of the carrier it would be slightly less appropriate there.

71. As regards paragraph (b), the Hague and Hague-Visby Rules not only reduce the circumstances in which the carrier might be liable in respect of fire (by requiring actual fault or privity and probably also some form of management failure by the carrier) but can also be taken to impose a burden of proof on the claimant. The Hamburg Rules do not appear to require management failure but specifically impose the burden of proof on the claimant. The above provision follows the Hague and Hague-Visby Rules. The fire exception has however been modified to make clear that the fire must be on the carrying vessel: the Hague and Hague-Visby Rules wording gives no indication in that respect.

72. The exception is usually justified on the ground that accidents by fire raise serious problems of proof and it is preserved here in its Hague and Hague-Visby Rules form in view of that opinion. It is not however necessary that this exception appear as a direct exoneration: the phrase "fire on the vessel" could if desired be placed within the events listed under the "presumption" regime set out below for the remaining Hague and Hague-Visby Rules excepted perils. That would necessitate removing the restriction to the actual fault or privity of the carrier. The result would then be very similar to that created by the Hamburg Rules by reason of the conjoined effect of article 6.3.2, under which the carrier is responsible for the acts of those carrying out its responsibilities under its control. The claimant's burden of proof would not be increased.

73. It is of course possible to take the view that no special exception is required and that fire can be dealt with under the general rule of article 6.1.1.

6.1.3 Notwithstanding the provisions of article 6.1.1, if the carrier proves that loss of or damage to the goods or delay in delivery has been caused by one of the following events it is presumed, in the absence of proof to the contrary, that neither its fault nor that of a performing party has caused or contributed to cause that loss, damage or delay.

74. This provision represents a much modified (but in some respects extended) version of most of the remaining excepted perils of the Hague and Hague-Visby Rules: in particular they appear here only as presumptions. The consultations indicated a division of opinion as to whether the traditional excepted perils should be retained as exonerations from liability or whether they should appear (insofar as possible) as presumptions only. The basis for the second approach is that certain events are typical of situations where the carrier is not at fault and that it is justifiable, where the carrier proves such an event, for the burden of proof to be reversed.

75. A body of opinion would however prefer to retain all the excepted perils, whether with or without the nautical fault exception, as genuine exonerations, that is, exceptions from liability. Certainly the nautical fault exception would only be effective as such and it is for that reason preserved in article 6.1.2 above as a direct exoneration.

76. Another view is that since most of the exceptions are usually interpreted as not applying where the carrier is negligent, there is not a great deal of difference in practice between the two approaches.

77. A quite different approach however is that the exceptions should be deleted completely, since the events to which they refer are covered by the general principle of liability. This is opposed on the grounds that in some countries the complete deletion of the catalogue might be taken by judges inexperienced in maritime law as indicating an intention to change the law. It is said that even if the list is not needed in some countries, it is useful in others and does no harm in those countries that do not need it.

78. For expository purposes the matters concerned are referred to in this commentary as “exceptions”, though there is obviously a substantial difference, in theory at least, between them as exonerations and as events raising a presumption only. What follows is therefore a new presentation of the exceptions (mostly, but not all, the traditional ones) as part of a presumption-based regime. In accordance with a view frequently expressed in the consultations, these exceptions are listed in approximately the familiar order in which they appear in the Hague and Hague-Visby Rules. Their preservation can be justified in part on the basis that they have generated valuable case law over the decades since 1924.

79. It has been mentioned above that many of the exceptions are usually interpreted as only applicable where the carrier has not been negligent in incurring the excepted peril. But there are at least two other exceptions that are, at least in some jurisdictions, specifically defined in terms requiring the absence of negligence on the carrier’s part. They are an act of God and perils of the sea. To establish these excepted perils at present, it would, at least in some jurisdictions, be necessary for the carrier to prove by way of defence that it was not negligent in getting into the situation involved. Both an act of God and a peril of the sea can be defined as acts occurring without a carrier’s negligence that could not reasonably have been guarded against. To define them for a “presumption” regime without reference to absence of fault is not so easy. New definitions might have to be evolved, referring only to serious external events that could raise a (rebuttable) presumption of non-liability. This might involve loss of existing case law in some jurisdictions. For this reason these two perils are listed in brackets at the end. They would not sit well in a presumption-based regime and it seems likely that situations that might attract either of them could fairly easily be dealt with under the basic rule of article 6.1.1.

- (i) [Act of God], war, hostilities, armed conflict, piracy, terrorism, riots and civil commotions;

80. These are basically traditional exceptions, but “hostilities, armed conflict, piracy and terrorism” have been added to expand on the word “war”, which might or might not at present be interpreted to cover some of the other matters. They will of course require interpretation. “Act of God” appears in brackets because, though traditional, it is usually defined by reference to the absence of negligence, which means that, as suggested above, it does not sit easily as creating a presumption.

- (ii) Quarantine restrictions; interference by or impediments created by Governments, public authorities rulers or people [including interference by or pursuant to legal process];

81. This is a survival of the old “restraint of princes” exception. There may be doubt as to what the phrase “public authorities” is taken to cover in various countries. It may therefore be prudent to retain a reference to judicial restraints.

- (iii) Act or omission of the shipper, the controlling party or the consignee;

82. “Controlling party” is defined in article 1.7.

- (iv) Strikes, lock-outs, stoppages or restraints of labour;
- (v) Saving or attempting to save life or property at sea;

- (vi) Wastage in bulk or weight or any other loss or damage arising from inherent quality, defect or vice of the goods;
- (vii) Insufficiency or defective condition of packing or marking;

83. The English version of the Hague Rules used the words “insufficiency or inadequacy” (French “*imperfection*”). The words “defective condition” may make it clearer that the provision covers marks that fade, are washed out in rain, etc.

- (viii) Latent defects not discoverable by due diligence;

84. The meaning of this Hague Rules exception is notoriously unclear. In particular, it gives no indication as to in what the defect must be, whether in the ship, the goods or shore equipment. It appears that in some jurisdictions reliance on it may have advantages connected with the burden of proof. The matter could be clarified by referring to the ship, its apparatus and equipment.

- (ix) Handling, loading, stowage or unloading of the goods by or on behalf of the shipper, the controlling party or the consignee;

85. The purpose of this provision, which is new, is to make provision for situations where article 5.2.2 permits functions to be performed by these parties.

- (x) Acts of the carrier or a performing party in pursuance of the powers conferred by articles 5.3 and 5.5 when the goods have been become a danger to persons, property or the environment or have been sacrificed;
- [(xi) Perils, dangers and accidents of the sea or other navigable waters.]

86. If the exceptions are retained as exonerations this provision should be restored somewhere nearer its original position as exception (iii). If however the presumption technique is adopted, for the reasons given above it is doubtful whether this exception could effectively be retained at all.

87. Most of the above exceptions relate to carriage by sea. It is for consideration whether further exceptions should be introduced to cover typical incidents of land carriage or whether these would be adequately dealt with by the general provision in article 6.1.1.

6.1.4 [If loss, damage or delay in delivery is caused in part by an event for which the carrier is not liable and in part by an event for which the carrier is liable, the carrier is liable for all the loss, damage or delay in delivery except to the extent that it proves that a specified part of the loss was caused by an event for which it is not liable.]

[If loss, damage or delay in delivery is caused in part by an event for which the carrier is not liable and in part by an event for which the carrier is liable, then the carrier is:

(a) Liable for the loss, damage or delay in delivery to the extent that the party seeking to recover for the loss, damage, or delay proves that it was attributable to one or more events for which the carrier is liable; and

(b) Not liable for the loss, damage or delay in delivery to the extent the carrier proves that it is attributable to one or more events for which the carrier is not liable.

If there is no evidence on which the overall apportionment can be established, then the carrier is liable for one half of the loss, damage or delay in delivery.]

88. These alternative provisions deal with concurrent and consecutive causes of damage and apply regardless of whether any of

the provisions of articles 6.1.2 and 6.1.3 are adopted: a provision would be required even if article 6.1.1 formed the sole liability regime.

89. The first alternative is intended to be much the same in effect as article 5.7 of the Hamburg Rules (as well as current law in many countries), but it has been sought to simplify the wording and make clear where the burden of proof lies.

90. The second alternative is intended to introduce an entirely new approach in which the burden of proof is shared and each party bears the risk of non-persuasion in certain respects. The consultation process revealed some support for such a new approach. Most significantly, the second alternative would relieve the carrier of the burden of having to prove a negative. Several delegates and industry representatives report that the practical effect of the current regimes that are similar to the first alternative is to impose full liability on the carrier whenever there are multiple causes of loss or damage.

91. The final sentence at the end of the second alternative is a fall-back provision to cover the rare situations in which adequate proof is lacking. It is intended as a last resort when a court is entirely unable to apportion the loss. Such a provision would be unnecessary under the first alternative. The fall-back rule under the first alternative would be to impose full liability on the carrier whenever the carrier is unable to discharge its burden of proof.

6.2 Calculation of compensation

6.2.1 If the carrier is liable for loss of or damage to the goods, the compensation payable shall be calculated by reference to the value of such goods at the place and time of delivery according to the contract of carriage.

6.2.2 The value of the goods shall be fixed according to the commodity exchange price or, if there is no such price, according to their market price or, if there is no commodity exchange price or market price, by reference to the normal value of the goods of the same kind and quality at the place of delivery.

6.2.3 In case of loss of or damage to the goods and save as provided for in article 6.4, the carrier shall not be liable for payment of any compensation beyond what is provided for in articles 6.2.1 and 6.2.2.

92. This provision follows the principle apparently reflected in the Hague-Visby Rules, article IV, rule 5 (b). It clarifies what is believed to be the intention of the Hague-Visby language to include a decrease in the value of the goods and to exclude consequential damages. Loss or damage due to delay is dealt with in article 6.4.

6.3 Liability of performing parties

6.3.1 (a) A performing party is subject to the responsibilities and liabilities imposed on the carrier under this instrument and entitled to the carrier's rights and immunities provided by this instrument (i) during the period in which it has custody of the goods; and (ii) at any other time to the extent that it is participating in the performance of any of the activities contemplated by the contract of carriage.

(b) If the carrier agrees to assume responsibilities other than those imposed on the carrier under this instrument, or agrees that its liability for the delay in delivery of, loss of or damage to or in connection with the goods is higher than the limits imposed under articles 6.4.2, 6.6.4 and 6.7, a performing party is not bound by this agreement unless the performing party expressly agrees to accept such responsibilities or such limits.

93. Paragraph (a) imposes liability on "performing parties": those that perform the carrier's core obligations under the contract of carriage. This provision does not define the extent of the performing parties' liability. That is determined under other provisions. In particular, the extent of the liability is specified in part by article 4.2, which establishes a "network" system that also applies to performing parties (such as inland carriers).

94. It is important to distinguish the performing party's liability from the carrier's liability. The carrier is liable (subject to the terms of this draft instrument) under the contract of carriage for the entire period of responsibility under article 4.1. A performing carrier, in contrast, is not liable under the contract of carriage and under this draft instrument it is not liable in tort. In return for escaping liability in tort, the performing carrier assumes liability under the draft instrument during the period it has custody of the goods or when it is otherwise participating in the performance of the contract of carriage. The burden is on the cargo claimant to show that the loss or damage occurred under circumstances that are sufficient to impose liability on the relevant performing party.

95. Paragraph (b) provides that each performing party is entitled to its own liability determination. A carrier's agreement to assume higher liability (an agreement for which the carrier alone has presumably been compensated) does not bind a performing party that did not assume the same agreement. Thus, a performing party may safely rely on the terms of this draft instrument in the absence of its own express agreement to the contrary.

96. Views have been expressed that this article should be deleted and that claims under the draft instrument should be directed solely to the carrier with which the shipper contracted. According to a different view, however, the performing party should be separately defined under this instrument and its liability should be limited to the part of the carriage that it performed.

97. The principal debate on this provision is reflected in the "performing party" definition. Those who argue for a broader liability regime favour a more inclusive definition of "performing party," while those who argue for a narrower liability regime favour a more restrictive definition. The basic hypothetical example in the commentary to article 1.17 once again provides a useful illustration. Those who argue for a broader liability regime contend that the trucking company that subcontracts its obligations to an independent owner-driver should be liable directly to the cargo claimant if the truck's owner-driver negligently damages the cargo. The trucking company would be liable to the carrier under its contract and thus the cargo claimant could reach the trucking company indirectly (unless the carrier could not be sued for some reason). In many jurisdictions, the trucking company would also be liable to the cargo claimant directly in tort. Providing a direct action under this draft instrument would simplify the process, better protect the cargo claimant's interests and achieve greater uniformity. Those who argue for a narrower liability regime contend that the trucking company that subcontracts its obligations to an independent owner-driver should not be liable under this draft instrument. A consignee that seeks to recover for damage negligently caused by the truck's owner-driver should be able to recover only from the NVOCC that entered into the contract of carriage or from the negligent owner-driver. Protecting the trucking company that entrusted the cargo to the negligent owner-driver protects the independence of its subcontract with the carrier.

6.3.2 (a) Subject to article 6.3.3, the carrier is responsible for the acts and omissions of:

- (i) Any performing party; and
- (ii) Any other person, including a performing party's subcontractors and agents, who performs or undertakes to perform any of the carrier's responsibilities under the contract

of carriage, to the extent that the person acts, either directly or indirectly, at the carrier's request or under the carrier's supervision or control,

as if such acts or omissions were its own. A carrier is responsible under this provision only when the performing party's or other person's act or omission is within the scope of its contract, employment or agency;

(b) Subject to article 6.3.3, a performing party is responsible for the acts and omissions of any person to whom it has delegated the performance of any of the carrier's responsibilities under the contract of carriage, including its subcontractors, employees and agents, as if such acts or omissions were its own. A performing party is responsible under this provision only when the act or omission of the person concerned is within the scope of its contract, employment.

98. Article 6.3.2 confirms that the carrier is responsible for the acts and omissions of all those who work under it (when they act within the scope of their contract, employment or agency, as the case may be). A performing party is similarly responsible for the acts and omissions of all those who work under it.

6.3.3 If an action is brought against any person, other than the carrier, mentioned in article 6.3.2, that person is entitled to the benefit of the defences and limitations of liability available to the carrier under this instrument if it proves that it acted within the scope of its contract, employment or agency.

6.3.4 If more than one person is liable for the loss of, damage to or delay in delivery of the goods, their liability is joint and several but only up to the limits provided for in articles 6.4, 6.6 and 6.7.

6.3.5 Without prejudice to the provisions of article 6.8, the aggregate liability of all such persons shall not exceed the overall limits of liability under this instrument.

6.4 Delay

6.4.1 Delay in delivery occurs when the goods are not delivered at the place of destination provided for in the contract of carriage within any time expressly agreed upon [or, in the absence of such agreement, within the time it would be reasonable to expect of a diligent carrier, having regard to the terms of the contract, the characteristics of the transport and the circumstances of the voyage].

99. The first part of the above provision has widespread support; the second part in brackets is more controversial. The phrase "the terms of the contract" provides for situations where the carrier expressly does not guarantee arrival times.

6.4.2 If delay in delivery causes loss not resulting from loss of or damage to the goods carried and hence not covered by article 6.2, the amount payable as compensation for such loss is limited to an amount equivalent to [. . . times the freight payable on the goods delayed]. The total amount payable under this provision and article 6.7.1 shall not exceed the limit that would be established under article 6.7.1 in respect of the total loss of the goods concerned.

100. Where delay causes loss of or damages to the goods a limit on damage is contained in the general limitation of article 6.7.1. The present provision creates a special limit for other loss caused by delay. This can be called "economic" or "non-physical" loss, and is sometimes referred to as "consequential" loss. But none of these terms has agreed meanings: all loss is economic, the loss in itself is not non-physical, and the meaning of the phrase "consequential loss" is not agreed between legal systems. It has been thought best therefore to put forward the formulation above.

101. As to the amount, the Hamburg Rules provide that the liability of the carrier for delay in delivery is limited to an amount equivalent to two and a half times the freight payable for the goods delayed, but not exceeding the total freight payable under the contract. Another example is the law of Australia where the amount payable is the lowest of the actual amount of the loss or two and a half times the sea freight payable for the goods delayed; or the total amount payable as sea freight for all of the goods shipped by the shipper concerned under the contract of carriage concerned.

102. The second sentence ensures that the overall limitation on amount contained in article 6.7.1 is not exceeded by any operation of this provision.

6.5 Deviation

(a) The carrier is not liable for loss, damage or delay in delivery caused by a deviation to save or attempt to save life or property at sea or by any other reasonable deviation.

(b) Where under national law a deviation of itself constitutes a breach of the carrier's obligations, such breach only has effect consistently with the provisions of this instrument.

103. The intention of this provision is that the draft instrument is not displaced by deviation, whether geographical or otherwise. Under some legal systems a misperformance by the carrier which can be described as a deviation has been held to displace the exceptions, especially the package or unit limitation of the Hague and (possibly) Hague-Visby Rules. It is intended that this should no longer be possible: like the Hague-Visby Rules, this draft instrument contains (in article 6.8) its own provisions for loss of the right to limit.

6.6 Deck cargo

6.6.1 Goods may be carried on or above deck only if:

- (i) Such carriage is required by applicable laws or administrative rules or regulations; or
- (ii) They are carried in or on containers on decks that are specially fitted to carry such containers; or
- (iii) In cases not covered by paragraphs (i) or (ii) of this article, the carriage on deck is in accordance with the contract of carriage or complies with the customs, usages and practices of the trade or follows from other usages or practices in the trade in question.

6.6.2 If the goods have been shipped in accordance with article 6.6.1 (i) and (iii), the carrier is not liable for loss of or damage to these goods or delay in delivery caused by the special risks involved in their carriage on deck. If the goods are carried on or above deck pursuant to article 6.6.1 (ii), the carrier is liable for loss of or damage to such goods, or for delay in delivery, under the terms of this instrument without regard to whether they are carried on or above deck. If the goods are carried on deck in cases other than those permitted under article 6.6.1, the carrier is liable, irrespective of the provisions of article 6.1, for loss of or damage to the goods or delay in delivery that are exclusively the consequence of their carriage on deck.

6.6.3 If the goods have been shipped in accordance with article 6.6.1 (iii), the fact that particular goods are carried on deck must be included in the contract particulars. Failing this, the carrier has the burden of proving that carriage on deck complies with article 6.6.1 (iii) and, if a negotiable transport document or a negotiable electronic record is issued, is not entitled to invoke that provision against a third party that has acquired such negotiable transport document or electronic record in good faith.

6.6.4 If the carrier under this article 6.6 is liable for loss or damage to goods carried on deck or for delay in their delivery, its liability is limited to the extent provided for in articles 6.4 and 6.7; however, if the carrier and shipper expressly have agreed that the goods will be carried under deck, the carrier is not entitled to limit its liability for any loss of or damage to the goods that exclusively resulted from their carriage on deck.

6.7 Limits of liability

6.7.1 Subject to article 6.4.2 the carrier's liability for loss of or damage to or in connection with the goods is limited to [...] units of account per package or other shipping unit, or [...] units of account per kilogram of the gross weight of the goods lost or damaged, whichever is the higher, except where the nature and value of the goods has been declared by the shipper before shipment and included in the contract particulars, [or where a higher amount than the amount of limitation of liability set out in this article has been agreed upon between the carrier and the shipper.]

6.7.2 When goods are carried in or on a container, the packages or shipping units enumerated in the contract particulars as packed in or on such container are deemed packages or shipping units. If not so enumerated, the goods in or on such container are deemed one shipping unit.

6.7.3 The unit of account referred to in this article is the special drawing right as defined by the International Monetary Fund. The amounts mentioned in this article are to be converted into 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 value of a national currency, in terms of special drawing rights, of a contracting State that is a member of the International Monetary Fund 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 value of a national currency, in terms of special drawing rights, of a contracting State that is not a member of the International Monetary Fund is to be calculated in a manner to be determined by that State.

104. It is considered that it would not be appropriate to insert any figures for units of account in the draft instrument at this stage. However, there is support for the view that the Hague-Visby limits should be the starting point for future discussion.

105. In the final provisions of this draft instrument it would be appropriate to include an article providing for an accelerated amendment procedure to adjust the amounts of limitation, such as article 8 of the 1996 Protocol to amend the Convention on Limitation of Liability for Maritime Claims. However, the level of the limits ultimately agreed to be inserted in article 6.7.1 would have a bearing on support for an accelerated amendment procedure.

106. The last part of article 6.7.1 is bracketed because it has to be decided whether any mandatory provision should be one-sided or two-sided mandatory, that is whether or not it should be permissible for either party to increase its respective liabilities.

6.8 Loss of the right to limit liability

Neither the carrier nor any of the persons mentioned in article 6.3.2 is entitled to limit their liability as provided in articles [6.4.2,] 6.6.4 and 6.7 of this instrument, [or as provided in the contract of carriage,] if the claimant proves that [the delay in delivery of,] the loss of, or the damage to or in connection with the goods resulted from a personal act or omission of the person claiming a right to limit done with the intent to cause such loss or damage or recklessly and with knowledge that such loss or damage would probably result.

107. The provision for "breaking" the overall limitation is of a type common in international conventions and corresponds to article IV, rule 5 (e) of the Hague-Visby Rules. The necessity for personal fault would require some form of management failure in a corporate carrier, but it is not thought appropriate to seek to specify this in any greater detail. The square brackets indicate that it is for consideration whether the limit should be breakable in cases of delay. It seems likely that it would rarely be appropriate to do so and the point can be made that the possibility of its being done might create insurance difficulties.

6.9 Notice of loss, damage or delay

6.9.1 The carrier is presumed, in the absence of proof to the contrary, to have delivered the goods according to their description in the contract particulars unless notice of loss of or damage to or in connection with the goods, indicating the general nature of such loss or damage, was given to the carrier or the performing party who delivered the goods before or at the time of the delivery, or, if the loss or damage is not apparent, within three working days after the delivery of the goods. Such a notice is not required in respect of loss or damage that is ascertained in a joint inspection of the goods by the consignee and the carrier or the performing party against whom liability is being asserted.

6.9.2 No compensation is payable under article 6.4 unless notice of such loss was given to the person against whom liability is being asserted within 21 consecutive days following delivery of the goods.

6.9.3 When the notice referred to in this chapter is given to the performing party that delivered the goods, it has the same effect as if that notice was given to the carrier and notice given to the carrier has the same effect as a notice given to the performing party that delivered the goods.

6.9.4 In the case of any actual or apprehended loss or damage, the parties to the claim or dispute must give all reasonable facilities to each other for inspecting and tallying the goods.

108. The giving of prompt notice is of practical importance. It enables the parties immediately to carry out a survey of the goods (preferably jointly) and to take necessary measures in order to prevent further damage to the goods. As such, giving prompt notice is part of the general obligation of the parties to act reasonably towards each other and to limit the damage as much as possible. If the damage is not apparent, the consignee must have a certain period for inspection. In view of the purpose of the notice, such period may reasonably be restricted to three days.

109. Under air transportation law, the sanction for not giving proper notice is the loss of the right to claim damages. In maritime transport this is considered too harsh a sanction for physical damage to the goods. Under the Hague Rules, taken over in this provision, only the assumption will apply that the goods are properly delivered in accordance with their description in the transport document. This does not apply to not giving due notice in case of economic loss. Any notice of a claim for delay in delivery can and, consequently, must be given within a short period. Normally, such a claim is a matter of calculation only.

110. For practical purposes it is provided in the third paragraph that valid notice may be given to a performing carrier when it is the person that delivers the goods to the consignee. Obviously, in that case notice may be properly given to the contracting carrier as well.

6.10 Non-contractual claims

The defences and limits of liability provided for in this instrument and the responsibilities imposed by this instrument apply in any action against the carrier or a performing party for loss of, for damage to, or in connection with the goods covered by a contract of carriage, whether the action is founded in contract, in tort, or otherwise.

111. The Working Group may wish to consider the appropriateness of this provision.

7. OBLIGATIONS OF THE SHIPPER

7.1 Subject to the provisions of the contract of carriage, the shipper shall deliver the goods ready for carriage and in such condition that they will withstand the intended carriage, including their loading, handling, stowage, lashing and securing and discharge, and that they will not cause injury or damage. In the event the goods are delivered in or on a container or trailer packed by the shipper, the shipper must stow, lash and secure the goods in or on the container or trailer in such a way that the goods will withstand the intended carriage, including loading, handling and discharge of the container or trailer, and that they will not cause injury or damage.

112. The basic obligation of the shipper is to deliver the goods to the carrier in accordance with the contract of carriage, that is, the goods as agreed and at the agreed place and time. Further, the goods must be brought by the shipper in the proper condition for the intended voyage, for example, packing must be sound, dangerous goods must be properly marked and labelled, temperature controlled goods must be delivered at the right temperature for carriage, etc. For reasons of accident prevention, this is of particular importance in respect of shipper-packed containers and trailers, because in the normal course of events carriers do not check their contents.

7.2 The carrier shall provide to the shipper, on its request, such information as is within the carrier's knowledge and instructions that are reasonably necessary or of importance to the shipper in order to comply with its obligations under article 7.1.

113. It should be a two-way street. Anything that a shipper does not know, it should ask for, whereupon the carrier should assist the shipper in meeting its responsibilities. A minority view criticizes this provision as being superfluous.

7.3 The shipper shall provide to the carrier the information, instructions and documents that are reasonably necessary for:

(a) The handling and carriage of the goods, including precautions to be taken by the carrier or a performing party;

(b) Compliance with rules, regulations and other requirements of authorities in connection with the intended carriage, including filings, applications and licences relating to the goods;

(c) The compilation of the contract particulars and the issuance of the transport documents or electronic records, including the particulars referred to in article 8.2.1 (b) and (c), the name of the party to be identified as the shipper in the contract particulars and the name of the consignee or order, unless the shipper may reasonably assume that such information is already known to the carrier.

7.4 The information, instructions and documents that the shipper and the carrier provide to each other under articles 7.2 and 7.3 must be given in a timely manner and be accurate and complete.

114. A safe and successful carriage of the goods may depend to a large extent on cooperation between the parties. It is of primary importance that the information, etc., that the parties reasonably require for the voyage is accurate and complete. Each party must be able to rely on the information given by the other party without first having to examine whether it is accurate and complete. It is also a matter of safety that the information not only is correct in the objective sense, but also appropriate in relation to the known intended purpose. It may be useful to exemplify: an otherwise correct description of the goods to be carried is not accurate and complete if the goods qualify as dangerous goods and their dangerous character cannot be detected from the description as given by the shipper. In an information society, time and money is often not available to make checks on the accuracy or completeness of information.

7.5 The shipper and the carrier are liable to each other, the consignee and the controlling party for any loss or damage caused by either party's failure to comply with its respective obligations under articles 7.2, 7.3 and 7.4.

115. The liability of the parties for wrong or incomplete information is a strict one. In principle, no excuses are available to either party for not adhering to this obligation.

7.6 The shipper is liable to the carrier for any loss, damage or injury caused by the goods and for a breach of its obligations under article 7.1, unless the shipper proves that such loss or damage was caused by events or through circumstances that a diligent shipper could not avoid or the consequences of which a diligent shipper was unable to prevent.

116. The majority view is that the shipper's liability for damage caused by the goods (and for non-fulfilment of its obligations under article 7.1) should be based on fault with reversed burden of proof. There is however a minority view that the strict liability for damage caused by dangerous goods, as in the Hague-Visby Rules, article IV, rule 6, and the Hamburg Rules, article 13, should be maintained. The majority view is that the distinction between ordinary goods and dangerous or polluting goods is out of date. Whether certain goods are dangerous depends on the circumstances. Harmless goods may become dangerous under certain circumstances and dangerous goods (in the sense of poisonous or explosive) may be harmless when they are properly packed, handled and carried in an appropriate vessel. The notion "dangerous" is relative. The majority feel that the essence of a shippers' liability regime should be that the risk of any damage attributable to the nature of the cargo should be on the shipper and any damage caused by improper handling or carriage should fall under the rules for the carrier's liability.

117. Another matter is how to deal with goods that may become a danger to human life, property or the environment during the voyage. It may be considered that a master (or another person actually responsible for the goods) must have a wide discretion to deal with such goods under the circumstances without regard to liabilities. This matter is dealt with in articles 5.3 and 6.1.3 (ix). Whether the goods are carried with or without the carriers' consent (see article IV, rule 6, of the Hague-Visby Rules) has become irrelevant under these articles. Article 13, rule 4, of the Hamburg Rules does not make this distinction either.

7.7 If a person identified as "shipper" in the contract particulars, although not the shipper as defined in article 1.19, accepts the transport document or electronic record, then such person is (a) subject to the responsibilities and liabilities imposed on the shipper under this chapter and under article 11.5, and (b) entitled to the shipper's rights and immunities provided by this chapter and by chapter 13.

118. This article should be read in relation to the definitions of carrier, shipper and consignor and to the provisions of article 8.1.

119. The shipper and the carrier are defined as the persons who are the parties to the contract of carriage. In that capacity they have certain rights and assume certain liabilities. Such a definition of the shipper leaves the question of how to deal with the position of one, the f.o.b. seller, two, the agent, not being the shipper, who nevertheless is mentioned as the shipper in the transport document, and three, the person who actually delivers the goods to the carrier in cases where such person is a person other than those mentioned under one and two.

120. As to three above, the definition of “consignor” includes this person. It has no liabilities under article 7.7 or under article 11.5. Its only right is to obtain a receipt pursuant to article 8.1 from the carrier or performing carrier to whom it actually delivers the goods.

121. The f.o.b. seller usually complies with the requirements of article 7.7 in that the seller is mentioned as shipper in the document and has accepted the document. Such an f.o.b. seller, therefore, will be subject to the provisions of this article. In addition, if a negotiable document is issued, the seller becomes the first holder and has all the rights and liabilities of a holder, including the right of control. If a non-negotiable document is issued, such an f.o.b. seller has the right of suit as per article 13 and has the right of control if the f.o.b. buyer (being the consignee as well as the shipper) so notifies the carrier.

122. The situation of the agent, not being the shipper (as defined), but mentioned as the shipper in the document, can only arise when such agent, expressly or impliedly, is authorized by the shipper (as defined) to be such “documentary shipper”. If such agent accepts the document, its position is the same as outlined above with respect to the f.o.b. seller. Its alternative course is not to accept the document.

7.8 The shipper is responsible for the acts and omissions of any person to which it has delegated the performance of any of its responsibilities under this chapter, including its subcontractors, employees, agents and any other persons who act, either directly or indirectly, at its request or under its supervision or control, as if such acts or omissions were its own. Responsibility is imposed on the shipper under this provision only when the act or omission of the person concerned is within the scope of that person’s contract, employment or agency.

123. The substance of this provision is based on article 8, paragraph 2, of the Budapest Convention on the Contract for Carriage of Goods by Inland Waterways, but the drafting has been conformed to article 6.3.2, paragraph (b).

8. TRANSPORT DOCUMENTS AND ELECTRONIC RECORDS

8.1 Issuance of the transport document or the electronic record

Upon delivery of the goods to a carrier or performing party:

- (i) The consignor is entitled to obtain a transport document or, if the carrier so agrees, an electronic record evidencing the carrier’s or performing party’s receipt of the goods;
- (ii) The shipper or, if the shipper so indicates to the carrier, the person referred to in article 7.7, is entitled

to obtain from the carrier an appropriate negotiable transport document, unless the shipper and the carrier, expressly or impliedly, have agreed not to use a negotiable transport document, or it is the custom, usage or practice in the trade not to use one. If pursuant to article 2.1 the carrier and the shipper have agreed to the use of an electronic record, the shipper is entitled to obtain from the carrier a negotiable electronic record unless they have agreed not to use a negotiable electronic record or it is the custom, usage or practice in the trade not to use one.

124. The first paragraph specifies that the consignor, as defined in article 1.3, is entitled to a receipt confirming the actual delivery of the goods to the carrier or to the performing party. If the consignor is not the shipper or the person referred in article 7.7, it may need such a receipt in its relations with any of these persons.

125. The second paragraph follows the Hague Rules and the Hamburg Rules, which require the carrier to issue a negotiable bill of lading to the shipper on demand. Differing views were expressed as to whether the “shipper” (the carrier’s contractual counterpart) or the “consignor” (the person actually delivering the goods to the carrier) should be entitled to the transport document or electronic record issued under this paragraph. In many cases, the two will be the same and the issue will not arise. But in the case of an f.o.b. shipment in which the consignor pays the freight on the consignee-shipper’s account, the two would be different. If the relationship between the consignor and the shipper breaks down, both may demand a transport document or electronic record issued under paragraph (ii). On the one hand, it seems logical to give the contracting shipper the right to control entitlements under the contract of carriage. On the other hand, giving a negotiable transport document to the shipper may undermine the consignor’s ability to receive payment for the shipment. The current text adopts the former argument, but it may be appropriate to give further thought to this issue. Some have suggested, for example, that the carrier should not issue a negotiable transport document or electronic record under paragraph (ii) except on surrender of the receipt issued under paragraph (i). Others have observed that this solution would not solve the underlying problem; it would simply shift it forward (and elevate the importance of the receipt issued under paragraph (i)).

126. The second paragraph also provides that the shipper and carrier may agree not to use a negotiable transport document or electronic record. In addition, it clarifies that such an agreement may be implied, thus enabling a carrier to offer a service in which the shipper may not require a negotiable transport document. Furthermore, in some trades it is highly unusual for shippers to request a negotiable document, or a negotiable document would be useless, for example, on short ferry voyages. Therefore, if there is a custom, usage or practice in the trade not to use negotiable documents, the carrier is not required to do so (even if the shipper demands such a document).

127. The reference is deliberately to a custom, usage or practice “in the trade” rather than “at the place where the transport document or electronic record is issued.” It is often difficult to know where a transport document or electronic record has been issued and it is easy to manipulate the place of issuance. Transport documents or electronic records could be issued in a distant office at a place having no other connection with the contract simply to take advantage of favourable customs, usages or practices.

8.2 Contract particulars

8.2.1 The contract particulars in the document or electronic record referred to in article 8.1 must include:

- (a) A description of the goods;
- (b) The leading marks necessary for identification of the goods as furnished by the shipper before the carrier or a performing party receives the goods;
- (c)
 - (i) The number of packages, the number of pieces or the quantity; and
 - (ii) The weight as furnished by the shipper before the carrier or a performing party receives the goods;
- (d) A statement of the apparent order and condition of the goods at the time the carrier or a performing party receives them for shipment;
- (e) The name and address of the carrier; and
- (f) The date:
 - (i) On which the carrier or a performing party received the goods; or
 - (ii) On which the goods were loaded on board the vessel; or
 - (iii) On which the transport document or electronic record was issued.

128. Article 8.2.1 (a) introduces a requirement that does not explicitly appear in current international conventions, but it conforms to virtually universal practice in the industry. As a practical matter, it is in both parties' interest to include a description of the goods in the contract particulars.

129. Article 8.2.1 (b) and (c) generally correspond to existing law and practice in most countries and to the current international regimes. The provisions do alter the existing law in one respect: the carrier's obligation to include the information furnished by the shipper is not qualified by any exception when the carrier has no reasonable means of checking the information. Under current law, the carrier may (in theory) simply omit this information from the contract particulars if it has no reasonable means of checking its accuracy. Under article 8.2.1 (b) and (c), the carrier must include the information furnished by the shipper in the contract particulars even if it has no reasonable means of checking its accuracy (but the carrier may protect its interests with a qualifying clause under article 8.3).

130. Article 8.2.1 (b) also omits the requirement that "the marks must be stamped or otherwise shown clearly upon the goods if uncovered or on the cases or coverings in which the goods are contained, in a manner that would ordinarily remain legible until the end of the voyage." In view of the alteration noted above (which means that the carrier must include information furnished by the shipper even if it has no reasonable means of checking the accuracy), it seems inappropriate to permit the carrier to omit information furnished by the shipper concerning the marks if the carrier believes that the marks might not remain legible until the end of the voyage. Once again, the carrier's remedy should be to protect its interests with a qualifying clause under article 8.3. This change is unlikely to make any difference in practice.

131. With respect to article 8.2.1 (b) and (c), the shipper must furnish the necessary information in writing before the carrier receives the goods; it is not sufficient to furnish the information before the carrier issues the transport document or electronic record. With respect to 8.2.1 (c), the contract particulars must include all of the listed information furnished by the shipper (e.g., the number of pieces and the weight); it is not sufficient to include only one of the items on the list (e.g., the number of pieces or the weight) when the carrier desires fuller information.

132. Article 8.2.1 (d) confirms the understanding that is clearly expressed in the *travaux préparatoires* of the Hague Rules and carried forward in subsequent international conventions. The courts in some countries have departed from this principle.

133. Article 8.2.1 (e) gives effect to the view that the carrier should be identified in the transport document.

134. Article 8.2.1 (f) gives the carrier three choices of date that may be included in the contract particulars.

8.2.2 The phrase "apparent order and condition of the goods" in article 8.2.1 refers to the order and condition of the goods based on:

- (a) A reasonable external inspection of the goods as packaged at the time the shipper delivers them to the carrier or a performing party; and
- (b) Any additional inspection that the carrier or a performing party actually performs before issuing the transport document or the electronic record.

135. Article 8.2.2 provides both an objective and a subjective component to the phrase "apparent order and condition of the goods." Under article 8.2.2 (a), the carrier has no duty to inspect the goods beyond what would be revealed by a reasonable external inspection of the goods as packaged at the time the consignor delivers them to the carrier or a performing party. If the goods are unpackaged, the contract particulars will need to describe the order and condition of the goods themselves. But if the goods are packaged, the statement of order and condition will relate primarily to the packaging (unless the order and condition of the goods themselves can be determined through the packaging). For containerized goods, in particular, the statement of order and condition is highly unlikely to relate to the goods themselves if the shipper delivered a closed container that the carrier did not open before issuing the transport document.

136. Under article 8.2.2 (b), however, if the carrier or a performing party actually carries out a more thorough inspection (e.g., inspecting the contents of packages or opening a closed container), then the carrier is responsible for whatever such an inspection reveals.

8.2.3 Signature

(a) A transport document shall be signed by the carrier or a person having authority from the carrier;

(b) An electronic record shall be authenticated by the electronic signature of the carrier or a person having authority from the carrier. For the purpose of this provision such electronic signature means data in electronic form included in, or otherwise logically associated with, the electronic record and that is used to identify the signatory in relation to the electronic record and to indicate the carrier's authorization of the electronic record.

137. Article 8.2.3 gives effect to the non-controversial view that a transport document should be signed and that an electronic record should be comparably authenticated. The definition of electronic signature is taken from the UNCITRAL Model Law on Electronic Signatures of 2001, as specifically adjusted to bring its intended meaning within the scope of this provision.

8.2.4 Omission of required contents from the contract particulars

The absence of one or more of the contract particulars referred to in article 8.2.1, or the inaccuracy of one or more of those particulars, does not of itself affect the legal character or validity of the transport document or of the electronic record.

138. Article 8.2.4 gives effect to the non-controversial view that the validity of the transport document or electronic record does not depend on the inclusion of the particulars that should be included. For example, an undated bill of lading will still be valid, even though a bill of lading should be dated. Article 8.2.4 also extends the rationale behind that non-controversial view to hold that the validity of the transport document or electronic record does not depend on the accuracy of the contract particulars that should be included. Under this extension, for example, a misdated bill of lading would still be valid, even though a bill of lading should be accurately dated.

139. Article 8.4.3 deals with the consequences of failing to comply with article 8.2.1 (d).

8.3 Qualifying the description of the goods in the contract particulars

8.3.1 Under the following circumstances, the carrier, if acting in good faith when issuing a transport document or an electronic record, may qualify the information mentioned in article 8.2.1 (b) or 8.2.1 (c) with an appropriate clause therein to indicate that the carrier does not assume responsibility for the accuracy of the information furnished by the shipper:

(a) For non-containerized goods:

- (i) If the carrier can show that it had no reasonable means of checking the information furnished by the shipper, it may include an appropriate qualifying clause in the contract particulars; or
- (ii) If the carrier reasonably considers the information furnished by the shipper to be inaccurate, it may include a clause providing what it reasonably considers accurate information;

(b) For goods delivered to the carrier in a closed container, the carrier may include an appropriate qualifying clause in the contract particulars with respect to:

- (i) The leading marks on the goods inside the container; or
- (ii) The number of packages, the number of pieces or the quantity of the goods inside the container;

unless the carrier or a performing party in fact inspects the goods inside the container or otherwise has actual knowledge of the contents of the container;

(c) For goods delivered to the carrier or a performing party in a closed container, the carrier may qualify any statement of the weight of goods or the weight of a container and its contents with an explicit statement that the carrier has not weighed the container if:

- (i) The carrier can show that neither the carrier nor a performing party weighed the container; and
- (ii) The shipper and the carrier did not agree prior to the shipment that the container would be weighed and the weight would be included in the contract particulars.

140. Article 8.3.1 generally corresponds to existing law and practice in most countries. Although current law generally permits the carrier to protect itself by omitting from the contract particulars a description of the goods that it is unable to verify, this protection is essentially meaningless in practice. Even if the carrier is unable to verify the description, the typical shipper still requires a transport document or electronic record describing the goods in order to receive payment under the sales contract. Commercial pressures therefore deny the carrier the one form of

protection that is clearly recognized under current law. Qualifying clauses represent the carrier's attempt to regain its protection. Common examples of qualifying clauses include "said to contain" and "shipper's weight and count". Other qualifying clauses may also be effective, depending on the particular needs of the case.

141. The standards for including a qualifying clause under article 8.3.1 (a) and (b) are generally similar to those under the proviso to article III, rule 3, of the Hague and Hague-Visby Rules and to article 16, rule 1, of the Hamburg Rules, except that this article eliminates the language in the Hague Rules and Hamburg Rules excusing the carrier from including the otherwise required information if there are reasonable grounds for suspecting that the information furnished by the shipper does not accurately represent the goods. If the carrier has reasonable grounds for suspecting that the information furnished by the shipper does not accurately represent the goods, the carrier is obligated to check the information if it has a reasonable means of doing so. Thus the carrier would be excused from including the otherwise required information only if there is no reasonable means of checking it. The reasonable suspicion exception is accordingly redundant.

142. Clauses regarding the weight of containerized goods create special problems. In some ports, facilities for weighing loaded containers simply do not exist. In such cases, it is an easy matter for the carrier to prove that it had no reasonable means of checking the weight information furnished by the shipper. But even in ports where weighing facilities exist, and could be used, it is often customary to load containers without weighing them. Sometimes this is because the time spent weighing containers would delay the ship's departure (particularly when the shipper delivers the container to the carrier shortly before sailing). Often it is because the weight is of no commercial importance and the time and expense of weighing a container is unjustified in the absence of any commercial benefit. In some cases, however, the weight is of commercial importance and the consignee should be permitted to rely on the statement of weight in the transport document unless it is clear that the carrier has in fact not weighed the container.

143. In view of these special problems with qualifying clauses regarding the weight of containerized goods, article 8.3.1 (c) specifically addresses the issue in unique fashion. It requires a clear statement that the carrier has in fact not weighed the container. The carrier can include such a statement only if it is true (i.e., if the carrier did not weigh the container) and if the carrier and the shipper did not agree in writing prior to the shipment that the container would be weighed and the weight would be included in the contract particulars. Article 8.3.1 (c)(ii) recognizes that in some cases the container's weight is of commercial importance and that in such cases the shipper may legitimately insist on having a weight listed in the transport document without a qualifying clause. A shipper may protect this legitimate interest with an explicit agreement prior to shipment (e.g., in the booking note). In the absence of such a prior agreement, however, the carrier may assume that the container's weight is of no commercial importance. A carrier may then load the container without weighing it and any weight listed on the transport document may be qualified—without proof that the carrier had no reasonable means of checking the weight furnished by the shipper.

144. Article 8.3.1 (a)(ii) and article 8.3.1 (b) also recognize that the carrier may also provide accurate information if it considers the information furnished by the shipper to be inaccurate.

8.3.2 Reasonable means of checking

For the purposes of article 8.3.1:

(a) A "reasonable means of checking" must be not only physically practicable but also commercially reasonable;

(b) A carrier acts in “good faith” when issuing a transport document or an electronic record if:

- (i) The carrier has no actual knowledge that any material statement in the transport document or electronic record is materially false or misleading; and
- (ii) The carrier has not intentionally failed to determine whether a material statement in the transport document or electronic record is materially false or misleading because it believes that the statement is likely to be false or misleading;

(c) The burden of proving whether a carrier acted in good faith when issuing a transport document or an electronic record is on the party claiming that the carrier did not act in good faith.

145. Article 8.3.2 (a) clarifies the meaning of “reasonable means of checking.” Opening a sealed container or unloading a container to inspect the contents, for example, would not be commercially reasonable, even if it might be physically practicable in some circumstances. Thus a carrier issuing a transport document or electronic record would always be permitted to qualify the description of goods delivered by the shipper inside a sealed container—unless the carrier had some physically practical and commercially reasonable means of checking the information furnished by the shipper (which would have to be something other than opening the container). For example, if the carrier had an agent present when the shipper stuffed the container and that agent verified the accuracy of the shipper’s information during loading, then the carrier would not be permitted to qualify the description of the goods.

146. Article 8.3.2 (b) clarifies the meaning of “good faith”. Article 8.3.2 (c) imposes the burden of proving a lack of good faith on the party claiming that the carrier did not act in good faith.

8.3.3 Prima facie and conclusive evidence

Except as otherwise provided in article 8.3.4, a transport document or an electronic record that evidences receipt of the goods is:

(a) Prima facie evidence of the carrier’s receipt of the goods as described in the contract particulars; and

(b) Conclusive evidence of the carrier’s receipt of the goods as described in the contract particulars:

- [(i)] If a negotiable transport document or a negotiable electronic record has been transferred to a third party acting in good faith [or
- (ii) If a person acting in good faith has paid value or otherwise altered its position in reliance on the description of the goods in the contract particulars].

147. Article 8.3.3 (a) simply confirms the widely recognized rule that, as a general matter, a transport document or electronic record that evidences a carrier’s receipt of the goods is prima facie evidence that the goods were as described in the contract particulars.

148. Article 8.3.3 (b) recognizes that, in order to protect innocent third parties who rely on the descriptions in transport documents and electronic records, a transport document or electronic record is in some circumstances not simply prima facie evidence but conclusive evidence. There is broad support for article 8.3.3 (b)(i), which protects the holder of a negotiable transport document or electronic record.

149. Nevertheless, there is also support for article 8.3.3 (b)(ii), which protects any person acting in good faith that pays value or otherwise alters its position in reliance on the description of the goods in the contract particulars, whether or not the transport document or electronic record is negotiable. For example, if an f.o.b. seller arranges carriage for the account of the f.o.b. buyer, the buyer is the shipper. The carrier, however, may issue a non-negotiable transport document to the seller and the buyer may pay the purchase price to the seller in reliance on the description of the goods in the transport document.

8.3.4 Effect of qualifying clauses

If the contract particulars include a qualifying clause that complies with the requirements of article 8.3.1, then the transport document will not constitute prima facie or conclusive evidence under article 8.3.3 to the extent that the description of the goods is qualified by the clause.

150. Article 8.3.4 simply describes the effect of a qualifying clause that complies with the requirements of article 8.3.1. A qualifying clause does not necessarily defeat the prima facie or conclusive evidence of the description of the goods in full. A qualifying clause such as “shipper’s weight”, for example, would not affect the evidentiary value of a description of the goods to the extent that it listed the number of packages in the shipment or described the leading marks.

151. Under this provision, every qualifying clause is effective according to its terms if it complies with the requirements of article 8.3.1. This conclusion is generally accepted with respect to non-containerized goods, but views are divided on whether the carrier should have such extensive rights with respect to containerized goods.

152. Some take the view that sharp distinctions exist between commercial expectations with respect to containerized and non-containerized goods. The carrier’s classic rationale for relying on a qualifying clause and escaping liability in a containerized goods case is that the carrier delivered to the consignee exactly what it received from the shipper: a closed container (the contents of which could not be verified). It is arguable that as soon as the carrier delivers something different (e.g., a container that is damaged in a way that may have caused the loss of or damage to the goods or a container that has been improperly opened during the voyage), the equities shift. At this point the carrier can no longer establish the same chain of custody. Moreover, it appears that something wrong was done while the container was in the carrier’s custody. The consignee’s entitlement to rely on the description of the goods in the contract particulars accordingly becomes much stronger. A draft reflecting these views might revise the current article to provide as follows in paragraph 153.

153. “If the contract particulars include a qualifying clause, then the transport document will not constitute prima facie or conclusive evidence under article 8.3.3, to the extent that the description of the goods is qualified by the clause, when the clause is ‘effective’ under article 8.3.5.”

154. It would then be necessary to add a new article 8.3.5, which might provide as follows:

“A qualifying clause in the contract particulars is effective for the purposes of article 8.3.4 under the following circumstances:

“(a) For non-containerized goods, a qualifying clause that complies with the requirements of article 8.3.1 will be effective according to its terms;

“(b) For goods shipped in a closed container, a qualifying clause that complies with the requirements of article 8.3.1 will be effective according to its terms if:

- “(i) The carrier or a performing party delivers the container intact and undamaged, except for such damage to the container as was not causally related to any loss of or damage to the goods; and
- “(ii) There is no evidence that after the carrier or a performing party received the container it was opened prior to delivery, except to the extent that:
 - a. A container was opened for the purpose of inspection;
 - b. The inspection was properly witnessed; and
 - c. The container was properly reclosed after the inspection and was resealed if it had been sealed before the inspection.”

8.4 Deficiencies in the contract particulars

8.4.1 Date

If the contract particulars include the date but fail to indicate the significance thereof, then the date is considered to be:

- (a) If the contract particulars indicate that the goods have been loaded on board a vessel, the date on which all of the goods indicated in the transport document or electronic record were loaded on board the vessel; or
- (b) If the contract particulars do not indicate that the goods have been loaded on board a vessel, the date on which the carrier or a performing party received the goods.

155. Article 8.4.1 specifies the consequences of including a date in the contract particulars without indicating its significance. For an “on board” bill of lading or a similar document or electronic record indicating that the goods have been loaded on board a vessel, the ambiguous date is considered to be the date on which the goods were loaded on board the vessel. In contrast, for a “received for shipment” bill of lading or other document or electronic record that does not indicate that the goods have been loaded on board a vessel, the ambiguous date is considered to be the date on which the carrier or a performing party received the goods.

[8.4.2 Failure to identify the carrier

If the contract particulars fail to identify the carrier but indicate that the goods have been loaded on board a named vessel, then the registered owner of the vessel is presumed to be the carrier. The registered owner can defeat this presumption if it proves that the ship was under a bareboat charter at the time of the carriage which transfers contractual responsibility for the carriage of the goods to an identified bareboat charterer. [If the registered owner defeats the presumption that it is the carrier under this article, then the bareboat charterer at the time of the carriage is presumed to be the carrier in the same manner as that in which the registered owner was presumed to be the carrier.]]

156. This provision attempts to deal with the problem facing a person seeking to exercise rights of suit against the carrier under chapter 13 if the name and address of the carrier is not stated in the contract particulars as required by article 8.2.1 (a). Although it has been the subject of considerable discussion, the issue remains controversial. Views are very much divided on the desirability of any presumption affecting the registered owner. Even

some supporters of the current provision consider it a problematic solution but the best that can be accomplished under the circumstances.

157. The article permits the registered owner to defeat the presumption by proving that the ship was under a bareboat charter at the time of the carriage and adequately identifying the bareboat charterer. The limitation period for an action against the bareboat charterer is addressed in article 14.5.

158. Under the final sentence of this article, the bareboat charterer is presumed to be the carrier “in the same manner that the registered owner was presumed to be the carrier.” This means, among other things, that the bareboat charterer would have the option of proving that there was a further bareboat charter at the time of the carriage. This second presumption may not be universally acceptable to the extent that it is irrebuttable save in respect of a subsequent bareboat charterer.

159. When door-to-door transport is involved, this provision could make the owner of the vessel performing the sea leg the “carrier” for the entire journey. Because the bill of lading may have been issued by a person owning no means of transport, this could subject that vessel owner to unexpected liability. The suggestion was made that this result should be avoided by exempting the vessel owner in respect of damage occurring before loading on or after discharge from the vessel. To draft such protection would not be easy. If the owner of each means of carriage were made the carrier for the part of the carriage performed by it, there would be scope for considerable problems if loss or damage occurred while the goods were being moved from one mode of transportation to another. If only some of the means of carriage were adequately specified, then no one would qualify as the carrier for parts of the carriage.

8.4.3 Apparent order and condition

If the contract particulars fail to state the apparent order and condition of the goods at the time the carrier or a performing party receives them from the shipper, the transport document or electronic record is either *prima facie* or conclusive evidence under article 8.3.3, as the case may be, that the goods were in apparent good order and condition at the time the shipper delivered them to the carrier or a performing party.

9. FREIGHT

9.1 (a) Freight is earned upon delivery of the goods to the consignee at the time and location mentioned in article 4.1.3, unless the parties have agreed that the freight is earned, wholly or partly, at an earlier point in time;

(b) Unless otherwise agreed, no freight becomes due for any goods that are lost before the freight for those goods is earned.

9.2 (a) Freight is payable when it is earned, unless the parties have agreed that the freight is payable, wholly or partly, at an earlier or later point in time;

(b) If subsequent to the moment at which the freight has been earned the goods are lost, damaged or otherwise not delivered to the consignee in accordance with the provisions of the contract of carriage, freight remains payable irrespective of the cause of such loss, damage or failure in delivery;

(c) Unless otherwise agreed, payment of freight is not subject to set-off, deduction or discount on the grounds of any counterclaim that the shipper or consignee may have against the carrier, [the indebtedness or the amount of which has not yet been agreed or established].

9.3 (a) Unless otherwise agreed, the shipper is liable to pay the freight and other charges incidental to the carriage of the goods;

(b) If the contract of carriage provides that the liability of the shipper or any other person identified in the contract particulars as the shipper will cease, wholly or partly, upon a certain event or after a certain point of time, such cessation is not valid:

- (i) With respect to any liability under chapter 7 of the shipper or a person mentioned in article 7.7; or
- (ii) With respect to any amounts payable to the carrier under the contract of carriage, except to the extent that the carrier has adequate security pursuant to article 9.5 or otherwise for the payment of such amounts;
- (iii) To the extent that it conflicts with the provisions of article 12.4.

9.4 (a) If the contract particulars in a transport document or an electronic record contain the statement "freight prepaid" or a statement of a similar nature, then neither the holder nor the consignee is liable for the payment of the freight. This provision does not apply if the holder or the consignee is also the shipper;

(b) If the contract particulars in a transport document or an electronic record contain the statement "freight collect" or a statement of similar nature, such a statement puts the consignee on notice that it may be liable for the payment of the freight.

9.5 (a) [Notwithstanding any agreement to the contrary,] if and to the extent that under national law applicable to the contract of carriage the consignee is liable for the payments referred to below, the carrier is entitled to retain the goods until payment of:

- (i) Freight, deadfreight, demurrage, damages for detention and all other reimbursable costs incurred by the carrier in relation to the goods;
- (ii) Any damages due to the carrier under the contract of carriage;
- (iii) Any contribution in general average due to the carrier relating to the goods has been effected, or adequate security for such payment has been provided;

(b) If the payment as referred to in paragraph (a) of this article is not, or is not fully, effected, the carrier is entitled to sell the goods (according to the procedure, if any, as provided for in the applicable national law) and to satisfy the amounts payable to it (including the costs of such recourse) from the proceeds of such sale. Any balance remaining from the proceeds of such sale shall be made available to the consignee.

10. DELIVERY TO THE CONSIGNEE

160. The subject of delivery is only to a limited extent dealt with in the existing maritime transport conventions. This article provides only some rules on this subject. It does not pretend to solve all the problems in connection with the subject of delivery.

161. The main problem is that often the goods arrive at their place of destination without someone there to receive them. In particular, problems arise if a negotiable transport document or negotiable electronic record has been issued. The proper functioning of the bill of lading system is based on the assumption that the holder of the document presents it to the carrier when the goods

arrive at their destination and that subsequently the carrier delivers the goods to such holder against surrender of the document. However, frequently the negotiable document is not available when the goods arrive at their destination. This may be caused by all kinds of business reasons, such as the credit term of the financing arrangements in respect of the goods being longer than the voyage, or it may be the result of remoteness of the place of destination or bureaucratic obstacles. Despite this, a carrier must be able to dispose of the goods at the end of the voyage. The carrier should not be compelled to bear the additional costs and risks connected with continued custody of the goods. Also, it may be the case that no suitable storage facilities are available at the place of destination. If in these cases the carrier delivers the goods to someone who is not (yet) the holder of the negotiable document, it is at risk, because its promise made by the bill of lading is to deliver the goods to the holder of that document. On the other hand, a holder must be able to count on the security that a negotiable document provides. The holder may have paid for the goods or may have provided finance for the goods in exchange for a pledge on the document. It rightfully may regard the negotiable transport document as the "key to the goods".

162. This article tries to strike a balance between these two legitimate interests. It does not impose a duty on the carrier to deliver the goods only against surrender of the document. The current practice deviates too much from either of these two duties to make them obligatory. Instead, the article takes into account the double function of a negotiable transport document: it is both a contract of carriage in the true sense and it is a document of title. Both functions have to be respected by either party. Which function should prevail may depend on the circumstances of the case. This article provides only some general rules.

10.1 When the goods have arrived at their destination, the consignee that exercises any of its rights under the contract of carriage shall accept delivery of the goods at the time and location mentioned in article 4.1.3. If the consignee, in breach of this obligation, leaves the goods in the custody of the carrier or the performing party, the carrier or performing party will act in respect of the goods as an agent of the consignee, but without any liability for loss or damage to these goods, unless the loss or damage results from a personal act or omission of the carrier done with the intent to cause such loss or damage, or recklessly, with the knowledge that such loss or damage probably would result.

163. Pursuant to article 5.1 the carrier is obliged to deliver the goods to the consignee. A corresponding provision that the consignee is obliged to take delivery is not included, because under current practice it is accepted that a consignee need not take delivery. Only if a consignee exercises any rights under the contract of carriage, is it obliged to do so. If the consignee does not do anything, it has no obligation to take delivery. See also article 12.2.

164. The consequence of not taking delivery, when there is a duty on the consignee to do so, is that the carrier in practice is no longer liable for loss or damage to the goods. The consequence of not taking delivery, while there is no obligation to do so, is worked out in articles 10.3 and 10.4.

10.2 On request of the carrier or the performing party that delivers the goods, the consignee shall confirm delivery of the goods by the carrier or the performing party in the manner that is customary at the place of destination.

165. In practice, many carriers request some form of written evidence from the consignee that the carrier has delivered the goods. This provision provides a legal basis for this usage.

166. In the event that a negotiable transport document has been issued, often the accomplishment of the document is evidenced by the signature of the latest holder of the document on its reverse side.

10.3.1 If no negotiable transport document or no negotiable electronic record has been issued:

- (i) The controlling party shall advise the carrier, prior to or upon the arrival of the goods at the place of destination, of the name of the consignee;
- (ii) The carrier shall deliver the goods at the time and location mentioned in article 4.1.3 to the consignee upon the consignee's production of proper identification.

167. This provision applies when no negotiable document or electronic record is issued and when no document at all, whether under a paper communication system or an electronic one, is used. In these cases, there is no "double function" of the contract of carriage. In principle, it is up to the party with whom the carrier made the contract, or up to the controlling party if it is a different person from the contracting party, to take care that the goods can be delivered.

10.3.2 If a negotiable transport document or a negotiable electronic record has been issued, the following provisions apply:

- (a) (i) Without prejudice to the provisions of article 10.1 the holder of a negotiable transport document is entitled to claim delivery of the goods from the carrier after they have arrived at the place of destination, in which event the carrier shall deliver the goods at the time and location mentioned in article 4.1.3 to such holder upon surrender of the negotiable transport document. In the event that more than one original of the negotiable transport document has been issued, the surrender of one original will suffice and the other originals cease to have any effect or validity;
- (ii) Without prejudice to the provisions of article 10.1 the holder of a negotiable electronic record is entitled to claim delivery of the goods from the carrier after they have arrived at the place of destination, in which event the carrier shall deliver the goods at the time and location mentioned in article 4.1.3 to such holder if it demonstrates in accordance with the rules of procedure mentioned in article 2.4 that it is the holder of the electronic record. Upon such delivery, the electronic record ceases to have any effect or validity;

(b) If the holder does not claim delivery of the goods from the carrier after their arrival at the place of destination, the carrier shall advise accordingly the controlling party or, if, after reasonable effort, it is unable to identify or find the controlling party, the shipper. In such event the controlling party or shipper shall give the carrier instructions in respect of the delivery of the goods. If the carrier is unable, after reasonable effort, to identify and find the controlling party or the shipper, then the person mentioned in article 7.7 is deemed to be the shipper for purposes of this paragraph;

(c) Notwithstanding the provision of paragraph (d) of this article, a carrier that delivers the goods upon instruction of the controlling party or the shipper in accordance with paragraph (b) of this article is discharged from its obligation to

deliver the goods under the contract of carriage [to the holder], irrespective of whether the negotiable transport document has been surrendered to it, or the person claiming delivery under a negotiable electronic record has demonstrated, in accordance with the rules of procedure referred to in article 2.4, that it is the holder;

(d) If the delivery of the goods by the carrier at the place of destination takes place without the negotiable transport document being surrendered to the carrier or without the demonstration referred to in paragraph (a) (ii) above, a holder who becomes a holder after the carrier has delivered the goods to the consignee or to a person entitled to these goods pursuant to any contractual or other arrangement other than the contract of carriage will only acquire rights under the contract of carriage if the passing of the negotiable transport document or negotiable electronic record was effected in pursuance of contractual or other arrangements made before such delivery of the goods, unless such holder at the time it became holder did not have or could not reasonably have had knowledge of such delivery;

(e) If the controlling party or the shipper does not give the carrier adequate instructions as to the delivery of the goods, the carrier is entitled, without prejudice to any other remedies that a carrier may have against such controlling party or shipper, to exercise its rights under article 10.4.

168. The problems referred to in the introductory commentary arise particularly if a negotiable document or electronic record has been issued. This article works out the balance of interest.

169. The first sentence of article 10.3.2 (a)(i) has limited scope. According to current practice, a holder that did not exercise any right under the contract of carriage is entitled but not obliged to claim delivery. Further, this paragraph does not exclude the possibility that a person other than the holder is entitled to claim delivery. It only provides that, if a holder claims delivery, the carrier is obliged to deliver and, consequently, must be held discharged from its obligation under the contract of carriage to deliver the goods at the place of their destination. The provision does not solve the problem of goods having a negative value at the place of destination.

170. Further, paragraph (i) follows the normal practice that the negotiable document has to be surrendered by the holder to the carrier. This practice also protects the carrier, because the document identifies the person entitled to take delivery. Contrary to the case of early delivery, to which article 11.2 (b)(iii) refers, the surrender of one original suffices. At that point any other becomes void.

171. Article 10.3.2 (a)(ii) mirrors (i) for the negotiable electronic record. Under an electronic communication system, some of the reasons that a negotiable record is not available at delivery may be taken away. But in cases, for example, where the credit terms are extended beyond the duration of the voyage, the problems are the same under any electronic commerce system as under a paper bill of lading system.

172. In article 2.4 it is provided that the contractual rules applicable to the use of negotiable electronic records must provide for the manner in which the holder should be able to identify itself to the carrier. If these rules did not make such provision, an essential feature of any negotiable document, whether in electronic or in paper form, is missing. The consequence must be that the record is not negotiable.

173. Paragraphs (b) to (e) deal with the situation where a holder does not make use of its right to obtain delivery of the goods. Here the proper functioning of the bill of lading system is at stake. Parties may elect to follow a more risky course.

174. Because it is the cargo side that decides not to pay due regard to the contract function of the negotiable document, it is provided in paragraph (b) that, if a holder does not appear, the carrier must first seek instructions from any of the persons mentioned in this paragraph. These persons are obliged to give the carrier proper instructions, unless a valid "cesser clause" has released any of them from this obligation. Without such cesser clause, these persons might be held liable for not giving the carrier proper instructions to dispose of the goods. It is not provided that any of such persons should take delivery themselves. Here, without any proper instruction, a carrier has no option but to make use of its rights under article 10.4: storing and selling the goods. In fact, paragraph (b) follows the widespread practice that a charterer is contractually entitled to instruct a carrier in respect of delivery of the goods.

175. Paragraph (c) provides for the consequences when a carrier has complied with instructions given under the previous paragraph. In such a case, it is discharged from its general obligation to deliver the goods to the consignee. To avoid any doubts, it may not be discharged from all of its obligations under the contract of carriage, such as that to pay compensation where the goods are delivered in damaged condition.

176. The alternative would be that the carrier would not be discharged but should be entitled to obtain a proper indemnity from the shipper or the controlling party. However, such an alternative would remain open ended if no proper indemnity could be obtained by the carrier.

177. Under all circumstances it is desirable that the holder of a negotiable document be vigilant and, in principle, should take steps on the arrival of the ship in order to protect its security.

178. Paragraph (d) gives a rule for cases where no negotiable document has been surrendered when the carrier has delivered the goods, such as under paragraphs (b) and (c). First, it should be noted that in such a case the main rule of paragraph (a) prevails: the "innocent" third-party bill of lading holder may still be held entitled to claim delivery. The last part of paragraph (d) confirms this rule again. This remains a carrier's risk and forms an essential part of the balance that this whole article 10.3.2 tries to strike.

179. Frequently, however, a holder knows or should reasonably have known of the delivery without production of a negotiable document. In that event, and if it becomes holder after such a delivery, there is no longer any reason for protecting it. In such a case it only acquires rights under the bill of lading (such as the right to claim for damages to the goods) if it had become holder pursuant to a contractual or other arrangement that already existed before the delivery. Otherwise, the bill of lading must be regarded as exhausted. Consequently, this rule covers the bona fide cases where the passing of the bill of lading within the string of sellers and buyers is delayed. It does not exclude the possibility that after delivery certain rights under the exhausted bill of lading may be transferred to a third party, but this has to be effected by specific agreement and not by mere endorsement of the bill.

180. It has nevertheless been argued that provisions such as those of paragraphs (b) and (c) are likely to facilitate fraud. If the carrier is unable to locate the holder and takes instructions from the shipper, the shipper may (for instance) be able to destroy the security of a bank holding the documents by directing delivery elsewhere. And in general the bank's security is much reduced in effect if the goods can easily be delivered other than against the document or documents they hold.

181. On the other hand it can be said that in many parts of the world it is simply impossible for the carrier always to insist on surrender of a bill of lading against delivery and that to put the

carrier who parts with the goods otherwise always (or usually) in the wrong simply does not reflect the realities of delivery in many places and circumstances. Rather, a consignee or endorsee must be vigilant to seek delivery on arrival of the ship; and a bank holding a bill of lading as security must act positively in its own interests and be vigilant to watch for and take steps on the arrival of the ship whose bill of lading represents its security. It is then argued that provisions such as (b) and (c) facilitate modern trade.

182. Paragraph (e) refers to the general fall back position under article 10.4

10.4.1 (a) If the goods have arrived at the place of destination and:

- (i) The goods are not actually taken over by the consignee at the time and location mentioned in article 4.1.3 and no express or implied contract has been concluded between the carrier or the performing party and the consignee that succeeds to the contract of carriage; or
- (ii) The carrier is not allowed under applicable law or regulations to deliver the goods to the consignee;

then the carrier is entitled to exercise the rights and remedies mentioned in paragraph (b).

(b) Under the circumstances specified in paragraph (a), the carrier is entitled, at the risk and account of the person entitled to the goods, to exercise some or all of the following rights and remedies:

- (i) To store the goods at any suitable place;
- (ii) To unpack the goods if they are packed in containers, or to act otherwise in respect of the goods as, in the opinion of the carrier, circumstances reasonably may require; or
- (iii) To cause the goods to be sold in accordance with the practices, or the requirements under the law or regulations, of the place where the goods are located at the time.

(c) If the goods are sold under paragraph (b)(iii), the carrier may deduct from the proceeds of the sale the amount necessary to:

- (i) Pay or reimburse any costs incurred in respect of the goods; and
- (ii) Pay or reimburse the carrier any other amounts that are referred to in article 9.5 (a) and that are due to the carrier.

Subject to these deductions, the carrier shall hold the proceeds of the sale for the benefit of the person entitled to the goods.

10.4.2 The carrier is only allowed to exercise the right referred to in article 10.4.1 after it has given notice to the person stated in the contract particulars as the person to be notified of the arrival of the goods at the place of destination, if any, or to the consignee, or otherwise to the controlling party or the shipper that the goods have arrived at the place of destination.

10.4.3 When exercising its rights referred to in article 10.4.1, the carrier or performing party acts as an agent of the person entitled to the goods, but without any liability for loss or damage to these goods, unless the loss or damage results from [a personal act or omission of the carrier done with the intent to cause such loss or damage, or recklessly, with the knowledge that such loss or damage probably would result].

183. Occasionally, it happens that at the place of destination the carrier is not able or entitled to deliver the goods. The consignee

may not appear or may decline delivery of the goods while the shipper is not interested either, or the goods may be attached or delivery of them may otherwise be legally prevented. In this type of case, the carrier often has to do something in order to dispose of the goods.

184. Generally, this provision follows the provisions in the various national laws on this issue. The carrier should be given a reasonable freedom to act, but always within the limits of reasonableness. If it decides to sell the goods, applicable national law may provide for some form of court supervision. The net proceeds of such sale must be kept available to the person entitled to the goods on whose behalf the carrier has acted. Such person need not necessarily be a party to the contract of carriage, but may be an owner of the goods or an insurer.

11. RIGHT OF CONTROL

185. Unlike under other transport conventions, the subject of the right of control is not dealt with in maritime conventions. Practices that have developed under the bill of lading system may have been the reason that in the past no urgent need was felt. Today, the situation in maritime transport is different. In many trades the use of negotiable transport documents is rapidly decreasing or has entirely disappeared. Furthermore, a well defined and transferable right of control may play a useful role in the development of electronic commerce systems, where no electronic record as defined in this draft instrument is used.

11.1 The right of control of the goods means the right under the contract of carriage to give the carrier instructions in respect of these goods during the period of its responsibility as stated in article 4.1.1. Such right to give the carrier instructions comprises rights to:

- (i) Give or modify instructions in respect of the goods that do not constitute a variation of the contract of carriage;
- (ii) Demand delivery of the goods before their arrival at the place of destination;
- (iii) Replace the consignee by any other person including the controlling party;
- (iv) Agree with the carrier to a variation of the contract of carriage.

186. This provision defines the right of control. It makes a distinction between instructions that constitute a variation of the contract of carriage and instructions that do not. Paragraph (i) relates to "normal" instructions within the scope of a contract of carriage, such as to carry the goods at a certain temperature. Paragraphs (ii) and (iii) are important for an unpaid seller that may have retained title to the goods or may wish to exercise a right of stoppage under its contract of sale. Paragraph (ii) may enable the seller to prevent the goods from arriving in the jurisdiction of the consignee, while paragraph (iii) enables the controlling party to have the goods delivered to itself, its agent or to a new buyer. Paragraph (iv) underlines that, for all practical purposes, the controlling party is the carrier's counterpart during the carriage. This article gives the controlling party full control over the goods.

11.2 (a) When no negotiable transport document or no negotiable electronic record is issued, the following rules apply:

- (i) The shipper is the controlling party unless the shipper and consignee agree that another person is to be the controlling party and the shipper so notifies the carrier. The shipper and consignee may agree that the consignee is the controlling party;
- (ii) The controlling party is entitled to transfer the right of control to another person, upon

which transfer the transferor loses its right of control. The transferor or the transferee shall notify the carrier of such transfer;

- (iii) When the controlling party exercises the right of control in accordance with article 11.1, it shall produce proper identification.

(b) When a negotiable transport document is issued, the following rules apply:

- (i) The holder or, in the event that more than one original of the negotiable transport document is issued, the holder of all originals is the sole controlling party;
- (ii) The holder is entitled to transfer the right of control by passing the negotiable transport document to another person in accordance with article 12.1, upon which transfer the transferor loses its right of control. If more than one original of that document was issued, all originals must be passed in order to effect a transfer of the right of control;
- (iii) In order to exercise the right of control, the holder shall, if the carrier so requires, produce the negotiable transport document to the carrier. If more than one original of the document was issued, all originals shall be produced;
- (iv) Any instructions as referred to in article 11.1 (ii), (iii) and (iv) given by the holder upon becoming effective in accordance with article 11.3 shall be stated on the negotiable transport document.

(c) When a negotiable electronic record is issued:

- (i) The holder is the sole controlling party and is entitled to transfer the right of control to another person by passing the negotiable electronic record in accordance with the rules of procedure referred to in article 2.4, upon which transfer the transferor loses its right of control;
- (ii) In order to exercise the right of control, the holder shall, if the carrier so requires, demonstrate, in accordance with the rules of procedure referred to in article 2.4, that it is the holder;
- (iii) Any instructions as referred to in article 11.1 (ii), (iii) and (iv) given by the holder upon becoming effective in accordance with article 11.3 shall be stated in the electronic record.

(d) Notwithstanding the provisions of article 12.4, a person, not being the shipper or the person referred to in article 7.7, that transferred the right of control without having exercised that right, shall upon such transfer be discharged from the liabilities imposed on the controlling party by the contract of carriage or by this instrument.

187. Paragraph (a) applies in all cases except when a negotiable document has been issued. The principle is that the shipper is the controlling party, but that it may agree with the consignee otherwise. The second principle included in this paragraph is that the controlling party is entitled to transfer its right to any third party.

188. Unlike the position under, for instance, the Convention on the Contract for the International Carriage of Goods by Road, where a certain copy of the non-negotiable road consignment note has to be transferred in order to transfer the right of control, under paragraph (a) the document does not play any role. The

controlling party remains in control of the goods until their final delivery. Also, there is no automatic transfer of the right of control from the shipper to the consignee as soon as the goods have arrived at their place of delivery, as is the case under the International Maritime Committee Uniform Rules for Sea Waybills. If there were such automatic transfer, the most common shipper's instruction to the carrier, namely not to deliver the goods before it has received the confirmation from the shipper that payment of the goods has been effected, could be frustrated. This, obviously, would raise serious practical concern.

189. When a negotiable transport document has been issued, paragraph (b) applies. Here, it is provided that the holder of such document is the sole controlling party. If through endorsement the negotiable document is passed to another party, the right of control is automatically transferred as well. Further, the presentation rule applies if the holder wants to exercise its right of control. In order to protect third party holders, any variation of the contract of carriage has to be stated on the negotiable document.

190. A complication may arise if the negotiable document has been issued in more than one original. The provision follows the current practice that only holding the full set of originals entitles the holder to exercise the right of control. The consequence is that, if a person has parted with one (or more) originals and has kept one or more other originals, nobody is in control of the goods.

191. Paragraph (d) follows the principle laid down in article 12.1.2.

11.3 (a) Subject to the provisions of paragraphs (b) and (c) of this article, if any instruction mentioned in article 11.1 (i), (ii) or (iii):

- (i) Can reasonably be executed according to its terms at the moment that the instruction reaches the person to perform it;
- (ii) Will not interfere with the normal operations of the carrier or a performing party; and
- (iii) Would not cause any additional expense, loss, or damage to the carrier, the performing party, or any person interested in other goods carried on the same voyage;

then the carrier shall execute the instruction. If it is reasonably expected that one or more of the conditions mentioned in subparagraphs (i), (ii) and (iii) of this paragraph is not satisfied, then the carrier is under no obligation to execute the instruction.

(b) In any event, the controlling party shall indemnify the carrier, performing parties and any persons interested in other goods carried on the same voyage against any additional expense, loss or damage that may occur as a result of executing any instruction under this article.

(c) If a carrier:

- (i) Reasonably expects that the execution of an instruction under this article will cause additional expense, loss, or damage; and
- (ii) Is nevertheless willing to execute the instruction;

then the carrier is entitled to obtain security from the controlling party for the amount of the reasonably expected additional expense, loss or damage.

192. In article 11.1 the distinction is made between instructions that constitute variations of the contract of carriage and instructions that do not. In this article, the distinction is between instructions that a carrier, in principle, has to execute and instructions that are subject to agreement between the carrier and the

controlling party. The line of distinction is not the same in both articles. It is obvious that variations of the contract of carriage are fully subject to agreement between the carrier and the controlling party. However, that does not apply to the two variations mentioned under article 11.1 (ii) and (iii). These two, in principle, have to be executed by the carrier, because either may be needed for a seller to resume control over the goods under the contract of sale, for example, when the goods are not paid for by the buyer.

193. For the carrier to be under an obligation to execute the instructions, it needs the protection of certain conditions precedent. These are also addressed in this article. Other transport conventions include similar protections. A carrier is entitled to decline the execution of an instruction, *inter alia*, if the execution interferes with its normal operations. That means that the carrier may never be forced to call at other ports than the ports in its normal itinerary or to discharge cargo that is stowed over with other cargo. Also, the carrier may decline the instruction if it would incur additional costs.

194. The view has been expressed that these provisions, insofar as they give a right to a controlling party in situations where the carrier does not agree to the instruction, that is, a right to vary what would otherwise be contract terms, are likely to create extensive uncertainties in return for very small advantage. It is also argued that, in respect of the right of control, maritime carriage cannot be compared with other transportation modes. The contrary view is that similar safeguards under other transport conventions do not create any difficulty. Further, the point has been made that the right of control should not be diluted too far, because of its potential role in the development of electronic commerce in maritime transport.

11.4 Goods that are delivered pursuant to an instruction in accordance with article 11.1 (ii) are deemed to be delivered at the place of destination and the provisions relating to such delivery, as laid down in article 10, are applicable to such goods.

11.5 If, during the period that the carrier holds the goods in its custody, the carrier reasonably requires information, instructions or documents in addition to those referred to in article 7.3 (a), it shall seek such information, instructions or documents from the controlling party. If the carrier, after reasonable effort, is unable to identify and find the controlling party or the controlling party is unable to provide adequate information, instructions or documents to the carrier, the obligation to do so shall be on the shipper or the person referred to in article 7.7.

195. The provision addresses the issue that a carrier needs instructions from the party interested in the goods during the carriage. Examples are that the goods cannot be delivered as envisaged, that additional instructions are needed for the care of the goods, etc. The principal person to give the carrier instructions is the controlling party, because that party may be assumed to have the interest in the goods. The obligation to provide instructions also applies to an intermediate holder if it is the controlling party. In article 11.2 (c) it is provided that such intermediate holder is discharged from this obligation as soon as it is no longer holder.

196. However, a controlling party may not always exist or is not always known to the carrier. Then, the obligation is on the shipper or on the person referred to in article 7.7. If the controlling party elects not to give (appropriate) instructions, that party may become liable to the carrier for not giving them.

11.6 The provisions of articles 11.1 (ii) and (iii) and 11.3 may be varied by agreement between the parties. The parties may

also restrict or exclude the transferability of the right of control referred to in article 11.2 (a)(ii). If a transport document or an electronic record is issued, any agreement referred to in this paragraph must be stated in the contract particulars.

197. This provision underlines that these essential elements of the right of control are not part of mandatory law. A controlling party may have reasons for insisting that its right of control should not be transferable. Carriers may wish to exclude the possibility that delivery of the goods might be claimed during the voyage. However, see also the commentary to article 12.3.

12. TRANSFER OF RIGHTS

12.1.1 If a negotiable transport document is issued, the holder is entitled to transfer the rights incorporated in such document by passing such document to another person:

- (i) If an order document, duly endorsed either to such other person or in blank; or,
- (ii) If a bearer document or a blank endorsed document, without endorsement; or,
- (iii) If a document made out to the order of a named party and the transfer is between the first holder and such named party, without endorsement.

12.1.2 If a negotiable electronic record is issued, its holder is entitled to transfer the rights incorporated in such electronic record, whether it is made out to order or to the order of a named party, by passing the electronic record in accordance with the rules of procedure referred to in article 2.4.

12.2.1 Without prejudice to the provisions of article 11.5, any holder that is not the shipper and that does not exercise any right under the contract of carriage, does not assume any liability under the contract of carriage solely by reason of becoming a holder.

198. The only obligation that an intermediate holder may incur is to give a carrier instructions relating to the goods during the carriage when such intermediate holder is a controlling party. Giving instructions may be regarded to be in the interest of such intermediate holder. According to article 11.3 (c) such intermediate holder is discharged from this obligation as soon as it is no longer holder.

12.2.2 Any holder that is not the shipper and that exercises any right under the contract of carriage, assumes any liabilities imposed on it under the contract of carriage to the extent that such liabilities are incorporated in or ascertainable from the negotiable transport document or the negotiable electronic record.

199. A later holder is not allowed to pick and choose. If it exercises any of its rights, it automatically also assumes all of a later holder's liabilities. However, such liabilities must, first, be "imposed on it under the contract of carriage". This means that not necessarily all liabilities under the contract of carriage are assumed by a later holder. There may be certain liabilities that are only the shipper's liabilities, such as liabilities under the articles 7.1 and 7.3. Further, the carrier and the shipper may have expressly or impliedly agreed that certain liabilities should be shipper's liabilities only, such as demurrage incurred in the loading port. Second a later holder must be able to ascertain from the negotiable document itself that such liabilities exist. This may be particularly important if the carrier and shipper have agreed that certain liabilities, which otherwise would have been the shipper's liabilities, shall (also) be assumed by a later holder.

200. It may be that under this article the later holder assumes liabilities that also remain liabilities of the shipper. Whether in

such a case these liabilities are joint and several is not provided for in this article, but is left to the terms of the contract of carriage, as evidenced by the negotiable transport document.

12.2.3 Any holder that is not the shipper and that:

- (i) Under article 2.2 agrees with the carrier to replace a negotiable transport document by a negotiable electronic record or to replace a negotiable electronic record by a negotiable transport document, or
- (ii) Under article 12.1 transfers its rights,

does not exercise any right under the contract of carriage for the purpose of the articles 12.2.1 and 12.2.2.

12.3 The transfer of rights under a contract of carriage pursuant to which no negotiable transport document or no negotiable electronic record is issued shall be effected in accordance with the provisions of the national law applicable to the contract of carriage relating to transfer of rights. Such transfer of rights may be effected by means of electronic communication. A transfer of the right of control cannot be completed without a notification of such transfer to the carrier by the transferor or the transferee.

201. It is appreciated that, generally, an express referral to national law is not necessary in any international instrument. The purpose of doing so in this provision is to make clear that a transfer of rights under a contract of carriage is possible without the use of a document, or, if a non-negotiable document has been issued, without such a document becoming a negotiable one. Further, this provision includes two obligations for States parties to this draft instrument. The first is to provide in their national law that any transfer of rights under a contract of carriage can be done electronically. This is regarded as beneficial to the development of electronic commerce in transport. Commercial parties may wish to develop electronic commerce systems without the use of an electronic record as defined in this draft instrument, but based on a simple electronic transfer of a right of control only. The second requirement is to provide that such (electronic) transfer of the right of control cannot be completed without a notification of such transfer to the carrier. Then, a situation may (eventually) arise that national law may attach to an (electronic) transfer of a right of control proprietary rights, comparable with those that national law attaches to the transfer of a paper negotiable transport document.

12.4 If the transfer of rights under a contract of carriage pursuant to which no negotiable transport document or no negotiable electronic record has been issued includes the transfer of liabilities that are connected to or flow from the right that is transferred, the transferor and the transferee are jointly and severally liable in respect of such liabilities.

202. Article 12.3 does not deal with the transfer of liabilities under a contract of carriage (for which no negotiable document has been issued). However, it may be that national law relating to transfer of rights provides that such transfer includes (or may include) liabilities associated with the right transferred. It is fair to provide that the liability of the transferor and transferee in such cases is joint and several, because normally a carrier is only able to judge the solvency of the shipper, as the original party to the contract of carriage, and not the solvency of other parties.

13. RIGHTS OF SUIT

13.1 Without prejudice to articles 13.2 and 13.3, rights under the contract of carriage may be asserted against the carrier or a performing party only by:

- (i) The shipper;

- (ii) The consignee;
- (iii) Any third party to which the shipper or the consignee has assigned its rights, depending on which of the above parties suffered the loss or damage in consequence of a breach of the contract of carriage;
- (iv) Any third party that has acquired rights under the contract of carriage by subrogation under the applicable national law, such as an insurer.

In case of any passing of rights of suit through assignment or subrogation as referred to above, the carrier and the performing party are entitled to all defences and limitations of liability that are available to it against such third party under the contract of carriage and under this instrument.

203. This provision applies to any contract of carriage, whether or not a document or electronic record has been issued and, if it has been issued, irrespective of its nature. A contracting shipper and a consignee can only assert those rights that belong to it and if it has a sufficient interest to claim. This means that in the case of loss of or damage to the goods the claimant must have suffered the loss or damage itself. If another person, for example, the owner of the goods or an insurer, is the interested party, such other person must either acquire the right of suit from the contracting shipper or from the consignee, or, if possible, assert a claim against the carrier outside the contract of carriage.

13.2 In the event that a negotiable transport document or negotiable electronic record is issued, the holder is entitled to assert rights under the contract of carriage against the carrier or a performing party, without having to prove that it itself has suffered loss or damage. If such holder did not suffer the loss or damage itself, it is to be deemed to act on behalf of the party that suffered such loss or damage.

204. It seems that under many legal systems claimants under a bill of lading are not confined to claiming for their own loss. This article does not provide that only such holder has the right of suit. Therefore, the second sentence is needed in order to avoid the possibility that a carrier might have to pay twice.

13.3 In the event that a negotiable transport document or negotiable electronic record is issued and the claimant is one of the persons referred to in article 13.1 without being the holder, such claimant must, in addition to its burden of proof that it suffered loss or damage in consequence of a breach of the contract of carriage, prove that the holder did not suffer such loss or damage.

205. A person mentioned in article 13.1 should not be dependent on the cooperation of the holder of a negotiable document if it and not the holder is the person who has suffered the damage. It might be that the holder, being a seller/shipper, has already received the full purchase price of the goods and is no longer interested in lodging a claim. Or it might be that the holder, being a purchaser/consignee, rejects the (damaged) goods and does not pay for them, in which case the seller/shipper must be entitled to claim damages from the carrier. In order to protect the position of the holder against the loss of the right of suit, it seems fair that in this type of case the claimant has to prove that the holder did not suffer the damage.

14. TIME FOR SUIT

14.1 The carrier is discharged from all liability in respect of the goods if judicial or arbitral proceedings have not been instituted within a period of one year. The shipper is discharged from all liability under chapter 7 of this instrument if judicial or arbitral proceedings have not been instituted within a period of one year.

206. The first sentence of this provision is loosely based on article 20, rule 1, of the Hamburg Rules and the fourth paragraph of article III, rule 6, of the Hague and Hague-Visby Rules. The second sentence reflects the view expressed at the thirty-seventh International Conference of the International Maritime Committee (Singapore Conference) that actions against the shipper under chapter 7 should also be subject to a time-for-suit provision.

207. The limitation period specified here follows the Hague and Hague-Visby Rules. Under the Hamburg Rules, the limitation period is two years. Those delegates who addressed the issue at the Singapore Conference appeared to believe that a one-year limitation period would be adequate.

208. To avoid ambiguity, the article clarifies that the carrier or the shipper, as the case may be, is discharged from all liability on the expiration of the period. On the expiration of the period the potential claimant loses the right, not simply the remedy.

14.2 The period mentioned in article 14.1 commences on the day on which the carrier has completed delivery of the goods concerned pursuant to article 4.1.3 or 4.1.4 or, in cases where no goods have been delivered, on the last day on which the goods should have been delivered. The day on which the period commences is not included in the period.

209. This provision is generally based on article 20, rules 2 and 3, of the Hamburg Rules and the fourth paragraph of article III, rule 6, of the Hague and Hague-Visby Rules. Although defining "delivery" has caused problems in some national legal systems, the clarifications in chapters 4 and 10 of the present draft instrument should provide greater clarity and predictability than exists under current law.

14.3 The person against whom a claim is made at any time during the running of the period may extend that period by a declaration to the claimant. This period may be further extended by another declaration or declarations.

210. This provision is based on article 20, rule 4, of the Hamburg Rules and the fourth paragraph of article III, rule 6, of the Hague-Visby Rules.

14.4 An action for indemnity by a person held liable under this instrument may be instituted even after the expiration of the period mentioned in article 14.1 if the indemnity action is instituted within the later of:

- (a) The time allowed by the law of the State where proceedings are instituted; or
- (b) 90 days commencing from the day when the person instituting the action for indemnity has either:
 - (i) Settled the claim; or
 - (ii) Been served with process in the action against itself.

211. This provision is substantially based on article 20, rule 5, of the Hamburg Rules and the sixth paragraph of article III, rule 6 of the Hague-Visby Rules.

[14.5 If the registered owner of a vessel defeats the presumption that it is the carrier under article 8.4.2, an action against the bareboat charterer may be instituted even after the expiration of the period mentioned in article 14.1 if the action is instituted within the later of:

- (a) The time allowed by the law of the State where proceedings are instituted; or
- (b) 90 days commencing from the day when the registered owner both:

- (i) Proves that the ship was under a bareboat charter at the time of the carriage; and
- (ii) Adequately identifies the bareboat charterer.]

212. This provision addresses the concern that the limitation period may have expired before a claimant has identified the bareboat charterer that is responsible as “carrier” under article 8.4.2. It was felt that the claimant should have an extension comparable to the extension under article 14.4 for bringing an indemnity action.

15. GENERAL AVERAGE

15.1 Nothing in this instrument prevents the application of provisions in the contract of carriage or national law regarding the adjustment of general average.

15.2 With the exception of the provision on time for suit, the provisions of this instrument relating to the liability of the carrier for loss of or damage to the goods also determine whether the consignee may refuse contribution in general average and the liability of the carrier to indemnify the consignee in respect of any such contribution made or any salvage paid.

213. The wording is based on article 24 of the Hamburg Rules. It reflects the principle that first the general average adjustment has to be made and the general average award has to be established, whereafter liability matters may be considered.

16. OTHER CONVENTIONS

16.1 This instrument does not modify the rights or obligations of the carrier or the performing party provided for in international conventions or national law governing the limitation of liability relating to the operation of [seagoing] ships.

16.2 No liability arises under the provisions of this instrument for any loss of or damage to or delay in delivery of luggage for which the carrier is responsible under any convention or national law relating to the carriage of passengers and their luggage by sea.

16.3 No liability arises under the provisions of this instrument for damage caused by a nuclear incident if the operator of a nuclear installation is liable for such damage:

(a) Under either the Paris Convention on Third Party Liability in the Field of Nuclear Energy of 29 July 1960, as amended by the Additional Protocol of 28 January 1964, or the Vienna Convention on Civil Liability for Nuclear Damage of 21 May 1963; or

(b) By virtue of national law governing the liability for such damage, provided that such law is in all respects as favourable to persons who may suffer damage as either the Paris or Vienna Conventions.

214. These provisions are based on article 25, rules 1, 3 and 4, of the Hamburg Rules. They will need to be updated at a later stage.

17. LIMITS OF CONTRACTUAL FREEDOM

17.1 (a) Unless otherwise specified in this instrument, any contractual stipulation that derogates from the provisions of this instrument are null and void, if and to the extent it is intended or has as its effect, directly or indirectly, to exclude [or] limit [or increase] the liability for breach of any obligation of the carrier, a performing party, the shipper, the controlling party or the consignee under the provisions of this instrument;

(b) [Notwithstanding paragraph (a), the carrier or a performing party may increase its responsibilities and its obligations under this instrument;]

(c) Any stipulation assigning a benefit of insurance of the goods in favour of the carrier is null and void.

215. The Hague Rules adopted the one-sided policy of prohibiting the carrier from reducing its liability, although a carrier may increase its liability. There are no explicit restrictions with respect to the shipper’s liability. The Hamburg Rules do not permit any derogation from its provisions and this may include a prohibition on increasing the shipper’s liability. But increasing the carrier’s liability is explicitly permitted.

216. The basic thrust of this article prohibits any reduction of liability below what is prescribed by the draft instrument, but it should be noted that this general rule applies to the liability not only of the carrier but also of performing parties, the shipper, the controlling party and the consignee.

217. The variants in square brackets deal with the possible prohibition of increasing liabilities and responsibilities. It would be possible to render unenforceable any increase of liabilities outside the draft instrument (on either side or on one side). The present draft instrument contains detailed rules about the responsibilities of the various parties and the effect of preventing any reduction of them or any increase of them, requires careful analysis.

218. The resolution of the issues identified in the commentary to articles 3.3 and 3.4 will affect at least the practical impact of this article. To the extent that modern equivalents of a traditional charter-party (such as a slot or space charter), volume contracts and towage contracts are excluded from the draft instrument’s scope of application, there will be a greater scope for freedom of contract. The resolution of these issues may also require a revision of the text of this article. For example, if the suggestion is accepted to subject volume contracts to the terms of this draft instrument (at least as a default rule) but to permit the parties to a volume contract to derogate from the terms of this draft instrument (at least as between the immediate parties to the volume contract), then this article will need to be revised to reflect such a conclusion.

17.2 Notwithstanding the provisions of chapters 5 and 6 of this instrument, both the carrier and any performing party may by the terms of the contract of carriage exclude or limit their liability for loss of or damage to the goods if:

(a) The goods are live animals; or

(b) The character or condition of the goods or the circumstances and terms and conditions under which the carriage is to be performed are such as reasonably to justify a special agreement, provided that ordinary commercial shipments made in the ordinary course of trade are not concerned and no negotiable transport document or negotiable electronic record is or is to be issued for the carriage of the goods.

219. In the Hague and Hague-Visby Rules live animals are excluded in the definition of goods. It is felt, however, that the exclusion of live animals is only justified for the purposes of the liability of carriers. Other provisions, such as those dealt with in chapters 7 and 11, are relevant to the carriage of live animals. Accordingly, the better place to deal with live animals is in this provision.

220. Paragraph (b) covers in simplified wording the seldom-applied escape possibility of article VI of the Hague and Hague-Visby Rules.

(A/CN.9/WG.III/WP.21/Add.1)

C. Note by the Secretariat on the preliminary draft instrument on the carriage of goods by sea: comments by the Economic Commission for Europe and the United Nations Conference on Trade and Development, working paper submitted to the Working Group on Transport Law at its ninth session

ADDENDUM

On 30 January and 5 February 2002, the Secretariat received comments on the preliminary draft instrument on the carriage of goods by sea by the Economic Commission for Europe and the United Nations Conference on Trade and Development respectively. Those comments are reproduced in annexes I and II in the form in which they were received; only typographical errors and errors of fact or terminology have been corrected.

ANNEX I

COMMENTS OF THE SECRETARIAT OF THE ECONOMIC COMMISSION FOR EUROPE ON THE DRAFT INSTRUMENT ON TRANSPORT LAW¹

I. INTRODUCTION

1. The present paper includes three parts. The introductory remarks briefly explain the involvement of the Economic Commission for Europe (ECE) in the field of multimodal transport, chapter II summarizes the comments of the ECE secretariat on the draft instrument on transport law presented by the secretariat of the United Nations Commission on International Trade Law (UNCITRAL) and chapter III presents some general conclusions.

2. The comments were prepared at the invitation of the UNCITRAL secretariat to be included in the background paper that will be submitted by the secretariat to the UNCITRAL Working Group on Transport Law, at its next meeting (15-26 April 2002) in New York.

3. ECE administers some 50 international conventions and agreements in the field of transportation, such as the Convention on the Contract for the International Carriage of Goods by Road and the International Convention to Facilitate the Crossing of Frontiers for Goods Carried by Rail. ECE is also co-author of the Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways, together with the Central Commission for the Navigation on the Rhine and the Danube Commission. In 1998, ECE was mandated by its member Governments (all European and Central Asian States, Canada, Israel and the United States of America) to study the possibilities for reconciliation and harmonization of civil liability regimes governing multimodal transport. Two expert group hearings were convened in 2000, at which a large number of governmental experts and representatives of shippers, freight forwarders, insurers, multinational companies, manufacturers and maritime, road, rail and combined transport interests participated. As a result of these hearings, two trends could be clearly identified: there was a large consensus on the principle of working towards achieving more transparent, harmonized and cost-effective rules to regulate multimodal transport, but there was no agreement on the approach to be adopted towards achieving that objective and, first of all, on whether this could and should be achieved through a new convention or through other alternative means. Experts representing mainly

maritime interests as well as freight forwarders and insurance companies generally did not favour the preparation of an international mandatory legal regime on civil liability covering multimodal transport operations. However, experts representing road and rail transport industries, combined transport operators, transport customers and shippers felt that work towards harmonization of the existing modal liability regimes should be pursued urgently and that a single international civil liability regime governing multimodal transport operations was required.

4. During recent discussions between the ECE, United Nations Conference on Trade and Development (UNCTAD) and UNCITRAL secretariats, it was agreed that possible work on the desirability and feasibility of a new international legal instrument covering door-to-door issues should be undertaken with the active involvement and substantive contributions of the three United Nations governmental organizations, as well as in cooperation with other interested United Nations organizations and with the participation of all competent non-governmental organizations and industry groups.

II. COMMENTS

A. Mandate of work

5. The starting point for UNCITRAL's work on the draft instrument on transport law² can be found during the discussions on future work in the area of electronic commerce, following the adoption of the UNCITRAL Model Law on Electronic Commerce at UNCITRAL's twenty-ninth session, in 1996. The session considered a proposal to include in UNCITRAL's work programme "a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving uniformity of laws".³

6. It was stated during that session that "the review of the liability regime was not the main objective of the suggested work;

¹Annex to document A/CN.9/WG.III/WP.21, "Transport Law: preliminary draft instrument on the carriage of goods by sea—note by the Secretariat", of 8 January 2002, pp. 9-70. The draft instrument was prepared by the International Maritime Committee.

²Referred to hereinafter as the "instrument".

³A/CN.9/497, Report of the Secretary-General on possible future work on transport law, para. 1.

rather, what was necessary was to provide modern solutions to the issues that either were not adequately dealt with or were not dealt with at all in treaties".⁴

7. The Commission decided that the UNCITRAL secretariat "should be the focal point for gathering information, ideas and opinions as to the problems that arose in practice and possible solutions to those problems. Such information-gathering should be broadly based and should include, in addition to Governments, the international organizations representing the commercial sectors involved in the carriage of goods by sea".⁵ The International Maritime Commission (CMI) stated at the Commission's thirty-first session, in 1998, that it welcomed the invitation to cooperate with the Secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information.⁶

8. At its thirty-fourth session, the Commission decided to establish a working group to consider issues of future work on transport law. With regard to the mandate of the working group, the Commission decided that considerations should cover initially port-to-port transport operations (including liability issues). However the working group could study the desirability and feasibility of dealing also with door-to-door transport operations, or certain aspects of those operations. Depending on the results of those studies, the working group could recommend to the Commission an appropriate extension of its mandate. The Commission also agreed that the work would be carried out in close cooperation with interested intergovernmental as well as international non-governmental organizations.⁷

9. In conclusion, the mandate given concerns the revision of maritime law and is limited to port-to-port transport operations. That explains the fact that the parties invited to contribute by the secretariat were sea-transport-related interests.

10. The ECE secretariat welcomes UNCITRAL's initiative to harmonize and modernize maritime transport law. With regard to the study of the desirability and feasibility of dealing with door-to-door transport operations, the ECE secretariat supports the Commission's recommendation that this work should be carried out in close cooperation with all interested parties and is willing actively to participate in it.

B. Scope of application of the instrument

11. The instrument is called a draft instrument on transport law. According to the title, it does not deal with maritime transport issues in particular. According to the definition of its scope of application (chapter 3) combined with the definition of the contract of carriage (article 1.5), the instrument will apply whenever

⁴Ibid., para. 5.

⁵Ibid., para. 6.

⁶Ibid., para. 7. CMI set up a working group (May 1998) and an international subcommittee (November 1999) to consider in what areas of transport law not at present governed by international liability regimes, greater international uniformity might be achieved; to prepare the outline of an instrument designed to bring about uniformity of transport law; and thereafter to draft provisions to be incorporated in the proposed instrument including those relating to liability. In September 2000, the CMI Executive Committee confirmed that the terms of reference of the International Subcommittee should extend to considering how the instrument might accommodate other forms of carriage associated with the carriage by sea. The CMI Singapore Conference, held in February 2001, discussed the outline instrument and concluded that multimodalism should be dealt with in the instrument.

⁷A/CN.9/WG.III/WP.21, para. 23.

a sea leg is involved. There was some discussion about the relative importance of the other modes of transport compared to the sea leg, but it was finally decided that the instrument "should contain provisions applying to the full scope of the carriage irrespective of whether or not the movement on land may be deemed subsidiary to that by sea, providing carriage by sea is contemplated at some stage".⁸

12. The instrument goes beyond maritime transport and port-to-port issues; it extends to door-to-door issues.

C. Door-to-door transport and the network system

13. The extension of liability coverage from the tackle-to-tackle carriage under the Hague-Visby Rules or port-to-port carriage under the Hamburg Rules to door-to-door carriage is said to respond to the reality of containerized transport of goods. According to article 4.2.1 of the instrument, the liability limits which, according to the explanatory notes to article 6.7, will be drafted along the lines of the Hague-Visby Rules, shall apply in all cases of non-located damage. This means that the liability rules drafted with a view to a mere maritime transportation may extend to other modes of transport such as a transport by road, rail and inland waterways. Such an approach seems, however, to be questionable when the instrument has not taken into account the views of the parties involved in other modes of transport than sea, as well as the point of view of the shippers, which finally create the transport demand. Rather, the instrument only reflects the view of the maritime-transport-related interests.

14. According to the comments to article 4.2.1 of the instrument, it is necessary to make provisions for the relationship between this instrument and conventions governing inland transport that may apply. This article provides for an as minimal as possible network system. The draft instrument is only displaced where a convention that constitutes mandatory law for inland carriage, is applicable to the inland leg of a contract for carriage by sea and it is clear that the loss or damage in question occurred solely in the course of inland carriage.⁹

15. The broad scope of the instrument may create conflict among conventions in cases where other unimodal conventions address the issue of multimodal/combined transport as well as in some narrowly defined instances. An example may be the case when a lorry transporting goods by road is carried over part of the journey by sea (for example, from France to the United Kingdom of Great Britain and Northern Ireland) and the goods have not been unloaded from the vehicle and the damage has not been localized. In such a situation, both the Convention on the Contract for the International Carriage of Goods by Road and the instrument are likely to apply. Article 2 of that Convention says that it applies to the whole carriage in this situation and chapter 4 of the instrument requires the instrument to be mandatorily applicable as long as it cannot be proved where the loss or damage occurred.¹⁰ This conflict of conventions should, however, be avoided.

16. There is certainly a need to further explore the possibilities of harmonization of the liability rules relating to a maritime transport on one hand and to an inland transport on the other hand. If rules governing the applicable law in a multimodal transport will still be needed, further consideration should also be given to the

⁸CMI document "Singapore I: issues of transport law—door-to-door transport", para. 3.2, available on the Internet at www.comitemaritime.org.

⁹See A/CN.9/WG.III/WP.21, annex, para. 49.

¹⁰See comments on chapter 4 of the instrument in A/CN.9/WG.III/WP.21.

different national solutions that exist today. Thus, the Netherlands provides in cases of non-localized damage in a multimodal transport for the applicability of the regime most favourable to the consignor. In contrast, Germany provides in cases of non-localized damage in a multimodal transport for the applicability of a single set of rules that mainly follows the Road Carriage Convention. However, special rules are provided for notice of loss, damage or delay and the limitation period.

17. Multimodal transport and containerized multimodal transport (intermodal transport) often involve a sea leg, but at the same time, and especially in Europe, multimodal transport involves to a major extent only inland transport modes (often referred to as combined transport). The CMI subcommittee found that although bills of lading were still used, especially where a negotiable document was required, the actual carriage of goods by sea sometimes represented only a relatively short leg of an international transport of goods.¹¹ Consideration should also be given to the relative economic importance of the sea leg in intermodal transport. In the view of the ECE secretariat, if and when a clear mandate is obtained on the elaboration of a multimodal transport convention, it is necessary, given the increasing integration of all modes of transport into the international logistics chain, that the new regime applies to all possible combinations of modes of transport and should not be restricted to the presence of a sea leg. It is also indispensable that representatives from all modes involved in multimodal transport, as well as from the shippers and from other interested parties, are consulted and participate in the elaboration of such an instrument.

18. According to article 6.3.1 of the instrument, liability is imposed on "performing parties"—those that perform the contractual carrier's "core obligations" under the contract of carriage. Where a performing party's liability is questioned directly by the cargo claimant's interests, it means that the claimant has been able to localize the loss or damage. In cases where the performing party performs the carriage preceding or subsequent to sea carriage, according to article 4.2.1 of the instrument, he will be subject, by virtue of the network system, to another legal mandatory regime. Quid in this case of the application of the defences provided for in article 6.3.3 (also incorporated in 6.3.1 (a))?

D. Carrier's liability

19. If a future instrument shall cover other modes of transport than transport by sea, a comparative analysis is needed as to the liability provisions. In most unimodal conventions, such as the Road Carriage Convention, the liability provisions are mandatory. The instrument provides, however, for several opting-out possibilities. One is found in article 4.3 (Mixed contracts of carriage and forwarding), which gives the carrier the possibility to act as an agent in respect of a specified part of the transport of goods and thereby to limit his liability to due diligence in selecting and

instructing the other carrier. Another one can be found in article 4.1.2, which gives the carrier, by contractually defining the period of responsibility, the right to restrict his liability (articles 5.2.1 and 6.1.1). Similar provisions cannot be found in conventions such as the Road Carriage Convention or the Convention concerning International Carriage by Rail.

20. Moreover, the carrier's exceptions are drafted merely with the view to a pure maritime transport. This can especially be seen in articles 6.1.2 and 6.1.3 of the instrument. The ECE secretariat supports the view that when work begins on the elaboration of an instrument covering door-to-door transport, consideration should be given to exceptions granted under other unimodal transport law conventions as well.

III. CONCLUSIONS

21. When it comes to finding solutions for the issue of civil liability in multimodal transport, the ECE secretariat strongly feels that further work to be undertaken in this field should not be based on the specific requirements of any particular mode of transport. Instead, it is necessary for all relevant interested parties to be consulted and participate in the elaboration of such an instrument.

22. The ECE secretariat considers it important to reconcile, in the longer term, civil liability rules for multimodal transport in a single regulation, thereby doing away with the present situation of legal uncertainty and forum shopping. Consequently it is necessary to avoid the creation of a number of multimodal transport regulations, which may even overlap. Given the special situation in maritime law regulations, the ECE secretariat believes that UNCITRAL has taken an important step towards the revision and modernization of the law governing international carriage of goods by sea. In this context, the contributions made by CMI are significant.

23. The ECE secretariat believes that, at this stage, the Commission should concentrate its efforts on port-to-port solutions. Coverage of door-to-door transport necessitates more studies and consultations. The instrument as it stands does not seem appropriate for covering multimodal transport, as it does not take into consideration all necessary factors, some of which have been developed above.

24. The ECE secretariat proposes therefore that the discussion of port-to-port issues during the forthcoming meeting of the UNCITRAL Working Group on Transport Law (15-26 April 2002) be separated from the discussion on door-to-door transport.

25. The ECE secretariat has proposed to organize a joint UNCITRAL-UNCTAD-ECE global hearing of all relevant industries and other parties interested in multimodal transport, which would assist in determining the desirability and feasibility of a new international instrument on multimodal transport contracts, including liability issues.

¹¹See A/CN.9/497, para. 13.

ANNEX II

COMMENTS SUBMITTED BY THE SECRETARIAT OF THE UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT ON THE DRAFT INSTRUMENT ON TRANSPORT LAW

I. INTRODUCTION

1. The United Nations Commission on International Trade Law (UNCITRAL) at its thirty-fourth session in determining the mandate of the Working Group specifically provided that "... the

considerations in the working group should initially cover port-to-port transport operators; however, the working group would be free to study the desirability and feasibility of dealing also with door-to-door transport operations, . . . and, depending on the results of those studies, recommend to the Commission an

appropriate extension of the working group's mandate. . . It was also agreed that the work would be carried out in close cooperation with interested intergovernmental organizations involved in work on transport law (such as UNCTAD, ECE . . .).¹

2. The involvement of UNCTAD with transport law, including both maritime and multimodal transport, goes as far back as the early 1970s. The relevant areas of work include the initial preparatory work in relation to the Hamburg Rules;² the preparation and adoption (under the auspices of UNCTAD) of the United Nations Convention on International Multimodal Transport of Goods (1980); the preparation, jointly with the International Chamber of Commerce (ICC), of the UNCTAD/ICC Rules for Multimodal Transport Documents; and an analysis of the implementation of multimodal transport rules³ following a request from the UNCTAD Ministerial Conference held in Bangkok in February 2000. More recently an Ad Hoc Expert Meeting on Multimodal Transport was convened (November 2001), and following its recommendations, the secretariat intends to study the feasibility of establishing a widely acceptable new international convention on multimodal transport. The results of the study will be made available to the Working Group and we hope it would assist the Working Group in its decision.

3. In view of this background the commentary on the draft instrument is provided for consideration of the Working Group. It includes some general observations highlighting areas of particular concern as well as specific comments on individual provisions. Owing to restrictions of time and space, the comments presented are of a preliminary nature.

II. GENERAL OBSERVATIONS

4. The draft instrument reproduced in the annex to UNCITRAL document A/CN.9/WG.III/WP.21 is entitled "Draft instrument on transport law". To a large extent, it covers matters that are dealt with in existing mandatory liability regimes in the field of carriage of goods by sea, namely the Hague-Visby Rules⁴ and the Hamburg Rules. In addition, the draft instrument also contains several chapters to deal with matters currently not subject to international uniform law, such as freight and the transfer of the right of control and of rights of suit. Special attention would need to be paid to some aspects of the draft instrument that present particular concerns, as outlined below.

Substantive scope of application

5. Despite the fact that the present mandate of the Working Group does not extend beyond consideration of port-to-port transportation, the draft instrument contains provisions that would extend its application to door-to-door transport (see also the title "Draft instrument on transport law"). According to the definition in article 1.5 of the draft instrument, contracts for multimodal transportation involving a sea-leg would be covered by the proposed regime. This gives rise to concern, as the draft instrument has been drawn up by representatives of only maritime interests, the International Maritime Committee (CMI), without broad consultation of parties involved with and experienced in the other modes of transportation. As a result, the proposed regime is, in

substance, based on maritime concepts and existing maritime liability regimes, which puts into question its suitability as a modern legislative framework to regulate liability where contracts involve several modes of transportation (e.g., air, road, rail or inland waterway carriage as well as sea carriage).

6. The current regulatory framework in the field of international multimodal transportation is notoriously complex and no uniform liability regime is in force internationally. As a result, liability is fragmented and cannot be assessed in advance.⁵ While the development of uniform international regulation in the field may be desirable, any new international liability regime would have to offer clear advantages as compared with the existing legal framework in order to succeed. Any new, but poorly designed or otherwise unsuccessful regime would only add to the current complexity without providing any benefits. The draft instrument does not appear to propose a solution that takes these considerations into account. It should be noted that, irrespective of the substantive merit of its provisions, the draft instrument does not provide for uniform levels of liability throughout all stages of a transport. Instead, it gives precedence to mandatory rules in unimodal transport conventions in cases where a loss or damage can be attributed to a particular stage of a multimodal transport (art. 4.2.1). As a result of this "network" approach to liability regulation, the determination of liability issues in door-to-door transactions would continue to involve the question of which particular regime may be applicable in a given jurisdiction and in a particular case. It is difficult to see in what way this approach would provide an improvement to the present regulatory framework. The analytical commentary in the document includes considerations relevant to the text of the draft instrument as presented. However, it is proposed to remove from the draft the provisions extending the scope of application of the regime beyond port-to-port transportation and to restrict the considerations of the Working Group, in accordance with its mandate, to maritime transport.

Substantive liability rules

7. The set of substantive liability rules proposed in the draft instrument appears to consist of a rather complex amalgamation of provisions in the Hague-Visby and Hamburg Rules, but with substantial modifications in terms of substance, structure and text. To a considerable extent, therefore, the benefits of certainty associated with the established meaning of provisions in existing regimes have been sacrificed. This should be borne in mind when considering the desirability of including in the draft instrument individual provisions that have been modelled on those in existing regimes, but where the context or wording has been modified significantly. Overall, the draft instrument appears to adopt a new approach to risk distribution between carrier and cargo interests, with a shift in balance favourable to carriers. In contrast to the Hague-Visby and Hamburg Rules, there is little evidence of any underlying intention to protect the interests of third parties to the contract of carriage.

Regulation of matters currently not subject to uniform international law

8. Chapters 9 (Freight), 11 (Right of control), 12 (Transfer of rights) and 13 (Rights of suit) in particular deal with matters of some complexity, which are not currently regulated in any international convention. The relevant national laws that are presently

¹See *Official Records of the General Assembly, Fifty-sixth session, Supplement No. 17 (A/56/17)*, para. 345.

²United Nations Convention on the Carriage of Goods by Sea (1978).

³See document UNCTAD/SDTE/TLB/2 and Add.1.

⁴International Convention for the Unification of Certain Rules of Law relating to Bills of Lading of 1924 (the Hague Rules), as amended in 1968 and 1979.

⁵For an overview of existing regulations, see the report and comparative table on implementation of multimodal transport rules, prepared by the UNCTAD secretariat (UNCTAD/SDTE/TLB/2 and Add.1).

applicable in these areas are diverse and it can be assumed that there is no consensus at the international level. Against this background, any attempt at developing successful regulation needs to be made with a clear and carefully considered purpose and great attention to detail. As presented, the proposed provisions contained in the draft instrument do not appear to be sufficiently clear and uncontroversial to make their inclusion in a new international regime desirable. The Working Group may therefore wish to consider more generally, whether it is advisable at this stage to attempt to deal with these matters.

Structure and drafting

9. Both in text and structure the draft instrument is unnecessarily complex and confusing. Unfortunately, little consideration appears to have been given to the need to ensure that internationally uniform rules are easy to understand and to apply. Many of the provisions are complicated, with extensive cross-referencing. Their understanding requires considerable legal expertise and often the proposed wording leaves much scope for interpretation. In many instances, lengthy and costly litigation may be required to clarify the meaning and application of provisions. There is obvious potential for considerable national differences in the interpretation of the proposed regulation; an outcome which would clearly be undesirable. The complexity of the draft instrument, as currently structured and drafted, makes assessment of its potential impact as a whole difficult. Unfortunately, there is thus the likelihood that efforts to amend the text of individual provisions may in turn create new problems, which may not always be apparent. In fact, it is doubtful whether a text suitable for uniform regulation and workable in practice can be agreed on the basis of the draft instrument as presented.

III. COMMENTARY ON INDIVIDUAL PROVISIONS

Note: The commentary should be read together with the text of the relevant provisions, which is reproduced in document A/CN.9/WG.III/WP.21.

A. Definitions

10. The chapter providing definitions for use throughout the draft instrument is not coherently structured. For the sake of clarity, the parties covered by the draft instrument and any reference to them should be dealt with in sequence. Similarly, all definitions relating to transport documents and electronic records should appear in sequence at a suitable point. Many of the provisions are complicated and give rise to uncertainty. This is unfortunate, as the purpose of a definition is to clarify the meaning of terms. It is not clear why none of the definitions adopts the wording established in existing conventions.

11. **Article 1.1, Carrier:** The definition of “carrier” is narrow and does not make reference to parties on whose behalf a contract of carriage is made. The position of freight forwarders under the draft instrument is not entirely clear, as these parties are arguably covered by the definition of carrier.

12. **Article 1.2, Consignee:** The definition is supplemented by the definition of a holder (art. 1.12) in cases where a so-called “negotiable” transport document or electronic record has been used. The definition makes reference to a transport document/electronic record in addition to the contract of carriage. It should be noted that several transport documents as defined in article 1.20 may have been issued, for example, by the contracting carrier and by different performing parties (see comment to art. 1.20) and naming different consignees.

13. **Article 1.3, Consignor:** The definition is restricted to a “person” that delivers goods to a carrier. No reference is made to delivery to a performing party or delivery by anyone acting on behalf of the shipper or consignee. The substantive provisions of the draft instrument refer to the consignor expressly only in article 8.1, where this party is given a right to demand a receipt upon delivery of goods to a carrier or performing party. If a consignor is identified as the shipper in the transport document, the provision of article 7.7 becomes relevant and a number of the contracting shipper’s responsibilities may fall on the consignor.

14. **Article 1.4, Container:** The definition of “container” is extremely wide and as such apt to include any unit load used to consolidate goods. The wide definition needs to be borne in mind when considering the carrier’s general right to load containers on deck (art. 6.6.1 (ii)) which is coupled with much limited responsibility for loss of such cargo and in connection with the carrier’s right to qualify the description of the goods (art. 8.3)

15. **Article 1.5, Contract of carriage:** This is one of the most central, controversial and problematic provisions of the draft instrument. The definition is apt to include any contract for the carriage of goods by different modes (see also the title of the draft instrument: “Draft instrument on transport law”). Typically, a contract for door-to-door transport will not specify the different modes of transport that may be used. Whether part of the contract is carried out by sea is often a commercial decision made by the carrier and not known to the cargo interests. Under the definition, any multimodal transport contract would be subject to the regime if part of the transport were in fact carried out by sea. As a result, most international transport contracts would potentially become subject to a regime that is essentially based on existing maritime concepts and liability regimes and has been drafted by representatives of largely maritime interests (CMI), without consultation with representatives of the other modes of transport. The proposed wide substantive scope of application of the draft instrument exceeds the initial mandate of the UNCITRAL Working Group as adopted by the Commission.⁶ Moreover, the draft instrument does not appear to provide coherent and suitable regulation for multimodal transportation (see general observations, above). The substantive scope of application of any regime now under discussion should therefore be restricted to maritime transport and the provision in article 1.5 should be amended to cover only contracts for the carriage of goods by sea.

16. **Article 1.6, Contract particulars:** The definition needs to be considered together with article 8.2, which sets out the contract particulars required for inclusion in a transport document or electronic record issued by the carrier or performing party. In article 7.7, the draft instrument refers to the person identified as “shipper” in the contract particulars, although it is not clear that the definition in article 1.6 (“Information relating to the contract of carriage or to the goods”) is apt to include such information.

17. **Article 1.7, Controlling party:** It is not clear why the right of control is separately defined in article 1.18 by reference to article 11.2 and why the controlling party and right of control are not dealt with in sequence. For the sake of clarity, any substantive definition of the right of control and of the controlling party should be made in close sequence or be included in one provision.

18. **Article 1.9, Electronic record:** All definitions relating to transport documents and electronic records should, for the sake of clarity, appear in logical sequence, after the relevant parties have been defined (see comment to art. 1.20). It should be noted that according to the second part of article 1.9, as drafted, any

⁶See *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17)*, para. 345.

information added by the carrier or performing party subsequent to the issue of the electronic record would be considered part of the electronic record, as defined. This appears problematic, as the wide terminology used may arguably allow the carrier to include additional contractual terms after the electronic record has been issued.

19. **Article 1.11, Goods:** The provision makes reference to goods that a carrier or a performing party “received for carriage” rather than “undertakes to carry”. As a result, the definition arguably does not cover cases where there is a failure by the carrier to receive goods or, as the case may be, load cargo on board a vessel. This is undesirable and the provision should be amended accordingly. In contrast to the Hague-Visby Rules (art. I (c)), but similar to the Hamburg Rules (art. 1, rule 5) the definition of goods includes live animals and deck cargo, but special complex provisions in articles 6.6 and 17.2 (a) provide for the carrier’s liability (see comments thereon).

20. **Article 1.12, Holder:** The concept of holder is particularly important in relation to the right of control and the transfer of rights (chaps. 11 and 12), as well as the right to delivery (chap. 10). However, references to the holder are also included in other parts of the draft instrument (chaps. 2, 9 and 13).

21. **Article 1.14, Negotiable transport document:** The definition should succeed any definition of the term “transport document” (art. 1.20). As has already been pointed out by various parties during the consultation process within CMI, the use of the term “negotiable” is problematic. The definition here proposed does not make clear what effect “consignment” of the goods “to the order of the shipper, consignee or bearer” actually has. In some legal systems, a document as defined here is truly negotiable in the sense of conferring good title (i.e., property free from any defects) to the consignee/endorsee. In other systems, such a document may not transfer more than the exclusive right to demand delivery from the carrier. In some legal systems, the notation “to order” may not be the relevant criterion for the transferability of the right

22. **Article 1.17, Performing party:** This complex provision is very important as it defines the parties that are subject to some of the carrier’s liabilities (art. 6.3.1) and may be sued directly by cargo interests. Covered by the definition are only parties who carry out certain of the carrier’s contractual functions, namely those of carriage, handling, custody or storage of the goods and who have not been retained by the shipper or consignee or one of its agents/employees/subcontractors. There is no provision in the draft instrument for liability of performing parties for other aspects of the performance of the contract of carriage. This means that parties performing other functions of the carrier under the contract of carriage are not covered by the definition and thus are not subject to the liability rules in any legal action against them by cargo interests. At the same time, these parties remain entitled to the benefit of the defences and limitations of liability available to the carrier under the draft instrument (art. 6.3.3). An example referred to in the explanatory notes to the draft instrument⁷ (at para. 17) is that of a security company guarding a container yard or a shipyard involved in ensuring the seaworthiness of the vessel. A cargo claimant would, thus, have different remedies under different regimes, depending on which party entrusted with the performance of the contract of carriage may have been responsible for loss, damage or delay. This is a complicating factor, which may adversely affect cargo interests and may also increase costs (re: localization of loss and legal advice on applicable regime).

23. Importantly, the provision has been drafted so as to exclude from the definition any intermediate subcontracting carriers. Performing parties are only those actually involved in the performance, but not those who have undertaken to carry out or to procure the performance of parts of the contractual obligations of the carrier. This narrowing down of the provisions appears both arbitrary and potentially problematic. The example referred to in the explanatory notes to the draft instrument (at para. 18) serves to illustrate this: a subcontracting sea carrier who has further subcontracted the performance of its obligations would not be covered by the definition of “performing party”. Whether this party would, in a recourse action by the main (head) carrier, be subject to the regime, depends on whether (a) the subcontracted carriage was international; or (b) the regime incorporated into the contract (see art. 3). Its subcontractors, however, for example, a sea carrier and/or a stevedore company, would be performing parties under the regime and a cargo claimant would potentially have rights against these parties directly. However, the cargo claimant may not know who, for instance, the stevedore company engaged by a subcontracting carrier is and/or whether this party may have been responsible for loss, damage or delay. Furthermore, the performing party may, in an action against it, be able to rely on protective provisions in its contract with another party (e.g., a subcontracting sea carrier) who is not under any obligation directly to the cargo claimant. A cargo claimant would not have rights under the regime against the intermediate subcontractor who may be in a much better position to satisfy a claim (e.g., a shipowner whose ship could be arrested as security for any claim). Read in conjunction with the provisions in the draft instrument on carriage preceding or subsequent to sea carriage (art. 4.2.1), mixed contracts of carriage and forwarding (art. 4.3) and contracting out (art. 5.2.2), it becomes clear that in many instances, it would be extremely difficult to determine who may be liable under the regime. In fact, no party may qualify as a performing party.

24. The provision as drafted is extremely complicated and may create a great deal of uncertainty. If parties who have been subcontracted to carry out the carrier’s contractual obligations are to be subject to the liability regime, there should be no distinction as to which functions have been subcontracted and who actually carries out any of the subcontracted obligations (compare, for example, art. 1, rule 2, of the Hamburg Rules, where the term “Actual carrier” is defined). It should also be noted that owing to the complexity and restrictive nature of the definition in article 1.17, it would often be difficult to identify correctly a responsible “performing party” within the one-year time limit for the institution of legal or arbitral proceedings (art. 14.1). In effect, the liability of anyone as performing carrier would depend on whether a claim was brought against the right party in the right jurisdiction within the short one-year limit.

25. **Article 1.18, Right of control:** Any reference to the right of control should preferably be included with the definition of “controlling party” (art. 1.7). The provision in article 1.18, as drafted, does not contain a definition.

26. **Article 1.19, Shipper:** Similarly to the definition of carrier, the definition of the shipper does not expressly include a party on whose behalf a contract of carriage is made.

27. **Article 1.20, Transport document:** It is not clear why the definition of transport document includes (a) a mere receipt; (b) a mere contract; and (c) a traditional transport document functioning both as a receipt and as a contract of carriage. The provision needs to be considered particularly in connection with chapter 8. Chapter 8 deals substantively with transport documents, but does not seem to have any meaningful application in respect of documents as defined under (b), above. The definition in article 1.20 makes reference to a “document issued pursuant to a contract of

⁷A/CN.9/WG.III/WP.21, annex. Hereinafter referred to as “explanatory notes”.

carriage by a carrier or a performing party". It should be noted that this definition may subject different transport documents issued by various subcontracted parties to the documentary requirements in chapter 8. This could lead to some confusion, in particular as the draft instrument as currently drafted may apply to multimodal transportation (see art. 1.5). An example could be the following scenario. A non-vessel-operating carrier (NVOC) subcontracts with a sea carrier and two different land carriers to carry out separate segments of a door-to-door transport. The subcontracted sea-carrier further subcontracts carriage from an intermediate port. The first subcontracting sea carrier (who does not qualify as a performing party under art. 1.17) issues a transport document on behalf of the contracting carrier (the NVOC). Equally, all parties falling within the definition of performing party (art. 1.17), namely, the sub-subcontracted sea carrier and both land carriers issue a transport document upon receipt of the goods for carriage. The definition here proposed would seem to cover all these documents, and provisions of the regime applicable to transport documents (chap. 8) would seem to be relevant in any action by a cargo claimant against any of the performing parties, although the transport documents would not be in the hands of the cargo claimant and even though the cargo claimant may not be the consignee under these documents (see art. 1.2).

B. Electronic communication

28. **Article 2.1:** Given that the practice of trading by means of an "electronic record" is not yet fully developed, any proposed regulation in this field needs to be looked at carefully and with a view to whether it (a) facilitates transactions; and (b) takes into account security considerations that may arise. Article 2.1 provides that the issuance and use of an electronic record may be made with "implied consent". This gives rise to some concern, in particular as evidentiary problems may arise. It would appear preferable to admit only express agreement on the issue and use of an electronic record.

29. **Article 2.2.1:** Article 2.2.1 provides for the substitution of a transport document with an electronic record. As drafted, the provision appears problematic, as difficulties may arise in the course of making a substitution as described. In particular, it is not clear what should happen if the holder failed to surrender a complete set of transport documents that had initially been issued.

30. **Article 2.2.2:** Article 2.2.2, as drafted, does not make clear what type of information needs to be included in a substitute transport document. The provisions of chapter 8, as drafted, would not seem to have any direct application to a document issued as a substitute for an electronic record. It is not clear whether, for instance, where the condition of goods had deteriorated after the issue of an electronic record (and before issue of a substitute transport document) a carrier would be entitled to include a statement to qualify the condition of the goods. Also, it is not clear which date would need to be included in the substitute transport document.

31. **Article 2.3:** Writing is not defined anywhere in the draft instrument (cf. art. 1, rule 8, of the Hamburg Rules).

32. **Article 2.4:** There are concerns whether sufficient protection is afforded to third parties, who may not be familiar with the protocol (rules of procedure) that has been agreed on by the original parties, but the contents of which would not be apparent from the electronic record itself. It is not clear why the full details of any agreed rules of procedure should not be included in or attached to an electronic record.

C. Scope of application

33. **Article 3.1:** According to article 3.1, the draft instrument applies to all international contracts where the contractual place of receipt or delivery is in a contracting State (paras. (a) and (b)) or where the contract incorporates the regime or national legislation giving effect to its provisions (para. (e)). In paragraphs (a) and (b), it is not clear why reference is made not only to the place specified in the contract, but also the place specified in the contract particulars. Where a transport document or electronic record has been issued, the contract particulars should tally with the contract (art. 1.6) and the reference therefore appears unnecessary. The text in brackets refers to a number of additional connecting factors to trigger the application of the regime.

34. **Article 3.1 (a) and (b), Contractual ports of loading or discharge:** The application of the regime should be restricted to maritime transport only, that is, to carriage port-to-port. However, as drafted, the provision would, together with article 1.5 not only provide for application of the regime to door-to-door transports, but introduce a rather arbitrary connecting factor, namely an intermediate port of loading or discharge. In multimodal transportation, the choice of mode by the carrier for individual segments of the transport should have no relevance for the application of substantive liability rules. The inclusion of this proposed connecting factor would therefore appear arbitrary and its application would increase uncertainty about the applicability of the regime.

35. **Article 3.1 (c), Actual place of delivery:** This connecting factor gives rise to uncertainty, as it would not be clear when the carrier receives goods for carriage whether or not the regime would apply. The Hamburg Rules make reference to a similar connecting factor in article 2, rule 1 (c). (NB. Outside maritime transport on board a chartered vessel, there is no room for such a connecting factor, as optional places of delivery are not normally agreed in door-to-door transactions). In current practice, optional places of discharge may be agreed in maritime contracts where goods are transported on a chartered vessel. The bill of lading may incorporate all terms of the charter-party, including the different optional ports of discharge agreed therein. Once the bill of lading has been transferred to a third party, its terms, including the choice of discharge ports, are relevant to a potential cargo claimant. However, it should be noted that under the law of international trade, a seller cost, insurance, freight (c.i.f.) or free on board (f.o.b.) extended services must tender a bill of lading for a contract destination; therefore, a bill of lading giving as destination a choice of additional ports would usually not be acceptable, for example under the ICC INCOTERMS (International Commercial Terms) or where payment is to be made by letter of credit under the UCP 500 (Uniform Customs and Practices for Documentary Credits).

36. **Article 3.1 (d), Place of conclusion of contract or issue of transport document/electronic record:** In the light of modern practices, there appears little justification for attaching significance to the place where a contract has been concluded. Moreover, both the place where a contract is made and where an electronic record has been issued may be difficult to determine in practice.

37. **Article 3.2:** The wording used in article 3.2 corresponds to the wording in other transport conventions, such as the Hague-Visby and Hamburg Rules. In the interests of uniformity and for the avoidance of doubt, it would be desirable to also include a reference to the applicable law. This would ensure that any new instrument applied irrespective of the law applicable to the contract or the transport document.

38. **Article 3.3.1:** Existing mandatory liability conventions do not apply to charter-party contracts, primarily because these

contracts are, in contrast to bill of lading contracts, individually negotiated by parties of potentially equal bargaining power. Charter-parties may therefore justifiably be excluded from the scope of the draft instrument. However, other types of contract where standard terms, issued by the carrier and not subject to individual negotiation, are used should be included.

39. **Article 3.3.2:** Despite the attempted comprehensiveness of the draft instrument in dealing with the right of control, transfer of rights and rights of suit, there is no indication as to the point at which a document or electronic record issued pursuant to a charter-party governs the contractual relations between carrier and holder. In the interests of certainty, this should be made clear, at any rate if the provisions in chapters 11-13 are retained. Concerning the text in brackets, see comments to article 3.3.1.

40. **Article 3.4:** See comments to article 3.3.1.

D. Period of responsibility

41. **Article 4.1:** The provisions on the relevant period of responsibility are of great significance, but require further consideration and should be redrafted. A clear provision defining a carrier's period of responsibility is contained in article 4 of the Hamburg Rules. Article 4.1.1 of the draft instrument seems, at first sight, to provide for a similar period of responsibility, namely "from the time when a carrier or a performing party has received the goods . . . until the goods are delivered . . .". "Delivery" is a well known legal concept (e.g., in sale contracts), which denotes voluntary transfer of possession. Although a contract may define the obligation to take receipt or to make delivery, it is evident that it is a matter of fact not contract when performance of any such obligation is completed, that is, when receipt or delivery actually takes place. However, while article 4.1.1 appears to state that the relevant period of responsibility covers the period from (actual) receipt to delivery, article 4.1.2 and article 4.1.3 indicate otherwise. Primarily contractual agreement, failing this customs, practices or trade usages and only as a fall-back situation actual receipt and delivery are to be relevant in determining the period of the carrier's contractual responsibility. In article 4.1.3, the time/location of delivery, in the absence of contractual agreement or any customs practices or usage, is defined as "discharge or unloading from the final vessel or vehicle . . .".

42. If, as proposed, contractual agreement on the time of receipt and delivery is permitted without any statutory guidance or limits, there is a likelihood that sea carriers would find it attractive to contract on tackle-to-tackle terms, so as to minimize their period of contractual responsibility. There is thus the potential for abuse, as sea carriers would be able to reduce their period of contractual responsibility by including a provision in their standard terms to the effect that receipt and delivery are "agreed" to coincide with loading and discharge using the ship's tackle. This potential for abuse is even greater in connection with article 5.2.2, which allows contractual agreement that, for example, loading and discharge of the cargo shall be the responsibility of the shipper/controlling party or consignee (see comment to article 5.2.2). Existing standard bill of lading forms already often contain detailed provisions defining the carrier's delivery obligation under the contract. However, due to current international regulations (Hague, Hague-Visby and Hamburg Rules), by no means all of these clauses are effective in all jurisdictions.

43. In cases where no time/place of receipt or delivery is contractually agreed, there may be much debate and uncertainty about any applicable customs or usage and a carrier's responsibility would, under article 4.1.3, often end at the point of discharge from a vessel. In the context of maritime container transport, this would be a most unsatisfactory result. It is important to note that

article 4.1.3 is also the time and location at which delivery is to be made under chapter 10 of the draft instrument.

44. **Article 4.2.1, Carriage preceding or subsequent to sea carriage:** As drafted, article 1.5, together with article 4.2.1 provides for a multimodal liability regime with a network system (for localized loss or damage). The provision in article 4.2.1 does not appear to have any useful application if the substantive scope of coverage of the regime is restricted to maritime transport. The declared intent of this provision is to ensure compatibility of the draft instrument with existing transport conventions containing mandatory provisions. The proposed mechanism is the introduction of a network system for localized losses whereby certain provisions of any mandatory international Convention applicable to the relevant segment where loss damage or delay occur is given precedence. Both the perceived need for this provision and the problems that may arise in its operation show why the successful regulation of international door-to-door (multimodal) transport is difficult and requires great care. The proposed approach is to give some provisions of applicable international mandatory regimes precedence if a loss or damage can be localized. This approach may, however, give rise to considerable uncertainty. Whether any mandatory international liability regime applies depends on (a) identifying the stage where the loss, damage or delay occurs and (b) identifying whether in a given jurisdiction any possibly applicable regime applies mandatorily. Once the court or arbitral tribunal where a claim is brought has identified a relevant applicable regime, only some of its provisions, as interpreted by that court or tribunal, would apply to the exclusion of the draft instrument. In other respects, the provisions of the draft instrument would continue to apply. As a result, in instances where the provision is triggered, an obscure patchwork of different regimes that were not designed to complement each other would apply. There is much scope for confusion and it is likely that national courts would take radically different approaches to the question of which provisions of one or other regime are applicable and to which parties. The result may be highly unpredictable jurisprudence. The provision should be deleted.

45. **Article 4.3, Mixed contracts of carriage and forwarding:** Article 4.3 is of central significance, as it allows "contracting out" of the regime by way of limiting the scope of the contract. In principle, there is no objection against the freedom of parties of equal bargaining power to determine the scope of their agreement. However, in the context of contracts that are concluded on standard terms, typically issued by one party, without scope for negotiation, there is the potential for abusive practice. The provision as drafted allows "express agreement" by the parties without providing any clear mechanism to ensure that the shipper and consignee are protected against abusive practice. Much would depend on judicial interpretation of the terms "express agreement" and "specified part[s] . . . of the transport" in a given forum for the resolution of a dispute. In legal terminology, the expression "express agreement" denotes explicit mention of a term in the contract and thus covers all of the small printed clauses commonly found on the reverse of a bill of lading. Even if a somewhat more restrictive approach were to be applied here, a pre-printed clause or box on the face of a document stating "it is expressly agreed that in respect of any segment of the transport not carried out on a vessel under the carrier's management and control the carrier shall act as freight forwarding agent only" may arguably be sufficient for an agreement as defined in article 4.3.1.

46. It would seem to be in the natural interests of a carrier to seek to restrict its responsibility in cases where a third party carries out parts of an agreed transport and there is thus considerable concern that the proposed provision would invite abusive practice. Moreover, even where a shipper were to freely enter a freight forwarding agreement with a carrier, the provision in article 4.3.2, as drafted, does not satisfactorily protect cargo interests:

(a) The obligation of the carrier acting as agent would be to exercise due diligence in selecting another carrier. What this means is not clear and there is no statement as to the qualities (diligent? reasonable? reputable?) another carrier would need to have. What type of behaviour would qualify as negligence in selection of a carrier? As there is no express allocation of the burden of proof, the carrier would not be responsible for breach of its obligation, unless the shipper/consignee were able to prove negligence.

(b) The carrier would be obliged to conclude a contract on "usual and normal terms" with the other carrier. What does "normal" mean beyond "usual"? At the very least, there should be an obligation to contract on "reasonable" terms (see, for example, the obligation on the c.i.f. seller under INCOTERMS), which would ensure some consideration of the type of cargo carried and special needs pertaining to its transportation. However, there seems to be no reason why a carrier should not be required to contract on the terms of internationally mandatory regulation, that is, in the case of sea carriage on the terms of the draft instrument.

(c) A consignee would be faced with a number of potential problems, such as the task of identifying the carrier (and the relevant jurisdiction), which is of particular concern in connection with the strict time bar for the institution of legal or arbitral proceedings (art. 14.1). It should be remembered that the second carrier may be a shipowner or a time or voyage charterer of another vessel (or, under the draft instrument as presented, even a land or air carrier). Under article 4.3.2, there is no obligation on the carrier, acting as agent, to obtain from another carrier a particular transport document (for example, negotiable (transferable)) that shows certain features (receipt function), or to hand over any such document(s) to the shipper/consignee. Where goods were damaged during trans-shipment to another carrier, litigation would in any event often be required to resolve the question as to who was liable, under which contract and under which regime.

(d) Attention should be given to the needs arising from the use of certain transport documents in international trade, for example the c.i.f. seller's obligation to provide the buyer with "continuous documentary cover". A transport document under which the carrier does not assume responsibility for the whole voyage may for instance not be acceptable under the UCP 500, the set of rules currently governing most letter of credit transactions.

E. Obligations of the carrier

47. **Article 5.1:** Article 5.1, which sets out the carrier's obligation to carry the goods and deliver them to the consignee does not establish any particular requirements regarding the carrier's delivery obligation. This is important, as the carrier would be able to (effectively unilaterally) determine its delivery obligation. The provision should be considered in context with article 4.1.3 and chapter 10.

48. **Article 5.2.1:** As noted in relation to article 4.1 and article 4.3 above, the provisions of the draft instrument as currently drafted allow a carrier effectively to minimize the period of its responsibility significantly. This has to be borne in mind when considering this provision. Within the period of responsibility, the carrier is, according to article 5.2.1, under obligations similar to those in article III, rule 2, of the Hague-Visby Rules. Although the draft instrument is intended to apply to port-to-port (and, as currently drafted, even to door-to-door) transportation and the period of the carrier's responsibility should normally cover the period from receipt to delivery, the present provision makes no reference to "proper . . . delivery".

49. **Article 5.2.2:** This provision is central, as it allows the carrier to contract out of certain of its obligations under the draft

instrument. The provision raises similar concerns as the provision in article 4.3, which allows the carrier to contract out of responsibility for certain parts of the transport. Currently charter-parties, but not normally bills of lading, sometimes allocate responsibility for loading and unloading of the cargo to the charterer who ships such cargo (FIO(S)) (free in and out, stowed) or similar clauses). When considering clauses of this nature, in particular where incorporated into a bill of lading contract on "liner terms", a distinction has to be made between contractual allocation of the responsibility for payment of the performance of certain duties and responsibility for the performance of the duty itself. FIO(S) clauses are not commonly used in bills of lading and even where charter-party terms are incorporated into bills of lading it remains doubtful whether under current international regulations (Hague-Visby Rules) a third-party bill of lading holder (consignee) would be bound by such an incorporated term. In English law for instance, there is no clear authority to this effect and an argument can be made that any such agreement would reduce the carrier's liability under the Hague-Visby Rules and thus be null and void under article III, rule 8, of the Rules (see, for example, the South African decision *The MV Sea Joy* 1998 (1) SA 487).

50. In contrast to article 4.3, the provision as drafted does not even require an "express agreement" (whatever this may mean, see comment to article 4.3 above), but would clearly allow a carrier to include a general standard term to this effect in the small print of any transport document, binding the shipper, consignee and controlling party. As has already been pointed out by some commentators during consultations within CMI, in practical terms, the provisions in articles 4.3 and 5.2.2 of the draft instrument effectively allow a carrier to contract out of all liability except the actual ocean voyage after loading and before discharge. A transport document may, for instance state that the carrier acts as agent only for the shipper and consignee as regards (a) carriage from an inland point to the ocean terminal and carriage from the ocean terminal to the point of destination, (b) arranging stevedoring services upon loading and discharge and (c) arranging for terminal services upon loading and discharge. Moreover, in these circumstances, even a carrier who in fact carried out these functions himself would appear to be exempt from liability under the provision in article 6.1.3 (ix) unless a cargo claimant were able to prove negligence on the part of the carrier (note the reversed burden of proof). The approach of "laissez faire", which is apparent throughout the draft instrument, neither aids international uniformity, nor appears to take into account the legitimate interests of shippers and consignees, particularly in developing countries (see also comment to article 6.3.2 (a)).

51. **Article 5.3:** This provision purports to allow the carrier to refuse to carry and, if necessary, destroy the cargo. It needs to be read in conjunction with article 6.1.3 (x), which exempts the carrier from liability unless the cargo claimant is able to prove negligence of the carrier or a performing party. Note that article 5.3 as drafted makes no reference to the rights of a performing party, but article 6.3.1 (a) extends the rights of a carrier generally to performing parties during the period in which they have custody of the goods. See also articles 7.1 and 7.6, which deal with the shipper's liability for loss, damage or injury caused by the goods.

52. In the Hague-Visby and Hamburg Rules, an equivalent (though not identical) right of the carrier is restricted to instances where (a) dangerous goods have been shipped without the carrier's knowledge or consent or (b) dangerous goods shipped with the carrier's knowledge become an actual danger. The provision as drafted makes no distinction between instances where a carrier does or does not have knowledge of the dangerous nature of the cargo. Dangerous cargo, which is defined in the Hague-Visby Rules (art. IV, rule 6), but is more generally referred to in the Hamburg Rules (art. 13), here encompasses any type of cargo,

not only inherently dangerous goods. Under the draft provision, the carrier is given a rather broad discretion as to whether goods “are or appear reasonably likely to become dangerous” and may decide upon the appropriate course of action to take. As drafted, the provision does not appear to contain any safeguards against unjustified claims or behaviour by the carrier, particularly in situations where a carrier has agreed to carry potentially dangerous cargo against an appropriate price and then finds that his vessel is not in a position to carry the cargo safely. The relationship between articles 5.3. and 5.4. is not clear and, as drafted, article 5.3 (“Notwithstanding the provisions of articles 5.1, 5.2 and 5.4...”) arguably allows a carrier to refuse to load or to discharge cargo which “appears reasonably likely to become dangerous”, without compensation, although the carrying vessel was unseaworthy.

53. **Article 5.4:** This provision resembles the provision in article III, rule 1, of the Hague and Hague-Visby Rules. It imposes an obligation on the carrier to exercise due diligence in providing a seaworthy vessel. The text in brackets would extend the duty beyond the commencement of the voyage and thus make the obligation a continuous one. However, unlike existing liability regimes, the text as drafted does not expressly impose on the carrier the burden of proving the exercise of due diligence (cf. art. IV, rule 1, Hague and Hague-Visby Rules and art. 5, rule 1, of the Hamburg Rules). Under article 6.1.1, the carrier generally bears the burden of disproving negligence whenever an occurrence causing loss, damage or delay takes place during the relevant period of responsibility (as defined in art. 4). However, this general rule is subject to article 6.1.3, which lists a number of events for which the carrier is presumed not to be at fault and imposes the burden of rebutting this presumption on the cargo claimant. See also article 6.1.2, which lists two apparently absolute exemptions from liability. It is not clear how the burden of proof is allocated in cases where both unseaworthiness and one of the events in articles 6.1.2 and 6.1.3 have contributed to a loss (see also comment to art. 6.1.3). Owing to the differences in drafting of the draft instrument as compared with the Hague-Visby Rules, existing jurisprudence on the seaworthiness obligation and its complex relationship to the list of exceptions (art. IV, rule 2, of the Hague-Visby Rules) would only be relevant to a limited extent.

54. **Article 5.5:** Article 5.5 gives the carrier a very broad new right to “sacrifice” goods, not contained in the Hague, Hague-Visby or Hamburg Rules, but apparently based on concepts contained in the York Antwerp Rules, a set of rules on general average distribution, which apply only if contractually agreed. Article 6.1.3. (x) contains a corresponding presumption excluding the carrier’s liability for loss, damage or delay. According to the draft text, neither the right itself nor the application of the presumption of the absence of fault are subject to the carrier exercising due diligence in providing a seaworthy vessel. It is not clear what the justification is for the inclusion of this provision, which benefits only carriers.

F. LIABILITY OF THE CARRIER

55. **Article 6.1.1 (Basis of liability):** The provision in article 6.1.1 resembles article 5, rule 1, of the Hamburg Rules. However, it should be noted that the definition of the period of responsibility differs significantly (see comment to art. 4.1). Moreover, the wording of the provision differs in that article 5, rule 1, of the Hamburg Rules states “. . . unless the carrier proves that he, his servants or agents took all measures that could reasonably be required to avoid the occurrence and its consequences”. It may be that the difference in drafting substantively affects the required standard of care and accordingly the burden of proof a carrier would have to discharge. For instance, the corresponding

provision in article 17, paragraph 2, of the Convention on the Contract for the International Carriage of Goods by Road states that the carrier is relieved from liability in cases where loss, damage or delay was caused by “circumstances which the carrier could not avoid and the consequences of which it was unable to prevent”. This has been interpreted as setting a standard of utmost care, which is higher than the standard of care required under the Hague or Hague-Visby Rules. It should be noted that this substantively high standard of “utmost” care applies under article 7.6 of the draft instrument, in relation to the shipper’s responsibility to the carrier for breach of any of its obligations under article 7.1.

56. The general liability rule in article 6.1.1 has to be considered together with the list of exceptions in article 6.1.2 and presumptions of the absence of fault in article 6.1.3, which does not exist in the Hamburg Rules. Taken together, the provisions in article 5 and article 6 of the draft instrument consist of a complicated amalgamation of the corresponding Hague-Visby and Hamburg Rules provisions and some significant new elements. As a result, the benefit of legal certainty created by longstanding jurisprudence on and analysis of the Hague-Visby and (to a lesser extent) the Hamburg Rules is lost. This needs to be borne in mind when considering the merit of including individual provisions as proposed in the draft instrument. It may be considered advisable to delete the provisions in article 6.1.2 and 6.1.3 and to retain only a general rule in article 6.1.1, modelled on article 5, rule 1, of the Hamburg Rules.

57. **Article 6.1.2:** The text of article 6.1.2 (in brackets) represents two very controversial exceptions to the carrier’s liability. In particular the exception under (a), which in the Hague and Hague-Visby Rules has come to be known as the nautical fault exception, is unsustainable, as it exempts a carrier from liability in cases of clear negligence on the part of his employees. This approach is without parallel in any existing transport convention and no justification exists for its continued availability in any new international regime. In the explanatory notes to the draft instrument (at para. 70), the view is expressed that the exception remains justified in cases of negligence on the part of a pilot. This, however, is difficult to justify. As a matter of commercial risk allocation, one of the two parties to any contract of carriage (including charter-parties) has to take responsibility for actions of the pilot. The carrier is clearly in a much better position than a shipper or consignee to take on this responsibility and to protect its interests. Traditionally, and contractually, under most standard charter-party forms, the carrier is responsible to the charterer for any actions of the pilot. There also appears to be little justification for maintaining a separate exception for fire on board a ship, with a reversed burden of proof. The carrier would be exempt from liability for losses resulting from a negligently caused fire, unless fault or privity at company management level could be proven by the cargo claimant. The relationship of article 6.1.2 to article 5.4 is not sufficiently clear (see comments to arts. 5.4 and 6.1.3).

58. **Article 6.1.3:** As stated in the explanatory notes (at para. 74), the list contained in article 6.1.3 “represents a much modified (but in some respects extended) version of the remaining excepted perils of the Hague and Hague-Visby Rules”. A matter that arises for initial consideration is whether in the light of the general rule set out in article 6.1.1, it is advisable to retain such a list. It should be noted that the text of the provision differs significantly from the text of article IV, rule 2, of the Hague-Visby Rules. That provision contains a list of exemptions from liability, with no express indication of the relevant burden of proof in relation to the events listed in article IV, rule 2 (c) to (p). As a result, different views have developed on whether a carrier would still be exempt from liability if he failed to disprove negligence as giving rise to an exempting event. The provision in article 6.1.3 makes it clear that under the draft instrument, once

the carrier has raised a defence, the burden of proving any negligence of the carrier would be on the cargo claimant. The relationship of this provision with the carrier's obligation regarding seaworthiness of the vessel (art. 5.4) is not sufficiently clear, particularly as article 6.1.3 is expressly drafted as an exception to the general presumption of fault in article 6.1.1. The provision, as drafted states: "Notwithstanding . . . article 6.1.1, . . . it shall be presumed, in the absence of proof to the contrary, that neither [the carrier's] fault nor that of a performing party has caused or contributed to cause that loss, damage or delay". It is arguable that a cargo claimant, in order to rebut the presumption, would not only need to establish unseaworthiness of the vessel as a contributory cause, but would also need to prove the absence of due diligence (i.e., negligence) on the part of the carrier/performing party. This would be in contrast to article IV, rule 1, of the Hague-Visby Rules, which expressly imposes upon the carrier the burden of proving the exercise of due diligence. Moreover, the general rule in article 6.1.1 would be deprived of much of its intended effect and its text would have to be considered to be misleading.

59. **Article 6.1.3 (ii):** The provision in article 6.1.3 (ii) is less specific than article IV, rule 2 (g) and (h), of the Hague-Visby Rules. The meaning of the text in brackets is not sufficiently clear.

60. **Article 6.1.3 (iii):** The corresponding provision in the Hague-Visby Rules, article IV, rule 2 (i), refers to "act or omission of the shipper or owner of the goods . . .". The draft instrument does not contain any general clause corresponding to article IV, rule 3, under which the shipper's liability is normally dependent on fault (though there are special rules in articles III, rule 5 and IV, rule 6).

61. **Article 6.1.3 (ix):** This important new exception/presumption needs to be considered in context with article 5.2.2 (see comment there). Under article 6.1.3 (ix), a carrier who, as "agent" of the shipper, carried out any of the carrier's functions contractually imposed on the shipper (possibly by way of a standard clause), would be exempt from liability, unless the shipper were able to prove negligence. This would, in many instances, be impossible, as the shipper does not have full access to the facts.

62. **Article 6.1.3 (x):** See comments to articles 5.3 and 5.5. The second line of the text appears to contain a typographical error ("have been become"). It is not clear whether the presumption is to be applicable only where the goods actually have become a danger (cf. article 5.3, which allows certain actions also where goods "reasonably appear likely to become" a danger). If so, the carrier's right to be exempt from liability would be similar to the position under the Hague-Visby Rules.

63. **Article 6.1.4:** It is sensible to include a clear provision on the allocation of liability in cases where loss is due to a combination of causes. However, neither of the proposed alternatives in article 6.1.4 appears appropriate. The first alternative is said to be intended to have much the same effect as article 5, rule 7, of the Hamburg Rules (see explanatory notes, at para. 89), but is poorly drafted. There is inconsistent use of the term "liable" ("If loss . . . is caused in part by an event for which the carrier is not liable and in part by an event for which the carrier is liable, the carrier is liable . . .") and it is not clear what exactly needs to be established for the provision to become relevant. The terminology "an event for which the carrier is (not) liable" does not sit well with the fact that in article 6.1.3 certain events are drafted as "presumptions of the absence of negligence". For instance, where a cargo was lost as a result of an explosion, the carrier would raise the presumption of the absence of fault in article 6.1.3 (iii) or (vi) and the cargo claimant would need to prove that the carrier was at fault, that is, that the underlying cause of the loss was the unseaworthiness of the vessel and, presumably, that this was owing to the carrier's negligence (cf. art. 5.4). If this is correct, article 6.1.4 would be without any relevance and the de facto result would be

contrary to the stated intention of the provision. Another example would be a case where a carrier disposes of cargo which becomes dangerous (art. 5.3) and invokes article 6.1.3 (x). What exactly would a cargo claimant who thinks the vessel was unfit to carry the cargo (i.e., was unseaworthy) have to prove, given that the right in article 5.3 attaches "[n]otwithstanding the provisions of articles 5.1, 5.2 and 5.4", that is, apparently irrespective of the carrier's performance of its seaworthiness obligation. If the intention of the provision is to hold the carrier liable unless it can prove the extent to which a breach was not contributed to by its negligence, the drafting of all provisions in articles 5 and 6 needs to be carefully reconsidered.

64. The second alternative set out in the draft text of article 6.1.4 gives rise to particular concern. This provision appears to have been modelled after the 1999 United States Senate bill for a new United States Carriage of Goods by Sea Act and has no parallel in any existing international or national regime for the carriage of goods by sea. If adopted, the provision would change materially the established risk allocation between carrier and cargo interests. Under all existing regimes, including the Hague, Hague-Visby and Hamburg Rules (as well as United States Carriage of Goods by Sea Act of 1936), a carrier will only be discharged from liability if—and to the extent that—it can establish that a loss is due to an excepted peril. In the absence of sufficient evidence, the carrier will be responsible for the whole loss. As a result, the carrier is thus always responsible in cases of unexplained losses. The rationale for this and indeed for the mandatory nature of existing regimes lies in the inherent inequality of the parties contracting on bill of lading terms. Inequality exists in relation to the bargaining power of the parties; this makes the terms of the contract—usually drafted by and for the benefit of the carrier and not individually negotiated—prone to abuse. Inequality also exists in relation to access to the facts surrounding a loss and thus the available evidence in respect of a cargo claim. In practice, it is often impossible to prove the extent to which identified causes contribute to a loss. It is in these cases that the allocation of the relevant legal burden of proof becomes crucial: whoever bears the legal burden of proof will bear the loss in the absence of sufficient or conclusive evidence. The result of providing in cases of insufficient evidence for a 50/50 apportionment between carrier and cargo interests would be to shift the benefit of uncertainty from consignee to carrier. As evidence about the causes of a loss will, in many cases, be almost exclusively confined to the carrier's sphere of influence, a departure from established principles might also lead to a change in attitudes. Carriers might be less inclined to investigate the causes for any given loss or damage. More cynical carriers might even consciously decide that it makes commercial sense to be more casual in the exercise of their contractual obligations, if their maximum exposure, in the absence of evidence, would be limited to liability for 50 per cent of a loss, subject to a monetary maximum. This would not seem to be desirable as a matter of policy, particularly for cargo-oriented States.

65. **Article 6.2.1 (Calculation of compensation):** This provision resembles part of article IV, rule 5 (b) of the Hague-Visby Rules. However, a different wording is used. Reference is made to the time and place of delivery according to the contract of carriage. This does not fully correspond to the provision in article 4.1.3 (see also comment there).

66. **Article 6.2.2:** This corresponds to the approach in article IV, rule 5 (b) of the Hague-Visby Rules. An alternative solution would be to stipulate that the market value of goods is only *prima facie* relevant for the calculation, so that proof of a higher actual loss remains possible.

67. **Article 6.2.3:** The Hague-Visby Rules do not contain a clear statement that the amount calculated as stated shall be the absolute maximum recoverable (cf. art. IV, rule 5 (b)). Under the

provision as drafted, there does not appear to be any scope for the recovery of any actual loss exceeding the market value of the goods (e.g., sale price, trans-shipment costs, additional costs for substitute purchase).

68. **Article 6.3.1 (Liability of performing parties):** Article 6.3 deals with the “liability of performing parties”. Article 6.3.1 is the central provision defining the rights and obligations of anyone falling within the definition of performing party in article 1.17. It makes clear that performing parties are treated as carriers during the period of their responsibility. However, the provision appears problematic in a number of respects as set out below.

69. Under Article 6.3.1 (a), the relevant period of responsibility is defined not by receipt and delivery of the goods, as in the case of the contracting carrier, but by the performing party’s “custody” of the goods. The use of different terminology should be avoided. A cargo claimant wishing to pursue a claim against a performing party would need to establish that a loss, damage or delay occurred while a performing party had the goods in its custody. As currently drafted, the draft instrument would also apply to contracts for door-to-door transportation (see art. 1.5). Where in this context evidence of loss, damage or delay pointed to the responsibility of a land or air carrier, the “network provision” in article 4.2.1 might be triggered (depending on a number of factors, see comment to art. 4.2.1). In the absence of a great deal of legal expertise, there clearly would be considerable scope for confusion as to who might be responsible under which regime. As stated earlier, the scope of application of the draft instrument should be restricted to maritime transport and article 4.2.1 should be deleted.

70. Although performing parties are engaged directly (as subcontractors) or indirectly (e.g., as subcontractor of a subcontractor) by the carrier, they may not be bound by any agreement as referred to in article 6.3.1 (b) made by the carrier. As a result, a cargo claimant who was party to such agreement with the carrier, might not be able to invoke the agreement against any performing party. This is of some concern, particularly as the draft instrument does not contain any provision that obliges a contracting carrier to subcontract on certain terms. Moreover, in the light of the complex and restrictive definition of “performing party”, a number of questions arise, such as with whom, for example, a sub-subcontracting performing party would “expressly agree” any increase in responsibilities/liability, where such agreement would be recorded and who would be entitled to its enforcement.

71. **Article 6.3.2 (a):** Although article 6.3 is entitled “Liability of performing parties”, article 6.3.2 deals with the responsibilities of the carrier. Under the provision, the carrier is liable for negligence on the part of performing parties (as defined in art. 1.17) and others who perform or undertake to perform part of the contract. It is not clear why the carrier’s responsibility is made “subject to article 6.3.3”, a provision which deals with the rights of other parties.

72. The concept of “any other person” in article 6.3.2 (a)(ii) has to be considered in context with the restrictive definition of the term “performing party” in article 1.17. A subcontractor, who further subcontracts performance of part of the transport would not fall within the definition of performing party, but would be considered as “any other person” under this provision.

73. Importantly, it has to be noted that under article 1.17, no one retained by the shipper or consignee qualifies as a “performing party”. This is of particular relevance in connection with the rights currently included in draft articles 4.3.1 and 5.2.2, which enable the carrier to contract out certain parts of the contract or some of a carrier’s obligations. In these cases, the carrier and all its subcontractors, employees or agents would not be subject to the obligations of a “carrier” or “performing party” under the draft instrument. This appears to be the case even where a contracting

carrier were de facto to carry out or supervise the performance of some functions (such as stowage), which contractually have been allocated to the shipper/consignee under article 5.2.2. This situation would clearly prejudice cargo interests.

74. **Article 6.3.2 (b):** Article 6.3.2 (b) sets out for whose acts and omissions a performing party shall be responsible. Only those entities falling within the definition of performing party in article 1.17 are affected by this provision. This would not seem to include (a) a subcontractor of the carrier who further subcontracts the performance of its obligations to another party, (b) the carrier if carrying out any of the functions of a carrier as “agent” of the shipper/consignee under article 5.2.2, or (c) a party performing other functions under the contract of carriage than those referred to in article 1.17. The provision restricts responsibility to acts or omissions within the scope of a person’s contract, employment or agency. This does not normally include illegal behaviour.

75. **Article 6.3.3:** Article 6.3.3 provides to whom the carrier’s defences and limitations of liability are available. Importantly, parties who do not fall within the definition of performing party (see comment to art. 1.17) and are thus not responsible under the draft instrument are entitled to avail themselves of any of the carrier’s defences and limitations of liability. The protective provisions include particularly the one year time bar for a claim, as well as the financial liability limits and the presumptions of the absence of fault in article 6.1. Apart from the carrier’s servants or agents (as in the Hague-Visby Rules, art. IV bis, rule 2), and subcontracting performing parties, the following parties would appear to benefit from this provision: (a) a subcontractor of the carrier who further subcontracts the performance of its obligations to another party, (b) the carrier if carrying out any of the functions of a carrier as “agent” of the shipper/consignee under article 5.2.2, and (c) a party performing other functions under the contract of carriage than those referred to in article 1.17. It is not clear why, under the draft instrument, these parties benefit without bearing any responsibility.

76. **Article 6.3.4:** The inclusion of a provision for joint and several liability is sensible.

77. **Article 6.4.1 (Delay):** The provision in article 6.4.1, including the text in brackets, appears sensible, as timely delivery is clearly a matter of commercial significance and the introduction of uniform liability rules in this context is as desirable as in cases of loss or damage.

78. It should be noted that article 4.1.3, the provision defining the time and location of delivery, makes reference to the “time . . . agreed in the contract”. The time of delivery is one of the relevant parameters defining the carrier’s period of responsibility under the draft instrument (see also chap. 10). Article 6.4.1 deals with the carrier’s obligation to make timely delivery in cases where a “time” for delivery has been “expressly agreed” upon. As article 4.1.3 and article 6.4.1 deal with different issues, it would appear to be advisable to revise the wording of the two provisions in order to avoid confusion about the time of/for delivery.

79. **Article 6.4.2:** The rather complicated wording of article 6.4.2 establishes a separate limitation amount for losses caused by delayed delivery and “not resulting from loss of or damage to the goods and hence not covered by article 6.2”. It is not entirely clear what the effect of this provision would be in a case where, for example, perishable goods have been spoilt (i.e., damaged) as a result of delayed delivery. The wording seems to imply that in these instances the cost of, for example, a lost subcontract or alternative goods would be covered by article 6.2 (as a loss “resulting from loss of or damage to the goods”). However, the wording of article 6.2.3 suggests otherwise, namely that the maximum recoverable under article 6.2 would be the value of the goods themselves (see comment to art. 6.2.3). The question is of some importance, because the limitation amount for losses

covered by article 6.4.2 is proposed to be calculated by reference to the freight. There may be differing views as to whether this is in fact desirable.

80. Article 6.5, Deviation: Article 6.5 contains a separate exemption from liability (similar to art. IV, rule 4, of the Hague-Visby Rules), which is additional to the list of presumptive events in article 6.1.3. It would be a matter of construction of the draft instrument whether a carrier would still be exempt from liability in cases where a deviation was made necessary by the carrier's negligence.

81. Article 6.6, Deck cargo: This is an extremely complex provision, which may lead to considerable confusion. While the provision is in some respects similar to article 9 of the Hamburg Rules, it differs significantly, both in wording and content. It appears important to juxtapose the draft provision with the situation under the Hague-Visby and Hamburg Rules.

82. The Hague-Visby Rules do not apply to cargo which "by the contract of carriage is stated as being carried on deck and is so carried", (art. 1 (c)). It should be noted that in the absence of a positive statement in the bill of lading that goods are in fact carried on deck, the Hague-Visby Rules apply and determine the carrier's liability. Under the Hamburg Rules (art. 9), deck carriage is permitted if legally required or in accordance with trade usage or a contractual agreement, which must be referred to in the transport document. The absence of a statement to this effect is *prima facie* evidence of the absence of an agreement on deck carriage vis-à-vis a shipper and conclusive evidence vis-à-vis a third party who has acquired a bill of lading in good faith. Where deck carriage is permitted, the carrier is liable in accordance with the Hamburg Rules (i.e., fault-based, subject to a financial limit). Where deck carriage is not permitted, the carrier is strictly liable (i.e., even in the absence of fault) for any losses arising solely from carriage on deck. If goods are carried on deck contrary to an express contractual agreement, the carrier loses its right to limitation of liability.

83. Under article 6.6.4 of the draft instrument, deck carriage is permitted in a number of instances and different consequences attach, depending on whether cargo is carried on deck in accordance with these different "headings" or in breach of these as follows:

(a) Deck carriage is admissible where legally required and the carrier is not liable for loss, damage or delay caused by the special risks of deck carriage. It would seem that such "special risks" would include sea-water damage or loss of a container carried on deck. The Hamburg Rules do not provide a similar exemption from liability;

(b) Deck carriage is permitted where containerized goods are carried on specially fitted container decks and the carrier is liable under the provisions of the draft instrument. It should be noted that there is no obligation on the carrier to state in the contract particulars that the goods will be carried on deck. Moreover, deck carriage of containerized cargo appears to be permitted, even if there is an express contractual agreement that the goods are to be carried under deck. Such agreement may be made in cases where the nature of the cargo requires protection from the elements, such as in the case of sensitive electronic equipment. Arguably, the carrier would be permitted to carry containerized cargo on deck despite an express contractual agreement to the contrary, but would lose the right to limit its liability in accordance with the draft instrument for loss or damage to the goods resulting exclusively from deck carriage (art. 6.6.4). There appears to be no legitimate reason for allowing deck carriage in cases of contrary agreement. A cargo claimant would bear the additional risks of such deck carriage and would only be entitled to compensation in excess of the limitation amounts if he was able to prove that a loss of damage was "resulting exclusively" from the carriage of the goods on deck. Any such compensation would,

however, be calculated in accordance with article 6.2, which may or may not amount to full compensation for a given loss (see comment to art. 6.2);

(c) Deck carriage is permitted where contractually agreed or in accordance with customs, usages or practices of the trade or where it "follows from other usages or practices in the trade in question". The meaning and purpose of the last category (here reproduced in quotes) is not at all clear. In cases where deck carriage is in accordance with (c), the contract particulars must state that the goods are carried on deck, otherwise the carrier bears the burden of proving compliance with (c) and, if a negotiable transport document/electronic record has been transferred to a third party acting in good faith, cannot rely on the provisions. However, in view of the general liberty to carry containerized cargo on deck (see (b)), the carrier would normally not need to rely on (c) for the carriage of containerized cargo. Where (c) is relevant, that is, where non-containerized cargo is shipped on deck in accordance with contractual agreement or trade customs/usage/practice or "following from other usages or practices in the trade", the carrier is not liable for loss, damage or delay caused by the special risks of deck carriage (see also comment to (a), above).

(d) In cases not covered by (a), (b) or (c), the carrier is strictly liable for loss damage or delay that are exclusively the consequence of their carriage on deck (see art. 6.6.2). Again, the cargo claimant would bear the burden of proving that a loss resulted exclusively from the carriage of goods on deck. As can be seen, the provision in article 6.6 is extremely difficult to understand and to apply and differs from existing regulation. It should be completely redrafted, possibly using the text of article 9 of the Hamburg Rules as a model.

84. Article 6.7, Limits of liability: The limitation amounts in article 6.7.1 should clearly be in excess of those established in the Hague-Visby Rules, as these were already considered to be out of date in 1978, when the Hamburg Rules were adopted. The limitation amounts in the Hamburg Rules, representing an increase of about 25 per cent to the limitation amounts in the Hague-Visby Rules, were adopted as part of a compromise and may accordingly still be considered somewhat modest. Some consideration might be given to the limitation amounts used in other modern transport conventions, which are higher. It should always be possible for a carrier to agree on an increase of its liability, but, given that the text otherwise adopts the relevant wording of the Hague-Visby Rules (art. IV, rule 5 (a)), it is not clear why the text here included in brackets differs from the corresponding wording in the Hague-Visby Rules (art. IV, rule 5 (g)). Curiously, the right to limit under article 6.7.1 applies to the carrier's liability "for loss of or damage to or in connection with the goods . . .", while the provision on the calculation of compensation in article 6.2 is more restrictively worded ("loss of or damage to the goods").

85. Article 6.8, Loss of the right to limit liability: Under article 6.8, the right to limit liability is lost in circumstances, which are expressed in more restrictive terms than in article IV, rule 5 (e) of the Hague-Visby Rules and article 8 of the Hamburg Rules. The relevant circumstances are described as "personal act or omission . . . done with the intent to cause such loss . . . or recklessly and with knowledge that such loss . . . would probably arise". In practice, "breaking the limit" would be virtually impossible as each party (carrier, performing party, "any other person") would (a) only be responsible for personal acts of recklessness/intent, namely, actions at company management level, and (b) only if the particular loss or damage occurring was intended or foreseeable. Moreover, relevant circumstances set out in article 6.8 would have to be established by the cargo claimant.

86. There is no provision equivalent to article 19, rule 7, of the Hamburg Rules, which requires the carrier to give notice of loss or damage if it wishes to make a claim against the shipper. Such a provision should be included.

87. **Article 6.9, Notice of loss, damage or delay:** The notice period in article 6.9.1 corresponds to that in the Hague-Visby Rules, but is shorter than in the Hamburg Rules (art. 19) and in other transport conventions, including the most recently adopted Budapest Convention on the Contract for the Carriage of Goods by Inland Waterways of 2000 (art. 23). In particular the reference to “before . . . the time of delivery” appears problematic. The wording in the last sentence of article 6.9.1 may give rise to confusion, as it is not made clear whether a notice shall be dispensable where a joint inspection has been made by a consignee and a performing party, but the claim is made against the contracting carrier. The notice period in article 6.9.2 is shorter than under article 19, rule 5, of the Hamburg Rules (60 consecutive days after the day when goods were handed over to consignee).

88. **Article 6.10, Non-contractual claims:** This provision omits mention of “any other person” who may, under article 6.3.3, rely on the same defences as a carrier or performing party. Article 6.10 does not refer to these persons, as, under the instrument, they do not bear any responsibility (see art. 6.3 and the narrow definition of “performing party” in art. 1.17).

G. Obligations of the shipper

89. The detail of the obligations of the shipper under chapter 7 of the draft instrument has no parallel in existing maritime liability conventions. Consideration may be given to adopting the relevant provisions in the Hamburg Rules instead (see Articles 12, 13 and 17 of the Hamburg Rules).

90. **Article 7.1:** Article 7.1 requires the shipper to deliver the goods ready for carriage “in accordance with the provisions of the contract of carriage”. Reference to the “contract of carriage” leaves open the possibility of a carrier including onerous provisions of delivery in the contract. As drafted, the obligation relating to the condition and packing of the goods is much more detailed than the carrier’s obligation of care in article 5.2.1. The detail of the obligation may give rise to some confusion and also to evidentiary problems.

91. **Article 7.2:** This provision imposes an obligation on the carrier, but is contained in the Article entitled “Obligations of the shipper”.

92. **Article 7.3:** The obligation set out in article 7.3 (a) and (b) would seem to be particularly relevant in connection with the transportation of dangerous cargo. In article 7.3 (c), it is not clear why the particulars referred to in article 8.2.1 (a) (i.e., description of the goods) are not mentioned. Article 7.3 needs to be considered in context with article 7.5, which provides for strict liability of the shipper.

93. **Article 7.5:** The provision establishes strict liability, irrespective of fault. This may be inappropriate, for instance where a shipper failed to provide relevant particulars under article 8.2.1 (b) and (c) for inclusion in the transport document before receipt of the goods by the carrier (as is required under art. 8.2.1). The shipper would be strictly liable for breach of its obligation under article 7.4, to provide the information “in a timely manner”. It is not entirely clear what the effect of the provision may be as regards liability to a consignee or controlling party. Would a shipper be liable to the consignee for providing inaccurate particulars to the carrier (e.g., because these particulars were then qualified by the carrier, thus depriving the consignee of evidence in a cargo claim)? Would a carrier be responsible to a consignee for a shipper’s failure to provide accurate particulars? The drafting of the provision leaves scope for some interpretation.

94. **Article 7.6:** In the Hague-Visby Rules, the carrier is entitled to claim an indemnity from the shipper for losses arising (a) from

the shipment of dangerous goods without the carrier’s knowledge or consent (art. IV, rule 6), and (b) from inaccurate particulars furnished by the shipper (art. III, rule 5). The shipper’s liability is in both cases commonly understood to be strict (i.e., not dependent on fault), although this is not expressly stated in the Hague-Visby Rules and there is a general rule that the shipper is normally only liable in case of fault (art. IV, rule 3). There may be differing views on this matter in different jurisdictions. Under draft article 7.6, the shipper would be liable in similar circumstances as (a) above, but also where dangerous goods had been shipped with the carrier’s knowledge and consent.

95. It is not entirely clear what a breach of the shipper’s obligations under article 7.1 triggering article 7.6 may consist of, other than “loss, damage or injury caused by the goods”. Normally, the carrier would not be liable to a consignee for damage to the consignee’s cargo owing to inherent vice, wastage, defective condition of packing or other acts or omissions of the shipper/consignee (see art. 6.1.3 and art. 6.1.1). Liability of the carrier towards *other* consignees, whose goods may have been damaged by dangerous cargo, would be a “loss [of the carrier] . . . caused by the goods”. The same would be true for direct loss to the carrier consisting of, for example, damage to the vessel or the like. It is therefore not clear what type of loss a carrier may suffer as a result of a shipper’s breach of article 7.1, other than the type of breach already referred to as “loss, damage or injury caused by the goods”. Further clarification of this issue is required, as the shipper’s liability under article 7.6 is fault-based, but with a reversed burden of proof and a particularly high standard of care required (similar to the standard of care in article 17, para. 2, of the Convention on the Contract for the International Carriage of Goods by Road; for an explanation, see comment to art. 6.1.1). In practice, it would be extremely difficult for a shipper to discharge the burden of proof, as it would not normally have access to the full facts.

96. **Article 7.7:** This provision extends certain obligations and rights of a contracting shipper to a party identified as shipper in the contract particulars who “accepts” a transport document/electronic record. In particular, this party would become strictly liable for a failure by the contracting shipper to provide timely and accurate particulars (see arts. 7.5, 7.4, 7.3 and 8.2.1 (b) and (c)) and be subject to the very high burden of proof under article 7.6 for failure of the contracting shipper to comply with article 7.1. The person referred to in article 7.7 is also mentioned in article 10.3.2 (delivery instructions where holder does not claim delivery) and may additionally be affected by the provisions of article 9.3.

97. There appear to be several problems with article 7.7. First, it is not clear what would amount to “acceptance” of the document/record and thus trigger application of the provision. Would taking receipt of or otherwise handling a transport document as agent, on behalf of the contracting shipper, be sufficient for acceptance? If so, the application of the provision would appear arbitrary. Secondly, the provision refers to “a person identified as shipper in the contract particulars”. Standard clauses could be drafted which define and therefore “identify” the shipper in the contract particulars as including the consignee. See, for example, bill of lading clauses currently used, which define the “merchant” as including, among others, the shipper, consignor, holder, consignee, etc. and state that the “merchant” bears the responsibilities of a shipper under the contract. It appears that article 7.7 would, to an extent, give statutory effect to standard clauses such as those mentioned. Most importantly, however, the purpose of the provision is not clear. Under article 7.7, a party who is not the contracting shipper would effectively be held responsible for failure by the contracting shipper to comply with its obligations. This responsibility would be in addition to that of the contracting shipper. Why this should be so is not obvious. Both the purpose and drafting of the provision may need to be reconsidered.

98. **Article 7.8:** Under this provision, a shipper would be responsible to the carrier for acts and omissions of the shipper's "subcontractors, employees, agents and any other person who act, . . . directly or indirectly, at its request or under its supervision or control . . .". It is important to note that under article 5.2.2, as currently drafted, a shipper may bear contractual responsibility for certain of the carrier's functions. In practice, the carrier may, of course, either perform these functions "as agent of the shipper" or arrange for the performance by other parties, such as stevedores, etc. It is in this context that article 7.8 appears problematic, as the shipper would arguably be considered responsible for acts or omissions of the carrier itself or of parties under the carrier's supervision and control. Moreover, it is not clear how the provision would work where, under article 7.7, a person other than the contracting shipper is stated to be responsible. This party would not have "delegated the performance of any of its responsibilities . . .", but may arguably be held responsible for the acts of parties to whom the contracting shipper had delegated its duties.

H. Transport documents and electronic records

99. The central purpose of any provision requiring the inclusion of certain particulars in a transport document/electronic record is to ensure there is recorded evidence of these particulars. This is of special importance where documents are negotiated in international trade and a cargo claim may be brought by a third party, who needs to prove evidence of loss, damage or delay during transport. This needs to be borne in mind, when considering the provisions in chapter 8. Unfortunately, the draft of this chapter is particularly complex and several of the provisions are difficult to understand and to apply. Although elements of the Hague-Visby and Hamburg Rules have been adopted, the wording and content of the provisions differ from existing rules. Considered in context, the draft rules appear to prejudice severely the interests of cargo claimants.

100. **Article 8.1, Issuance of the transport document or the electronic record:** This provision requires reference to the extensive and confusing definitions in chapter 1 and appears to be in need of some further attention. Under article 8.1 the consignor is entitled to a transport document/electronic record upon delivery of the goods for carriage. The shipper or the party named as shipper in the transport document is entitled to a negotiable transport document/electronic record, unless this is not required according to trade practice/usage/custom or the parties agree otherwise. Importantly, an agreement that (a) no negotiable document be issued, or (b) an electronic record be issued may be made "impliedly". As implied agreements may give rise to evidentiary problems, it may be preferable to permit only express agreements on both matters. It appears that it was the intention of the draftsmen of this provision that only the shipper should have a right to a "negotiable" document or electronic record, but the wording of article 8.1 (i), if read against the background of the definitions in article 1, also allows a different interpretation (note that the terms "transport document" and "electronic record" as defined in articles 1.20 and 1.9 are not necessarily restricted to non-negotiable documents/records).

101. **Article 8.2, Contract particulars:** Article 8.2 lists a number of contract particulars to be included in the transport document/electronic record issued by the carrier. Unlike under article 15, rule 1, of the Hamburg Rules, there is no requirement to include any agreement on deck carriage (but see art. 6.6.3) or indicate if any freight is payable by the consignee. Moreover, there is no requirement to state any agreed delivery date. For purposes of clarity, it would seem to be advisable to mention in one provision all particulars which under the draft instrument are required for inclusion in the "contract particulars". It should be noted that the party referred to in article 7.7 could indirectly be affected by article 8.2, which imposes an obligation on the

contracting shipper. This party may be able to demand issue of a transport document under article 8.1 and may become liable to the carrier for inaccuracies of particulars contained in the transport document, under articles 7.7, 7.5 and 7.3 (c).

102. It is difficult to understand why the shipper should provide the information relating to the goods under article 8.2.1 (b) and (c) before the goods are delivered for carriage. It should be satisfactory if the information is available before the document/electronic record is issued. It is also not clear why, under article 8.2.1 (c), the shipper needs to provide details on the weight, in addition to the number of packages/pieces or the quantity. As the shipper would be liable strictly for failure to provide the details required under article 8.2.1 (b) and (c) accurately and timely (art. 7.4), a shipper would be obliged to weigh the cargo, including containerized goods, in each case. Conversely, a carrier would be under no obligation to weigh containerized goods, (except where agreed prior to shipment and in writing) and could therefore always include in the transport document a qualifying clause (art. 8.3.1 (c)), which would destroy the evidentiary value of any statement regarding the weight of a container (art. 8.3.3). It is difficult to see why the shipper/consignee should be burdened with the cost of weighing containerized cargo, without obtaining any benefit at all. It must be noted that the carrier would normally also be entitled to qualify the statement on the contents of a sealed container (art. 8.3.1 (b)). In the case of containerized transport, the transport document would, therefore, be often irrelevant as evidence of a loss or short delivery during the transport. In the case of non-containerized cargo, a carrier would also be entitled to include a qualifying clause, whenever it would be "commercially unreasonable" to verify the quantity or weight of the cargo (see arts. 8.3.1 (a) and 8.3.2 (a)). There may, of course, be much debate about what is or is not commercially reasonable. In the bulk trade, too, the transport document would therefore be of limited value as a receipt providing evidence.

103. A provision like that in article 8.2.1 (e), requiring the inclusion of the carrier's name and address in the contract particulars would clearly be of some help to cargo interests in identifying the contracting carrier within the short time limit for claims (art. 14.1). However, it may be advisable to require information on the carrier's principal place of business, as this would provide the most reliable indication of where a carrier may be found.

104. **Article 8.2.1 (f)** requires the inclusion of a date in the contract particulars. The date of shipment included in a transport document is of particular commercial significance, for instance where goods are sold on shipment terms (c.i.f., f.o.b.) in a string of contracts. In this context, it is of concern that the last alternative in article 8.2.1 (f)(iii) permits the inclusion of the date of issue of the transport document/electronic record, instead of the date of receipt or shipment of the goods. By itself, the date of issue is of only limited relevance. Any transport document/electronic record should include the date of (a) shipment of the goods or, as the case may be, (b) receipt of the goods (with a possibility of converting the document into a "shipped" record upon loading of the goods onto a vessel, should this information be required).

105. **Article 8.2.3, Signature:** Article 8.2.3 (b) states the relevant signature requirements in cases where an electronic record has been issued. It is not clear why the definition of "electronic signature" differs from the definition in article 2 (a) of the UNCITRAL Model Law on Electronic Signatures, which was adopted in 2001. It should be noted that in article 8.2.3 (b), an electronic signature is said to indicate "authorization of the electronic record", rather than "approval of the information contained in" the electronic record (as under the definition in the UNCITRAL Model Law on Electronic Signatures). Whether any substantive difference in regulation was intended is, however, not clear.

106. **Article 8.3.1, Circumstances under which the carrier may qualify . . .:** There appears to be a particular problem with

the drafting of article 8.3.1 (a). Under subparagraph (ii) of the provision, the carrier is given the right to substitute any information provided by the shipper which it considers inaccurate. The structure of the provision suggests that in these circumstances too, the introductory sentence of article 8.3.1 would apply and allow the carrier to include a qualifying clause. This is, however, evidently unjustified and cannot be the intention of the provision. As regards the operation of the provision in article 8.3.1 (c), please note the concerns expressed in the comments to article 8.2.1.

107. **Article 8.3.2, Reasonable means of checking:** Under article 8.3.2 (b), the carrier is presumed to have acted in good faith when issuing a transport document/electronic record containing qualifying clauses. In practice, it would be clearly very difficult for a (third party) cargo claimant to prove that a carrier had not acted in good faith. The reversed burden of proof may arguably invite abuse, as an irresponsible carrier would effectively be free to ignore the instrument's conditions for including a qualifying statement in the transport document/electronic record.

108. **Article 8.3.3, Prima facie and conclusive evidence:** The purpose of this provision, which is based loosely on article III, rule 4, of the Hague-Visby Rules, is to preserve the evidentiary value of the issued document/record in a cargo claim. This is of particular importance where a third-party consignee, with no connection to the initial shipper, may have no other evidence available of what was delivered to the carrier for transport. The practical effect of this provision, however, would be minimal, in view of the other provisions in this chapter, considered in context.

109. **Article 8.4.2, Failure to identify the carrier:** Article 8.4.2 contains an important provision safeguarding the ability of a cargo claimant to identify the carrier and thus to commence a claim in the correct jurisdiction within the short and strict time limit (art. 14.1). The provision establishes a presumption that the registered owner of a vessel carrying the goods is the carrier. The provision is necessary, in particular where a carrying vessel operates under a charter-party and a charterer may be the contracting carrier. However, it is not clear why the registered owner should be able to defeat the presumption if the ship was under a bareboat charter. It is correct that under a bareboat charter, the registered owner is not involved in the management of the vessel and therefore would not wish to be regarded as the carrier. However, in the interests of effective protection of the consignee's legal rights to pursue a cargo claim, it would seem to be vital to ensure that one party may be held to account if the contracting carrier cannot be identified. If the presumption in article 8.4.2 can be defeated, the rights of the cargo claimant depend effectively on whether the bareboat charterer has any assets. Moreover, the bareboat charterer may itself dispute being the contracting carrier and the claimant would be left in the same position as if no presumption applied at all. Even worse, by that time, any claim against the true contracting carrier (e.g., a time-charterer) would very likely be time barred (see art. 14). The provision is only applicable in cases where a "shipped" transport document has been issued. There is no equivalent presumption applicable in cases where goods are delivered for shipment to a container terminal and are lost or damaged before shipment. The short and strict time bar applies, however, equally in these cases.

I. Freight

110. The chapter dealing with freight seeks to address matters currently not covered in any international regime. The law relating to freight depends on relevant national laws and it may be assumed that a considerable variety of rules exists in different jurisdictions. For this reason, any attempt at drawing up uniform rules in this area needs to be made with special care. In particular, the content of provisions that benefit carriers rather than cargo interests should be scrutinized as to their desirability for inclusion

in an international regime. Overall, the rules contained in this chapter appear considerably to favour carrier interests. It may therefore be open to discussion whether the chapter should be included.

111. **Articles 9.1 and 9.2:** The rules set out in these provisions determine when freight is earned and becomes payable. They appear to correspond with standard bills of lading clauses that are currently in use. In the absence of mandatory law on the subject, matters relating to the payment of freight are, generally, subject to contractual agreement. However, it is questionable whether the rules set out in articles 9.1 and 9.2 should be adopted internationally. The provisions fail to address concerns that have arisen in current practice, for instance in cases where bills of lading have been issued to a charterer who has shipped goods under a charter-party. In these cases, the bill of lading may incorporate all provisions of the charter-party, including those on freight, but a consignee to whom this bill of lading has been transferred by the charterer may not have any knowledge of their content. The consignee may thus be subject to an agreement that freight has been earned on shipment without any clear indication to this effect in the contract particulars. The provisions set out in articles 9.1 and 9.2 (a) are subject to contractual agreement and would therefore not provide the consignee with any indication of whether or not it would be liable for the payment of freight. Of particular concern is article 9.2 (b). This provision stipulates that once freight has been earned, it remains payable if goods have been lost, damaged "or otherwise not been delivered to the consignee in accordance with the contract", ". . . irrespective of the causes of such loss, damage or failure in delivery". As drafted, the provision appears not to be subject to contractual agreement. There is no reason why this should be so (even if it may be unlikely that a carrier would wish to depart contractually from the provision). More importantly, however, under article 9.2 (b), the right to freight would not be affected even by gross misconduct of the carrier, such as theft of the cargo. It is doubtful whether this corresponds to the present law in all jurisdictions and whether this provision can be justified.

112. **Article 9.3:** There is no indication anywhere in the draft instrument of what is meant by "charges incidental to the carriage of the goods" (see art. 9.3 (a)), in particular whether this may include demurrage incurred at the port of loading or discharge.

113. It is not clear why article 9.3 (b) introduces an apparently mandatory provision for the exclusive benefit of carriers, although the regulation of freight is generally subject to contractual agreement. The parties should be able to agree freely on the matters set out in article 9.3 (b). A carrier is in a position to protect its position by drafting appropriate contractual clauses for inclusion in a transport document, if it so wishes. As drafted, the provision would ensure that the shipper or the party named as shipper remains liable, although the contract indicates otherwise. Moreover, the drafting of article 9.3 (b)(ii) (together with the introductory sentence of article 9.3 (b)) appears to suggest that the party identified as shipper in the contract particulars would "remain" liable for the payment of any amounts under the contract of carriage, which this party had never agreed to pay. This would clearly be difficult to justify. As concerns the text of the provision in article 9.3 (b)(ii), it is not clear what exactly is meant by "amounts payable to the carrier under the contract" and why a reference to "security pursuant to article 9.5" has been included. In article 9.3 (b)(iii), the reference to article 12.4 is very unfortunate. Article 12.4 states that both assignee and assignor shall be jointly and severally liable if the transfer of rights by assignment "includes the transfer of liabilities". It is not clear whether this is to be determined by the law applicable to the contract of carriage or the assignment or by the contract of carriage itself. Accordingly it is unclear what exactly the effect of article 9.3 (b) may be in any given case.

114. **Article 9.4, Freight prepaid and freight collect statements:** This provision is of particular relevance to a third-party consignee who may have bought goods under a c.i.f., c.&f. (cost and freight), or f.o.b extended services contract, but is faced with a freight claim by a carrier who has not been paid. It is sensible to provide clearly in the draft instrument that a party who is not the original contracting shipper may rely conclusively against the carrier on a statement in the transport document/electronic record that freight has been prepaid. This will also correspond to the legal position in most jurisdictions. However, the provision as drafted does not provide any protection to an f.o.b extended services buyer (shipper) who obtains from his seller (the consignor) a "freight prepaid" document/record. It is not clear why the carrier should be able to state incorrectly that freight has been paid when this is not the case and why a party who places reliance on the document should bear the risk associated with this practice. Article 9.4 (b) provides appropriately that a "freight collect" statement in the contract particulars puts a consignee or holder on notice that it may be liable for the payment of freight. The provision fails, however, to address the question of what should happen if the contract particulars simply state "freight payable as per charter-party". A consignee or holder may find itself liable for the payment of charter-party freight, although, under its contract with the shipper (as seller), freight should have been paid by that party. It may be desirable to include a provision along the lines of article 15, rule 1 (k), and article 16, rule 4, of the Hamburg Rules, which seek to protect a third-party consignee in cases where the transport document does not indicate that freight is payable by a third-party consignee or holder.

115. **Article 9.5:** Article 9.5 (a) provides the carrier with a lien on the cargo and a right to sell the goods in the absence of payment or provision of "adequate security". These rights are made dependent on existing liability for certain types of payment obligations under the national law applicable to the contract of carriage. The provision causes a number of serious concerns, which may make deletion of the provision advisable, as follows:

(a) By making reference to national law, a great deal of uncertainty is introduced, as identifying the applicable national law depends on the conflict of law rules of any given forum in which a dispute is litigated or arbitrated. In some jurisdictions, these rules may differ according to whether the claim is brought under the contract of carriage or under a "negotiable" document. The provision introduces a "network" approach rather than a "uniform" approach. As a result, the benefits of uniform regulation are lost and a great deal of uncertainty is produced.

(b) By giving precedence to national law over a contrary contractual agreement (see the text in brackets in art. 9.5 (a)), the provision increases the uncertainty referred to under (a) to an unacceptable degree: not only would the parties have to identify the relevant applicable law and its substantive rules, but any contractual agreement they have made would be irrelevant and thus misleading. It does not appear justified to afford a carrier the benefit of national law in its favour, despite the fact that it had contractually agreed otherwise. It needs to be emphasized, again, that carriers should be perfectly able to protect their interests by the inclusion of terms in their standard form contracts.

(c) The drafting of the types of situations in which a carrier should be able to be entitled to a lien and to sell off any goods is not satisfactory. Article 9.5 (a)(i)-(iii) refer to diverse heads of liability, which are expressed in very vague terms. Whether any liability on the part of the consignee exists under the law applicable to the contract requires a considerable degree of legal expertise and is not a question which a carrier can or should decide quickly and act upon by exercising a "right" to sell the goods. In particular in respect of "damages due to the carrier under the contract of carriage" (see art. 9.5 (a)(ii)) it becomes apparent how inappropriate the proposed approach would be. The carrier would be placed in the position of judge, jury and enforcer of any right

to damages it may claim to have. Clearly, this is not really in the interests of carriers either, as a misjudgement on the part of a carrier could set off a chain of litigation, exposing the carrier to significant legal costs and to substantive liability.

(d) Article 9.5 (b) gives the carrier the right to sell goods if payment as referred to in paragraph (a) is not (fully) effected. The provision does not mention security other than payment and it does not state any time frame or notice requirement for the exercise of this drastic remedy. Moreover, it states rather vaguely that the balance of any proceeds of sale (after deduction of "the amounts payable to it" (presumably under article 9.5 (a)?) "shall be made available to the consignee". As drafted, the provision would clearly invite legal dispute.

J. Delivery of the consignee

116. Article 10.1 establishes a new obligation of the consignee to "accept delivery of the goods at the time and location mentioned in article 4.1.3". There is no obligation on the carrier to inform the consignee of the arrival of the goods. If the consignee fails to "accept delivery", the carrier will not be responsible for the goods except in cases of personal recklessness or where damage or loss are caused intentionally by the carrier. Although the obligation to take delivery arises only when the consignee exercises any of its rights under the contract of carriage, this would be a matter of interpretation. Any consignee who, as shipper, demands issue of a bill of lading under article 8.1 (ii) or exercises any right it may have as controlling party under article 11.1 would arguably be affected. The obligation is strict (independent of fault) and the consignee would appear to be in breach even in cases of delay in taking delivery. It is not clear why a carrier, who remains in custody of the goods after their arrival at the destination, should not remain under at least a residual obligation to exercise reasonable care.

117. Article 10.3 contains detailed and complicated rules on the carrier's delivery obligation and article 10.4 contains equally detailed and complicated rules on the carrier's rights if the consignee fails to take delivery. The drafting of the provisions is far too complex to provide any reliable and clear guidance to carriers faced with a decision on which course of action may be required or permitted under the instrument. The content and effect of the provisions may be broadly summarized as follows. Where no negotiable transport document/electronic record has been issued, the controlling party shall advise the carrier of the name of the consignee and the carrier shall make delivery to that person upon proof of identity (art. 10.3.1). Where a negotiable transport document/electronic record has been issued, the holder has a right to claim delivery of the goods against surrender of the original document(s) (or in accordance with the relevant procedure under art. 2.4) (art. 10.3.2 (i)). However, if the holder does not claim delivery of the goods after their arrival at the place of destination, the carrier is entitled to demand delivery instructions from the controlling party or, if that party cannot be found, the shipper, or the person named as shipper in the contract particulars (cf. art. 7.7). Delivery in accordance with such instructions discharges the carrier from its obligation, even if the negotiable transport document has not been surrendered (or the electronic record is still valid). If no delivery instructions are forthcoming, the carrier is entitled to exercise its rights under article 10.4, which include storing and unpacking the goods, as well as other actions which "in the opinion of the carrier, circumstances reasonably may require" and, finally, selling the goods (art. 10.4.1 (b)). If the carrier sells the goods, it is entitled to deduct amounts necessary to "pay or reimburse any costs incurred in respect of the goods" and "pay and reimburse any amounts referred to in article 9.5 (a) [. . .] that are due to the carrier". Before exercising these rights, the carrier must give notice of the arrival of the

goods to the party to be notified as stated in the contract, or to the consignee or the controlling party or the shipper. A carrier exercising any rights under article 10.4.1 is only liable for loss of or damage to the goods if caused intentionally and with knowledge that such loss would probably result, or if caused by personal recklessness.

118. As drafted, the provisions in article 10.3 and 10.4 do not appear to be reasonable. The carrier is given extremely broad rights to dispose of the goods, if the consignee or holder, for whatever reason, does not take delivery of the goods upon their arrival at destination (in accordance with art. 4.1.3). The carrier may ultimately sell the cargo and satisfy any claims it may have from the proceeds. Whether any monies are in fact due to the carrier at that time, may however, be a matter open to much controversy and possibly requiring lengthy litigation (note that article 9.5 is itself a very problematic provision, see comments thereon). A cargo claimant would be left with a claim against the carrier, while the carrier would effectively be given a statutory right of set-off for potentially disputed claims. Moreover, the carrier would practically never be liable for any loss or damage to the goods if the goods were left in its custody after their arrival at destination. Finally, the carrier would not be liable for failure to deliver against surrender of a negotiable transport document if it acted in accordance with delivery instructions of the controlling party or the shipper.

119. In effect, the provisions appear to sanction a carrier's right to self-help in all cases where the consignee is late in taking delivery upon arrival of the goods. While there may be understandable concerns in situations when goods are not collected at destination, it would seem that any attempt at addressing these should strike a balance between carriers' and consignees' legitimate interests. As drafted, however, the provisions in articles 10.3 and 10.4 provide the carrier with extensive rights, without any consideration of the position of the consignee. In particular, it should be noted that any change to established principles, as proposed, would adversely affect the rights of third-party holders of a "negotiable transport document". Traditionally, a "negotiable" bill of lading provides the holder with the exclusive right to demand delivery of the goods against surrender of the document. Possession of the document thus provides the holder with constructive possession of the goods. It is on this basis that international trade on shipment terms (c.i.f., c.&f., f.o.b.) has developed and is conducted. Article 10.3.2 (iii) provides that the carrier may, in certain circumstances, not be responsible to a bill of lading holder for failure to deliver against surrender of the document. It is not clear why this should be so, given that a carrier who wishes to avoid the problems associated with the delay of paper bills of lading would be able to contract on electronic terms.

K. Right of control

120. Chapters 11, 12 and 13 deal with issues of great complexity, which are not currently governed by any international convention but are subject to very diverse national laws. The provisions of these chapters, as drafted, do not sufficiently appear to represent international consensus on the concepts used and the rights described. Moreover, the structure of the chapters, as well as the drafting of individual provisions, is problematic and may give rise to considerable confusion. In this context, it should be remembered that clarity and ease of application is required for any international regulation to be successful. It would seem to be advisable to remove chapters 11-13 as drafted from the draft instrument and to reconsider whether regulation at this time is required. If it is decided to retain these chapters as part of the instrument, more detailed comment on the effects of the complex individual provisions will be provided at a later stage.

121. Chapter 11 deals with the right of control, a matter which has never been subject to uniform international regulation. The rules set out in this chapter require close consideration of a number of definitions (chap. 1). Unfortunately, the text of the provisions is poorly drafted and the chapter lacks coherence. Much cross-referencing of provisions makes the rules difficult to understand and apply. Article 11.1 defines the right of control, article 11.2 provides detailed rules on the controlling parties, and, to an extent, the transfer and exercise of the right to control. Article 11.3 sets out the conditions under which a carrier needs to comply with any instructions received under article 11.1 (i)-(iii). The relationship of these provisions to each other and to the provisions of chapter 12 is complex. In order to comment, one needs to consider some provisions in context.

122. Under article 11.1, the controlling party is stated to have the right to give instructions in respect of the goods. This would include the right to give instructions regarding delivery of the goods at destination. More specifically, article 11.1 states that this includes (a) the right to give or modify instructions in respect of the goods, (b) the right to demand delivery before arrival of the goods at destination, (c) the right to replace the consignee and (d) the right to agree with the carrier on a variation of the contract. However, except for the right to agree on any variation of the contract, the exercise of all other rights referred to in article 11.1 (i)-(iii) is subject to article 11.3. That provision states (in some detail) that the carrier shall execute instructions mentioned in article 11 (i)-(iii) only if this can reasonably be done and would not cause interference, expense, etc., to the carrier. Otherwise, the carrier is under no obligation to execute the instruction. If the carrier nevertheless chooses to comply, it can demand security from the controlling party. The parties may "vary" by agreement the provisions of articles 11.1 (ii) and (iii) and 11.3. According to article 11.4, goods delivered short of destination in accordance with instructions received by the controlling party under article 11.1 (ii) are deemed to be delivered at the place of destination and chapter 10 applies to the delivery obligation. Article 11.5 provides the carrier with a right to demand instructions, documents and/or information from the controlling party or, if that party cannot be found, from the shipper or the "named shipper" (see art. 7.7).

123. Effectively, the list of rights in article 11.1 corresponds to the rights of a contracting shipper under a contract of carriage, namely to give certain instructions and to agree on a variation of the contract. The right to demand delivery of the goods at destination is not expressly referred to, but would seem to be included as part of the general right to give instructions. Instead of simply stating in article 11.1 that there is a right to give only reasonable instructions, very complicated and lengthy requirements have been set out separately, in article 11.3. The rights to give instructions under article 11.1 (i)-(iii) are limited rights, which may also be excluded contractually. The purpose and aim of any regulation of the right of control should be to set out clear and simple rules to determine which types of instructions and whose instructions a carrier is required to comply with. Overall, it appears that the provisions in article 11 are not at all helpful.

124. Article 11.2 deals with the controlling party and, to an extent, the transfer of the right of control. It distinguishes according to the type of documentation/record used and needs to be considered in context with the rules in article 12. It is most unfortunate that the matters dealt with in article 11.2 and article 12 are not provided for in context. This causes a great deal of confusion. In overview, article 11.2 provides as follows:

(a) Where no negotiable transport document/electronic record has been issued. This includes both the situation where a non-negotiable document/record has been issued (e.g., a sea waybill) or where no transport document has been issued. Under article 11.2 (a), the shipper is the controlling party, unless the

shipper and consignee agree on a different party and the shipper notifies the carrier accordingly. The controlling party may transfer the right of control (the transferor or transferee need to notify the carrier accordingly), but this right can be restricted or excluded contractually (art. 11.6). Exercise of the right of control (i.e., the giving of instructions under art. 11.1) requires that the controlling party provides identification. It should be noted that the mechanisms of transfer of the right of control are not set out in the draft instrument, but, according to article 12.3, such transfer “may be effected in accordance with the national law applicable to the contract of carriage relating to transfer of rights”. Article 12.3 nevertheless adds that transfer cannot be effected by passing a document or electronic record, but may be made electronically and that the transferor or transferee needs to notify the carrier of any transfer. Article 12.4 provides that “if the transfer of rights under a contract of carriage . . . includes the transfer of liabilities that are connected to or flow from the right . . . transferor and transferee are jointly and severally liable . . .”.

(b) Where a negotiable transport document has been issued. The holder (art. 1.12) of all originals is the sole controlling party (the word “sole” is not used in relation to the controlling party under art. 11.2 (a)). It is not clear who would be the controlling party if several originals were in different hands. The holder may transfer the right of control by transfer of (all originals of) the document in accordance with article 12.1 to another party. In order to exercise rights under article 11.1, the holder may be required to produce (all originals of) the document and once the holder has given instructions under article 11.1 (ii), (iii) and (iv), these need to be stated on the document.

(c) Where a negotiable electronic record has been issued. The holder is the sole controlling party and may transfer the right of control in accordance with article 2.4. In order to exercise any rights under article 11.1, the holder may be required to produce evidence of its being a holder in accordance with article 2.4. Once the holder has given instructions under article 11.1 (ii), (iii) and (iv), these need to be stated in the electronic record. As article 2.4 itself only provides that parties may agree on a procedural protocol, the provision in article 11.1 effectively restates that the transfer of the right of control is governed by contractual agreement.

L. Transfer of rights

125. The provisions of chapter 12 deal with the mechanism of the transfer of rights “under a contract of carriage” or “incorporated” in a negotiable transport document or electronic record. These rights are, effectively, the right of control set out in chapter 11, including the right to demand delivery of the goods at destination. Chapter 12 further contains rules on the effects of a transfer. It is proposed to reconsider the text and structure of the provisions completely and, more generally, the inclusion of the chapter in the draft instrument.

126. **Article 12.2.2** states that any holder, other than a shipper, who exercises any rights under the contract “assumes liabilities imposed on it under the contract to the extent that such liabilities are incorporated in or ascertainable from the negotiable transport document or negotiable electronic record”. As drafted, the provision appears to benefit carriers considerably. The provision would allow contracting carriers to include standard clauses in the transport document/ electronic record to extend any liability of the shipper (under the contract as well as under the draft instrument) to the holder of the document/record. For instance, a standard clause might state that anyone falling within a wide definition of the term “merchant”, (including the consignor, shipper, consignee, holder, etc.) was to be liable for the payment of freight, demurrage and expenses and for losses arising from the shipment of dangerous cargo and/or the inaccuracy of contract particulars.

127. Under the Hague-Visby Rules, the position is as follows. First, freight and demurrage are not dealt with in the Hague-Visby Rules. Whether the clause would be effective in this respect would depend on the relevant law applicable to the contract. Second, under article III, rule 5, only the shipper is liable for losses due to the inaccuracy of particulars. The carrier is liable to the consignee, but remains entitled to an indemnity from the shipper. Any contractual clause that purports to impose these liabilities on a party other than the shipper would arguably be incompatible with article III, rule 8, and thus be null and void. Third, under article IV, rule 6, the shipper is liable for losses that are due to the shipment of dangerous goods without knowledge and consent of the carrier. Whether this liability is transferred to a third-party endorsee of a bill of lading is controversial and varies from jurisdiction to jurisdiction. Under the draft instrument, by virtue of article 12.2.2, any clause imposing any and all of the shipper’s obligations on a third-party holder would be effective. It is not clear why this should be justified. In the light of article 12.2.2, the title of chapter 7 (“Obligations of the shipper”) is, to some extent, misleading.

M. Rights of suit

128. See the general observations.

N. Time for suit

129. **Article 14.1:** This provision deals with the time allowed for the institution of legal or arbitral proceedings, a matter of immense practical significance. The provision adopts for both judicial and arbitral proceedings a strict one-year time bar. Its wording resembles the provision in article III, rule 6, of the Hague-Visby Rules, which establishes a comprehensive time bar extinguishing any claims against the carrier (contrast the Hamburg Rules two-year limitation period, which does not have the same effect). The time bar as drafted in article 14.1 would extinguish any cargo claim against the carrier, or indeed against any “other person”, namely, the carrier’s subcontractors, employees, agents or any “performing” parties and their subcontractors, employees and agents (see art. 6.3.3). The time bar would also be applicable in any action against the shipper for breach of its obligations under chapter 7, though not for other claims, for example, regarding matters dealt with in chapter 9. It is not clear whether the time bar would apply in an action against the consignee, controlling party or holder. In contrast to the Hague-Visby Rules, the provision does not make reference to liability of the “ship”, which may mean that the time bar would not apply in actions in rem, commenced against a vessel. It should be noted that the wording “liability . . . in respect of the goods” is based on the Hague-Visby Rules. However, the wording of related provisions, dealing with liability and limitation of liability, differs from that of the corresponding provisions in the Hague-Visby Rules. As a result, there may be differences in the judicial interpretation of the scope of application of the time bar in article 14.1.

130. **Article 14.2:** As the short limitation period under article 14.1 is drafted as an absolute bar to the commencement of any proceedings, it is extremely important to be clear about the beginning of the one-year period. The wording of article 14.2 is similar to article 19, rule 2, of the Hamburg Rules, but there are some differences to both the Hague-Visby Rules and the Hamburg Rules. There is no reference to cases of partial delivery of goods and there is a specific reference to “the goods concerned”. More importantly, the limitation period is stated to commence “on the day on which the carrier has completed delivery of the goods concerned pursuant to articles 4.1.3 or 4.1.4 . . .”. This reference to delivery “pursuant to article 4.1.3 or 4.1.4” introduces some uncertainty, mainly due to the fact that article 4.1.3 itself defines

the delivery obligation in an unclear and unsatisfactory manner. It is important to note that article 4.1.3, as drafted, appears to allow the carrier unilaterally to introduce standard terms for its own benefit, defining the “contractually agreed” time/location of delivery (see comments to art. 4.1). Finally, it should be noted that in cases where the consignee fails for any reason to take delivery of the goods in accordance with article 4.1.3, chapter 10 provides the carrier with various courses of action. In these instances, the limitation period may start running, under article 14.2, irrespective of whether delivery had actually taken place.

131. **Article 14.3:** This provision explicitly refers to “any person against whom a claim is made”, rather than to “the carrier” and the “shipper” as article 14.1. For the sake of clarity, the same terms should be used throughout. It may be advisable to include an obligation on any party who is asked to extend the limitation period “as carrier” to inform the applicant if it is not a contracting carrier. This way, some of the problems associated with correctly identifying the contracting carrier within a short period of time could be avoided. It is to be expected that such problems would continue to exist, despite the requirement in article 8.2 (i)(e) to include the name and address of the carrier in the contract particulars. Similar problems of identification may also arise in claims against other parties, owing, for instance, to the complex definition of “performing party” in article 1.17.

132. **Article 14.4:** This provision corresponds in substance to article 20, rule 5, of the Hamburg Rules and article III, rule 6 bis, of the Hague-Visby Rules. Although apparently no change in substance was intended, the text of the provision is new.

133. **Article 14.5:** It should be noted that this provision would be of no help to a cargo claimant who sued a bareboat charterer, only to find that another party, for example, a time or voyage charterer, was the contracting carrier. The bareboat charterer would not be liable and any action against the contracting carrier would be time barred under article 14.1. This situation would be unsatisfactory from the point of view of cargo interests. See also the comments to article 8.4.2.

O. General average

134. An overview of the arguments for and against general average can be found in reports prepared by UNCTAD on the subject.⁸ Article 15 is identical with the corresponding provision in article 24 of the Hamburg Rules. However, it should be noted that the provisions relating to the carrier’s liability under the Hamburg Rules are different to those under the draft instrument. This needs to be borne in mind when considering whether the inclusion of this provision in the draft instrument would be appropriate.

P. Limits of contractual freedom

135. **Article 17.1:** This is one of the most crucial provisions for consideration, as it defines the mandatory scope of the draft

instrument. The text of the provision adopts elements of both the relevant provisions in the Hague-Visby Rules (art. III, rule 8) and the Hamburg Rules (art. 23, rule 1). As a result, established case law on either provision would be of only limited relevance. The Hamburg Rules prohibit any direct or indirect contractual derogation, but permit an increase of the carrier’s liability. The Hague-Visby Rules prohibit any contractual derogation reducing or limiting the carrier’s liability. Article 17.1 is drafted so as to prohibit any contractual derogation that is “intended or has as its effect” to exclude or limit the liability of any party, including the shipper and consignee. Moreover, in brackets, the draft text also prohibits any contractual increase of liability.

136. Given that contracts for the carriage of goods by sea are concluded on the basis of standard terms, drafted by and often for the benefit of the carrier, it is clearly vital to protect potential cargo claimants from unfair contract terms that exclude or reduce the carrier’s liability to an unacceptable degree. It was on the basis of these considerations that the original Hague Rules were adopted in 1924, following national legislation in Canada and the United States of America. Consequently, it is appropriate to give the minimum levels of liability established in any new international instrument mandatory status. However, it is not at all clear why the obligations or liabilities of the shipper or consignee should also be mandatory. If a carrier freely chooses to enter an agreement under which the shipper’s or consignee’s liability would be reduced, the agreement should be given effect. There are no policy considerations apparent that suggest that interference into the principle of freedom of contract would be justified in this context. Equally, there appears to be no convincing reason why a contractual increase of the carrier’s liability should not be permissible. In the light of these considerations, it appears appropriate to amend the provision in article 17.1 so as to prohibit only contractual derogation to exclude, reduce or limit the liability of the carrier (or any other person who performs or undertakes to perform any of the carrier’s obligations under the draft instrument).

137. **Article 17.2:** This provision allows contractual exclusion of liability by the carrier or the performing carrier where live animals are carried or where “special cargo”, not carried in the ordinary course of trade, is transported. Both types of cargo remain otherwise subject to the draft instrument. The Hague-Visby Rules do not apply to live animals and, with regard to the transportation of special cargo, allow contractual limitation of liability, if not contrary to public policy. In contrast, the Hamburg Rules apply to live animals, but contain a special provision excluding the carrier’s liability where loss, damage or delay is due to special risks inherent in that kind of carriage (art. 5.5). The Hamburg Rules do not contain special provisions relating to ‘special cargo not carried in the ordinary course of trade’. It is not clear why the draft instrument in article 17.2 (a) permits contractual exclusion of the carrier’s liability where live animals are carried. It would seem appropriate for a carrier who consents to the carriage of live animals and remains entitled to the benefit of the limitation and time bar provisions to also be subject to minimum liability levels. The same may be true as regards “special cargo not carried in the ordinary course of trade”.

⁸General average, a preliminary review (TD/B/C.4/ISL/58); The place of general average in marine insurance today (UNCTAD/SDD/LEG/1).

VII. CASE LAW ON UNCITRAL TEXTS (CLOUT)

The secretariat of the United Nations Commission on International Trade Law (UNCITRAL) continues to publish court decisions and arbitral awards that are relevant to the interpretation or application of a text resulting from the work of UNCITRAL. For a description of CLOUT (Case Law on UNCITRAL Texts), see the users guide (A/CN.9/SER.C/GUIDE/1), published in 1993 and available on the Internet at www.uncitral.org.

A/CN.9/SER.C/ABSTRACTS may be obtained from the UNCITRAL secretariat at the following address:

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Copies of complete texts of court decisions and arbitral awards, in the original language, reported on in the context of CLOUT are sent by the secretariat to interested persons, upon request, against a fee covering the cost of copying and mailing.

VIII. STATUS OF UNCITRAL TEXTS

Status of conventions and model laws

(A/CN.9/516) [Original: English]

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IX. TRAINING AND ASSISTANCE

Note by the Secretariat on training and technical assistance (A/CN.9/515) [Original: English]

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I. INTRODUCTION

1. Pursuant to a decision taken at the twentieth session of the United Nations Commission on International Trade Law (UNCITRAL),¹ in 1987, training and assistance activities count among the high priorities of UNCITRAL. The training and technical assistance programme carried out by the Secretariat under the mandate given by the Commission, in particular in developing countries and in countries with economies in transition, encompasses two main lines of activity: (a) information activities aimed at promoting understanding of international commercial law conventions, model laws and other legal texts; and (b) assistance to Member States with commercial law reform and adoption of UNCITRAL texts.

2. The present note lists the activities of the Secretariat subsequent to the issuance of the previous note submitted to the Commission at its thirty-fourth session, in 2001 (A/CN.9/494), and indicates possible future training and technical assistance activities in the light of the requests for such services from the Secretariat.

II. IMPORTANCE OF TEXTS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

3. Increasing importance is being attributed by Governments, international organizations, including multilateral and bilateral aid agencies, and the private sector to the improvement of the legal framework for international trade and investment. UNCITRAL has an important function to play in that process because it has produced and promotes the use of legal instruments in a number of key areas of commercial law that represent internationally agreed standards and solutions acceptable to different legal systems. Those instruments include:

(a) In the area of sales, the United Nations Convention on Contracts for the International Sale of Goods² and the Convention on the Limitation Period in the International Sale of Goods;³

(b) In the area of dispute resolution, the Convention on the Recognition and Enforcement of Foreign Arbitral

¹See *Official Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17)*, para. 335.

²United Nations, *Treaty Series*, vol. 1489, No. 25567.

³*Ibid.*, vol. 1511, No. 26119.

Awards⁴ (a United Nations convention adopted prior to the establishment of the Commission, but actively promoted by it), the UNCITRAL Arbitration Rules,⁵ the UNCITRAL Conciliation Rules,⁶ the UNCITRAL Model Law on International Commercial Arbitration⁷ and the UNCITRAL Notes on Organizing Arbitral Proceedings;⁸

(c) In the area of government contracting, the UNCITRAL Model Law on Procurement of Goods, Construction and Services⁹ and the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects;¹⁰

(d) In the area of banking, payments and insolvency, the United Nations Convention on the Assignment of Receivables in International Trade (General Assembly resolution 56/81, annex), the United Nations Convention on Independent Guarantees and Standby Letters of Credit (General Assembly resolution 50/48, annex), the UNCITRAL Model Law on International Credit Transfers,¹¹ the United Nations Convention on International Bills of Exchange and International Promissory Notes (General Assembly resolution 43/165, annex) and the UNCITRAL Model Law on Cross-Border Insolvency;¹²

(e) In the area of transport, the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules),¹³ and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade;¹⁴

(f) In the area of electronic commerce and data interchange, the UNCITRAL Model Law on Electronic Commerce¹⁵ (General Assembly resolution 51/162, annex) and the UNCITRAL Model Law on Electronic Signatures.¹⁶

III. TECHNICAL ASSISTANCE IN THE PREPARATION AND IMPLEMENTATION OF LEGISLATION

4. Technical assistance is provided to States preparing legislation based on UNCITRAL texts. Such assistance is provided in various forms, including review of preparatory drafts of legislation from the viewpoint of UNCITRAL texts, technical consultancy services and assistance in the preparation of legislation based on UNCITRAL texts,

preparation of regulations implementing such legislation and comments on reports of law reform commissions, as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL texts embodied in national legislation. Another form of technical assistance provided by the Secretariat consists of advising on the establishment of institutional arrangements for international commercial arbitration, including training seminars for arbitrators, judges and practitioners in the area. Training and technical assistance promote awareness and wider adoption of the legal texts produced by the Commission and are particularly useful for developing countries lacking expertise in the areas of trade and commercial law covered by the work of UNCITRAL. The training and technical assistance activities of the Secretariat could thus play an important role in the economic integration efforts being undertaken by many countries.

5. In its resolution 56/79 of 12 December 2001, the General Assembly reaffirmed the importance, in particular for developing countries, of the work of the Commission concerned with training and technical assistance in the field of international trade law, such as assistance in the preparation of national legislation based on legal texts of the Commission; expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide such training and technical assistance; and appealed to the United Nations Development Programme and other bodies responsible for development assistance, such as the International Bank for Reconstruction and Development and the European Bank for Reconstruction and Development, as well as to Governments in their bilateral aid programmes, to support the training and technical assistance programme of the Commission and to cooperate and coordinate their activities with those of the Commission. In the same resolution, the Assembly requested the Secretary-General to adjust the terms of reference of the UNCITRAL Trust Fund for Symposia so as to make it possible for the resources in the Trust Fund to be used also for the financing of training and technical assistance activities undertaken by the Secretariat.

6. The secretariat of the Commission has taken steps to increase cooperation and coordination with development assistance agencies, with a view to ensuring that the legal texts prepared by the Commission and recommended by the General Assembly for consideration are in fact so considered and used. From the standpoint of recipient States, UNCITRAL technical assistance is beneficial because of the Secretariat's accumulated experience in the preparation of UNCITRAL texts.

7. States that are in the process of revising their trade legislation may wish to request the UNCITRAL secretariat to provide technical assistance and advice.

IV. SEMINARS AND BRIEFING MISSIONS

8. The information activities of UNCITRAL are typically carried out through seminars and briefing missions for government officials from interested ministries (such as trade, foreign affairs, justice and transport), judges, arbitrators, practising lawyers, the commercial and trading community,

⁴Ibid., vol. 330, No. 4739.

⁵Official Records of the General Assembly, Thirty-first Session, Supplement No. 17 (A/31/17), chap. V, sect. C.

⁶Ibid., Thirty-fifth Session, Supplement No. 17 (A/35/17), para. 106.

⁷Ibid., Fortieth Session, Supplement No. 17 (A/40/17), annex I.

⁸Ibid., Fifty-first Session, Supplement No. 17 (A/51/17), chap. II.

⁹Ibid., Forty-ninth Session, Supplement No. 17 and corrigendum (A/49/17 and Corr.1), annex I.

¹⁰United Nations publication, Sales No. E.01.V.4.

¹¹Official Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17), annex I.

¹²Ibid., Fifty-second Session, Supplement No. 17 (A/52/17), annex I.

¹³United Nations, Treaty Series, vol. 1695, No. 29215.

¹⁴Official Records of the United Nations Conference on the Liability of Operators of Transport Terminals in International Trade, Vienna, 2-19 April 1991 (United Nations publication, Sales No. E.93.XI.3), part I, document A/CONF.152/13, annex.

¹⁵Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), annex I.

¹⁶United Nations publication, Sales No. E.02.V.8.

scholars and other interested individuals. Seminars and briefing missions are designed to explain the salient features and utility of international trade law instruments of UNCITRAL. Information is also provided on certain important legal texts of other organizations, for example, Uniform Customs and Practice for Documentary Credits and International Commercial Terms (INCOTERMS) of the International Chamber of Commerce.

9. In its resolution 56/79, the General Assembly expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide training and technical assistance.

10. Lectures at UNCITRAL seminars are generally conducted by one or two members of the UNCITRAL secretariat, experts from the host countries and, occasionally, external consultants. After the seminars, the UNCITRAL secretariat maintains contact with seminar participants in order to provide the host countries with the maximum possible support during the process leading up to the adoption and use of UNCITRAL texts.

11. Since the previous session, the secretariat of the Commission has organized seminars in a number of States, which have typically included briefing missions. The following seminars were financed with resources from the UNCITRAL Trust Fund for Symposia:

(a) Vilnius (11-13 June 2001), seminar held in cooperation with the Vilnius International Commercial Arbitration Centre (approximately 40 participants);

(b) Ouagadougou (18-22 June 2001), seminar held in cooperation with the Ministry of Justice and Promotion of Humanitarian Affairs (approximately 40 participants);

(c) Santo Domingo (20-21 June 2001), seminar held in cooperation with the Ministry of Foreign Affairs (approximately 100 participants);

(d) Nairobi (10-13 September 2001), seminar held in cooperation with the Ministry of Foreign Affairs (approximately 40 participants);

(e) Minsk (26-28 September 2001), seminar held in cooperation with the International Arbitration Court of the Chamber of Commerce (approximately 50 participants);

(f) Kiev (2-4 October 2001), symposium held in cooperation with the International Arbitration Court of the Chamber of Commerce (approximately 60 participants);

(g) Dubrovnik, Croatia (1-5 October 2001), symposium held in cooperation with the Inter-University Centre in Dubrovnik (approximately 50 participants);

(h) Lima (15-16 October 2001), symposium held in cooperation with the Ministry of Foreign Affairs (approximately 200 participants);

(i) Arequipa, Peru (18-19 October 2001), symposium held in cooperation with the Ministry of Foreign Affairs (approximately 200 participants);

(j) Bogota (25-26 October 2001), symposium held in cooperation with the Ministry of Foreign Affairs (approximately 160 participants);

(k) Hanoi (6-12 December 2001), symposium held in cooperation with the Ministries of Trade and Justice (approximately 35 participants);

(l) Phnom Penh (3-5 April 2002), symposium held in cooperation with the Ministry of Commerce (approximately 40 participants);

(m) Jakarta (8-10 April 2002), symposium held in cooperation with the Central Bank of Indonesia (approximately 70 participants).

V. PARTICIPATION IN OTHER ACTIVITIES

12. Members of the UNCITRAL secretariat have participated as speakers in various seminars, conferences and courses where UNCITRAL texts were presented for examination and possible adoption or use. The participation of members of the secretariat in the seminars, conferences and courses listed below was financed by the institution organizing the events or by another organization:

(a) University of Paris X-Nanterre, course on the international sale of goods (Paris, 30 April-7 May 2001);

(b) Pallas Consortium, Centre for Postgraduate Legal Education, International Conference on Cross-Border Insolvency (Nijmegen, The Netherlands, 4 May 2001);

(c) University of Lecce, course on the international sale of goods (Lecce, Italy, 14-16 May 2001);

(d) University of Bologna and Loyola and Brooklyn Law Schools, course on the international sale of goods (Bologna, Italy, 28 May-2 June 2001);

(e) University of Verona, Conference on Alternative Dispute Resolution Methods, International Contracts and Related Questions (Verona, Italy, 15-16 June 2001);

(f) Sixth Follow-up Build-Operate-Transfer (BOT) Conference, sponsored by the Cairo Regional Centre for International Commercial Arbitration (Sharm El Sheikh, Egypt, 29-30 September 2001);

(g) University of Verona, seminar on international trade law (Verona, Italy, 8-12 October 2001);

(h) Joint Conference of the Permanent Court of Arbitration and the Arab Union of International Arbitration (The Hague, 12 October 2001);

(i) National Conference of Bankruptcy Judges and the American Bar Association, annual conference (Orlando, United States of America, 17-19 October 2001);

(j) Commercial Finance Association, fifty-seventh annual Convention of the Asset-Based Financial Services Industry (San Francisco, United States of America, 24-26 October 2001);

(k) International Bar Association, Cancun 2001 Conference (Cancun, Mexico, 28 October-1 November 2001);

(l) Universities of Verona and Catania, master's degree in advanced international legal studies course (Verona, Italy, 5-7 November 2001);

(m) American Bar Association, Corporate Counsel Committee of the board of directors' meeting (New York, 9 November 2001);

(n) Conference on Legal Framework for Electronic Business, sponsored by the University of Montreal and the Government of Quebec (Montreal, 12 November 2001);

(o) Colloquium on on-line dispute resolution, sponsored by the University of Geneva (Geneva, 16 November 2001);

(p) University of Paris X-Nanterre, course on the international sale of goods (Paris, 7-14 December 2001);

(q) International Conference on the Legal Aspects of Electronic Commerce and the Recent Trends in Settling Commercial Disputes, sponsored by the Cairo Regional Centre for International Commercial Arbitration (Cairo, 12-13 January 2002);

(r) Second Arab Judicial Colloquium, sponsored by the Cairo Regional Centre for International Commercial Arbitration (Cairo, 14 January 2002);

(s) World Intellectual Property Organization, International Conference on Intellectual Property and Electronic Business (Tehran, 15-16 January 2002);

(t) University of Palermo, master's degree programme on international contracts (Palermo, Italy, 17-18 January 2002);

(u) University of Padua, master's degree programme on international contracts (Padua, Italy, 25 January 2002);

(v) University of Padua, master's degree programme on international contracts (Padua, Italy, 1-2 February 2002);

(w) E-Business Conference, sponsored by the Electronic Business Development Activity of the Amman Chamber of Industry (Amman, 19-20 February 2002);

(x) University of Bologna, master's degree programme on comparative law (Bologna, Italy, 25-27 February 2002);

(y) International trade law postgraduate course, sponsored by the International Training Centre of the International Labour Organization (ILO) and the University Institute of European Studies (Turin, Italy, 12 April 2002);

(z) Seminar on new ICC rules on electronic presentation of documents, sponsored by the International Chamber of Commerce (Vienna, 22 April 2002).

13. The participation of members of the UNCITRAL secretariat in the seminars, conferences and courses listed below was financed with resources from the United Nations regular travel budget:

(a) European Bank for Reconstruction and Development Business Forum, legal round-table seminar on building the legal environment for public-private partnerships (London, 22 April 2001);

(b) The Economic Commission for Europe (ECE) Forum on Trading into the Future, e-services for trade, investment and enterprise (Geneva, 11-12 June 2001);

(c) Sixth Biennial Dispute Resolution Conference, sponsored by the International Federation of Commercial Arbitration Institutions (Prague, 22 June 2001);

(d) UNCITRAL/INSOL international judicial colloquium (London, 16-17 July 2001);

(e) Sixth International Federation of Insolvency Professionals (INSOL International) World Congress (London, 16-20 July 2001);

(f) UNCTAD expert meeting on electronic commerce and international transport services (Geneva, 26-28 September 2001);

(g) Ninth International Zagreb Arbitration Conference, sponsored by the Permanent Arbitration Court, Croatian Chamber of Commerce (Zagreb, 6-7 December 2001);

(h) United Nations/ECE workshop on e-regulatory framework development (Geneva, 13 February 2002);

(i) United Nations/ECE working party on industry and enterprise development (Geneva, 14-15 February 2002);

(j) Research development symposium: international commercial arbitration, sponsored by the Global Center for Dispute Resolution Research (Barcelona, Spain, 21-24 February 2002);

(k) Conference on Shaping Market Economy Legislation in the Context of the European Union Stabilization and Association Process, sponsored by the United Nations Mission in Kosovo (European Union Pillar) (Pristina, 27-28 February 2002);

(l) 2002 annual survey of letter of credit law and practice, sponsored by the Institute of International Banking Law and Practice (Amsterdam, 25-26 March 2002).

VI. INTERNSHIP PROGRAMME

14. The internship programme is designed to give young lawyers the opportunity to become familiar with the work of UNCITRAL and to increase their knowledge of specific areas in the field of international trade law. During the past year, the Secretariat has hosted 15 interns, from Belgium, Brazil, China, Egypt, Germany, Hong Kong Special Administrative Region of China, Italy, Nigeria, Peru and the United States of America. Interns are assigned tasks such as basic or advanced research, collection and systematization of information and materials or assistance in preparing background papers. The experience of UNCITRAL with the internship programme has been positive. However, as no funds are available to the Secretariat to assist interns to cover their travel or other expenses, interns have to be sponsored by an organization, university or government agency, or to meet their expenses from their own means. As a result, there is limited participation of interns from developing countries. In that connection, the Commission may wish to invite Member States, universities and other organizations, in addition to those which already do so, to consider sponsoring the participation of young lawyers, in particular from developing countries, in the United Nations internship programme with UNCITRAL.

15. The Secretariat also occasionally accommodates requests by scholars and legal practitioners who wish to conduct research in the UNCITRAL law library for a limited period of time.

VII. FUTURE ACTIVITIES

16. For the remainder of 2002, seminars and legal assistance briefing missions are being planned in Africa, Asia

and countries with economies in transition in Eastern Europe and Latin America. Since the cost of training and technical assistance activities is not covered by the regular budget, the ability of the Secretariat to implement those plans is contingent upon the receipt of sufficient funds in the form of contributions to the UNCITRAL Trust Fund for Symposia.

17. As it has done in recent years, the Secretariat has agreed to co-sponsor the next three-month international trade law postgraduate course to be organized by the University Institute of European Studies and the International Training Centre of ILO in Turin. Typically, approximately half the participants are from Italy, with many of the remainder coming from developing countries. The contribution from the UNCITRAL secretariat to the next course will focus on issues of harmonization of laws on international trade law from the perspective of UNCITRAL, including past and current work.

18. Also, as it has done for the past seven years, the Secretariat co-sponsored the ninth Willem C. Vis International Commercial Arbitration Moot in Vienna from 22 to 28 March 2002. The Moot is principally organized by the Institute of International Commercial Law at Pace University School of Law. With its broad international participation, involving 108 teams from 36 countries in 2002, it is seen as an excellent way to disseminate information about uniform law texts and teaching international trade law. This year, the Secretariat offered a series of lectures on international sales and international trade financing issues to about 140 participants of the Moot.

VIII. FINANCIAL RESOURCES

19. The Secretariat continues its efforts to devise a more extensive training and technical assistance programme to meet the considerably greater demand from States for training and assistance, in keeping with the call of the Commission at its twentieth session for an increased emphasis both on training and assistance and on the promotion of the legal texts prepared by the Commission. However, as no funds for UNCITRAL seminars are provided for in the regular budget, expenses for UNCITRAL training and technical assistance activities (except for those which are supported by funding agencies such as the World Bank) have to be met from voluntary contributions to the UNCITRAL Trust Fund for Symposia.

20. Given the importance of extrabudgetary funding for the implementation of the training and technical assistance component of the UNCITRAL work programme, the Commission may again wish to appeal to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL Trust Fund for

Symposia, in particular in the form of multi-year contributions, so as to facilitate planning and to enable the Secretariat to meet the increasing demands from developing countries and States with economies in transition for training and assistance. Information on how to make contributions may be obtained from the UNCITRAL secretariat.

21. In the period under review, contributions were received from Cyprus, France, Greece and Switzerland. The Commission may wish to express its appreciation to those States and organizations which have contributed to the Commission's programme of training and assistance by providing funds or staff or by hosting seminars.

22. In that connection, the Commission may wish to recall that, in accordance with General Assembly resolution 48/32 of 9 December 1993, the Secretary-General was requested to establish a trust fund to grant travel assistance to developing countries that are members of UNCITRAL. The trust fund so established is open to voluntary financial contributions from States, intergovernmental organizations, regional economic integration organizations, national institutions and non-governmental organizations, as well as to natural and juridical persons.

23. At its thirty-fourth session, the Commission noted with appreciation that the General Assembly, in its resolution 56/79 of 12 December 2001, had appealed to Governments, the relevant United Nations organs, organizations, institutions and individuals, in order to ensure full participation by all Member States in the sessions of the Commission and its Working Groups, to make voluntary contributions to the trust fund for granting travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General.

24. Since the establishment of the trust fund, contributions have been received from Austria, Cambodia, Cyprus, Kenya, Mexico and Singapore.

25. It is recalled that in its resolution 51/161 of 16 December 1996, the General Assembly decided to include the trust funds for UNCITRAL symposia and travel assistance in the list of funds and programmes that are dealt with at the United Nations Pledging Conference for Development Activities.

26. In order to ensure full participation of all Member States in the sessions of UNCITRAL and its Working Groups, the Commission may wish to reiterate its appeal to the relevant bodies in the United Nations system, organizations, institutions and individuals to make voluntary contributions to the trust fund established to provide travel assistance to developing countries that are members of the Commission.

Part Three

ANNEXES

I. UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

Article 1. Scope of application and definitions

1. This Law applies to international^a commercial^b conciliation.
2. For the purposes of this Law, “conciliator” means a sole conciliator or two or more conciliators, as the case may be.
 3. For the purposes of this Law, “conciliation” means a process, whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person or persons (“the conciliator”) to assist them in their attempt to reach an amicable settlement of their dispute arising out of or relating to a contractual or other legal relationship. The conciliator does not have the authority to impose upon the parties a solution to the dispute.
4. A conciliation is international if:
 - (a) The parties to an agreement to conciliate have, at the time of the conclusion of that agreement, their places of business in different States; or
 - (b) The State in which the parties have their places of business is different from either:
 - (i) The State in which a substantial part of the obligations of the commercial relationship is to be performed; or
 - (ii) The State with which the subject matter of the dispute is most closely connected.
5. For the purposes of this article:
 - (a) If a party has more than one place of business, the place of business is that which has the closest relationship to the agreement to conciliate;
 - (b) If a party does not have a place of business, reference is to be made to the party’s habitual residence.
6. This Law also applies to a commercial conciliation when the parties agree that the conciliation is international or agree to the applicability of this Law.
7. The parties are free to agree to exclude the applicability of this Law.

^aStates wishing to enact this Model Law to apply to domestic as well as international conciliation may wish to consider the following changes to the text:

(a) Delete the word “international” in paragraph 1 of article 1; and
(b) Delete paragraphs 4, 5 and 6 of article 1.

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

8. Subject to the provisions of paragraph 9 of this article, this Law applies irrespective of the basis upon which the conciliation is carried out, including agreement between the parties whether reached before or after a dispute has arisen, an obligation established by law, or a direction or suggestion of a court, arbitral tribunal or competent governmental entity.

9. This Law does not apply to:

- (a) Cases where a judge or an arbitrator, in the course of judicial or arbitral proceedings, attempts to facilitate a settlement; and
- (b) [. . .].

Article 2. Interpretation

1. In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.

2. Questions concerning matters governed by this Law which are not expressly settled in it are to be settled in conformity with the general principles on which this Law is based.

Article 3. Variation by agreement

Except for the provisions of article 2 and article 6, paragraph 3, the parties may agree to exclude or vary any of the provisions of this Law.

Article 4. Commencement of conciliation proceedings^c

1. Conciliation proceedings in respect of a dispute that has arisen commence on the day on which the parties to that dispute agree to engage in conciliation proceedings.

2. If a party that invited another party to conciliate does not receive an acceptance of the invitation within thirty days from the day on which the invitation was sent, or within such other period of time as specified in the invitation, the party may elect to treat this as a rejection of the invitation to conciliate.

Article 5. Number and appointment of conciliators

1. There shall be one conciliator, unless the parties agree that there shall be two or more conciliators.

^cThe following text is suggested for States that might wish to adopt a provision on the suspension of the limitation period:

“Article [. . .]. *Suspension of limitation period*

“1. When the conciliation proceedings commence, the running of the limitation period regarding the claim that is the subject matter of the conciliation is suspended.

“2. Where the conciliation proceedings have terminated without a settlement agreement, the limitation period resumes running from the time the conciliation ended without a settlement agreement.”

2. The parties shall endeavour to reach agreement on a conciliator or conciliators, unless a different procedure for their appointment has been agreed upon.

3. Parties may seek the assistance of an institution or person in connection with the appointment of conciliators. In particular:

(a) A party may request such an institution or person to recommend suitable persons to act as conciliator; or

(b) The parties may agree that the appointment of one or more conciliators be made directly by such an institution or person.

4. In recommending or appointing individuals to act as conciliator, the institution or person shall have regard to such considerations as are likely to secure the appointment of an independent and impartial conciliator and, where appropriate, shall take into account the advisability of appointing a conciliator of a nationality other than the nationalities of the parties.

5. When a person is approached in connection with his or her possible appointment as conciliator, he or she shall disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence. A conciliator, from the time of his or her appointment and throughout the conciliation proceedings, shall without delay disclose any such circumstances to the parties unless they have already been informed of them by him or her.

Article 6. Conduct of conciliation

1. The parties are free to agree, by reference to a set of rules or otherwise, on the manner in which the conciliation is to be conducted.

2. Failing agreement on the manner in which the conciliation is to be conducted, the conciliator may conduct the conciliation proceedings in such a manner as the conciliator considers appropriate, taking into account the circumstances of the case, any wishes that the parties may express and the need for a speedy settlement of the dispute.

3. In any case, in conducting the proceedings, the conciliator shall seek to maintain fair treatment of the parties and, in so doing, shall take into account the circumstances of the case.

4. The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute.

Article 7. Communication between conciliator and parties

The conciliator may meet or communicate with the parties together or with each of them separately.

Article 8. Disclosure of information

When the conciliator receives information concerning the dispute from a party, the conciliator may disclose the substance of that information to any other party to the conciliation. However, when a party gives any information to the conciliator, subject to a specific condition that it be kept confidential, that information shall not be disclosed to any other party to the conciliation.

Article 9. Confidentiality

Unless otherwise agreed by the parties, all information relating to the conciliation proceedings shall be kept confidential, except

where disclosure is required under the law or for the purposes of implementation or enforcement of a settlement agreement.

Article 10. Admissibility of evidence in other proceedings

1. A party to the conciliation proceedings, the conciliator and any third person, including those involved in the administration of the conciliation proceedings, shall not in arbitral, judicial or similar proceedings rely on, introduce as evidence or give testimony or evidence regarding any of the following:

(a) An invitation by a party to engage in conciliation proceedings or the fact that a party was willing to participate in conciliation proceedings;

(b) Views expressed or suggestions made by a party in the conciliation in respect of a possible settlement of the dispute;

(c) Statements or admissions made by a party in the course of the conciliation proceedings;

(d) Proposals made by the conciliator;

(e) The fact that a party had indicated its willingness to accept a proposal for settlement made by the conciliator;

(f) A document prepared solely for purposes of the conciliation proceedings.

2. Paragraph 1 of this article applies irrespective of the form of the information or evidence referred to therein.

3. The disclosure of the information referred to in paragraph 1 of this article shall not be ordered by an arbitral tribunal, court or other competent governmental authority and, if such information is offered as evidence in contravention of paragraph 1 of this article, that evidence shall be treated as inadmissible. Nevertheless, such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement.

4. The provisions of paragraphs 1, 2 and 3 of this article apply whether or not the arbitral, judicial or similar proceedings relate to the dispute that is or was the subject matter of the conciliation proceedings.

5. Subject to the limitations of paragraph 1 of this article, evidence that is otherwise admissible in arbitral or judicial or similar proceedings does not become inadmissible as a consequence of having been used in a conciliation.

Article 11. Termination of conciliation proceedings

The conciliation proceedings are terminated:

(a) By the conclusion of a settlement agreement by the parties, on the date of the agreement;

(b) By a declaration of the conciliator, after consultation with the parties, to the effect that further efforts at conciliation are no longer justified, on the date of the declaration;

(c) By a declaration of the parties addressed to the conciliator to the effect that the conciliation proceedings are terminated, on the date of the declaration; or

(d) By a declaration of a party to the other party or parties and the conciliator, if appointed, to the effect that the conciliation proceedings are terminated, on the date of the declaration.

Article 12. Conciliator acting as arbitrator

Unless otherwise agreed by the parties, the conciliator shall not act as an arbitrator in respect of a dispute that was or is the

subject of the conciliation proceedings or in respect of another dispute that has arisen from the same contract or legal relationship or any related contract or legal relationship.

Article 13. Resort to arbitral or judicial proceedings

Where the parties have agreed to conciliate and have expressly undertaken not to initiate during a specified period of time or until a specified event has occurred arbitral or judicial proceedings with respect to an existing or future dispute, such an undertaking shall be given effect by the arbitral tribunal or the court until the terms of the undertaking have been complied with, except to the

extent necessary for a party, in its opinion, to preserve its rights. Initiation of such proceedings is not of itself to be regarded as a waiver of the agreement to conciliate or as a termination of the conciliation proceedings.

Article 14. Enforceability of settlement agreement^d

If the parties conclude an agreement settling a dispute, that settlement agreement is binding and enforceable . . . *[the enacting State may insert a description of the method of enforcing settlement agreements or refer to provisions governing such enforcement]*.

^dWhen implementing the procedure for enforcement of settlement agreements, an enacting State may consider the possibility of such a procedure being mandatory.

II. GUIDE TO ENACTMENT AND USE OF THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

[Issued as a United Nations publication, Sales No. E.05.V.4]

III. SUMMARY RECORDS OF THE MEETINGS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW DEVOTED TO THE PREPARATION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

Summary record of the 739th meeting, held at United Nations Headquarters
on Monday, 17 June 2002, at 10 a.m.

[A/CN.9/SR.739]

Temporary Chairman: Mr. Hans CORELL (Under-Secretary-General for Legal Affairs, the Legal Counsel)

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

The meeting was called to order at 10.30 a.m.

OPENING OF THE SESSION

1. THE TEMPORARY CHAIRMAN invited the members of the United Nations Commission on International Trade Law (UNCITRAL) to look at their work during the thirty-fifth session from the broader perspective of the social development goals of the United Nations, including those set forth in the United Nations Millennium Declaration (General Assembly resolution 55/2). Economic growth, political modernization, the protection of human rights and other larger objectives of the United Nations all hinged, at least in part, on the rule of law, and hence policy makers in developing and transition countries were seeking ways to establish or strengthen the rule of law in their countries. Measures to fight corruption, adopt market-oriented policies and spend more on the needs of the poor were all the more important as globalization advanced and the United Nations searched for solutions to advance sustainable economic growth.

2. The Commission had made a significant contribution to facilitating a number of economic activities that formed the basis of an orderly functioning open economy, thus helping developing countries to participate fully in the benefits of the global marketplace. The economic development that resulted from countries' modernizing and harmonizing their trade laws paid direct dividends to all segments of a developing country's population.

3. The use of electronic commerce, for instance, had become indispensable to developing countries to reduce transaction costs and facilitate penetration in new markets. Electronic commerce could not prosper, however, without the adaptation of national and international laws that had been largely written against the background of paper-based commercial communications. Such adaptation of laws should be based on harmonized and balanced standards such as the UNCITRAL Model Law on Electronic Commerce.

4. Another crucial need was to enhance the conditions under which business entities in developing countries could gain access to credit. Financing to creditworthy enterprises was often not available at commercially affordable terms because many national

laws had not been updated. The solution was to prepare internationally harmonized models for such laws that took into account the legitimate interests of creditors and debtors, variations in economic circumstances and different legal traditions, a task being carried out by UNCITRAL through its Working Group VI (Security Interests).

5. The importance of public-private partnerships for achieving sustainable development in the provision of basic public infrastructure had been stressed in the Programme for the Further Implementation of Agenda 21 (Assembly resolution S-19/2, annex), adopted by the General Assembly in 1997. An essential component of an enabling national environment for such partnerships was a legislative framework that promoted private participation in infrastructure, while taking into account the public interest concerns of the host country. Those were two of the main objectives of the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects.

6. One of the most significant barriers to transparent and accountable governance, another pillar of people-centred sustainable development, was the failure to stem corruption. Recent experience in law reform showed that national action plans to combat corruption included revisions of outdated domestic procurement laws and regulations to ensure that they met international standards of good practice in procurement. Perhaps the most widely recognized set of such standards was the UNCITRAL Model Law on Procurement of Goods, Construction and Services. Savings achieved through a modern and transparent procurement system made it possible for Governments in developing countries to re-allocate resources to attend pressing social needs.

7. Progressive harmonization and unification of law was an incomplete process, however, without the implementation of international conventions and model laws by States and the fostering of public awareness of those texts. International governmental and non-governmental organizations had joined in the Commission's efforts to carry out such promotional activities. Nonetheless, the success of harmonization efforts depended on ensuring a high level of coordination between all the agencies involved, a

function which reflected a fundamental element of the UNCITRAL mandate that could not be delegated to other organizations.

8. The performance of the legal affairs programme of the United Nations had recently been re-evaluated by the Office of Internal Oversight Services, and the Secretary-General had transmitted a report thereon to the Committee for Programme and Coordination for consideration at its forty-second session (E/AC.51/2002/5). Although the overall assessment of the activities had been highly positive, the Office of Internal Oversight Services had identified in its survey three areas for improvement. First, there was a need to enhance the substance and depth of coordination among agencies associated with trade law, both within and outside the United Nations system. Aware of that need, the secretariat had begun to use new approaches to draw upon the work done in other forums, including requesting comments from relevant agencies on draft texts. Secondly, the Office of Internal Oversight Services had recommended that the secretariat should increase the range and breadth of its technical assistance in the field of trade law reform. Accordingly, the secretariat was considering a strategy to work jointly with funding agencies supporting trade-related programmes and to increase contributions to its trust funds, including funding from the private sector.

9. Thirdly, doubts had been expressed as to whether the International Trade Law Branch would be able to maintain the quality and efficiency of its work, in view of the fact that staff resources had remained at their 1968 levels. In its conclusions and recommendations, the Office of Internal Oversight Services had said that the implementation of a number of recommendations relating to the Office of Legal Affairs might require additional resources, for which the Office of Legal Affairs should prepare a detailed justification for review through the appropriate programme and budget review processes. The Temporary Chairman suggested that the Commission should hold informal consultations on that topic during the second week of the current session, and that the consultations should also address recommendation 15 of the report of the Office of Internal Oversight Services, referring to the secretariat requirements in the light of the increase in the number of UNCITRAL working groups from three to six.

10. The Temporary Chairman stated that he and his colleagues in the Office of Legal Affairs had come to the conclusion that the only workable options were either to reduce drastically the Commission's current work programme or to increase the resources of its secretariat significantly. In that connection, he noted that the Committee for Programme and Coordination was currently meeting to make recommendations on, among other things, the amount of resources to be allocated to strengthening the UNCITRAL secretariat. Those recommendations were crucial for the deliberations of the Fifth Committee of the General Assembly, which would be making the final recommendations to the Assembly.

11. The strengthening of the secretariat was necessary for several reasons: (a) there was a clear demand from Member States for the Commission to prepare legal standards for a globalized economy in areas where until recently the United Nations had not been active; (b) there was an increased need for coordination among a growing number of international organizations that formulated rules and standards for international trade; and (c) the increased need for technical assistance would require particular attention on the part of the Commission as the formulating agency when Governments considered implementation of international standards in domestic legislation.

12. With regard to the Commission's agenda at the current session, he noted that procedures for amicable, non-adversarial settlement of commercial disputes were being increasingly recognized as an indispensable element for promoting international trade. The Commission had already made a significant contribution to

the development of such procedures with the adoption of the UNCITRAL Conciliation Rules in 1980. The adoption of the draft UNCITRAL Model Law on International Commercial Conciliation would represent yet another valuable contribution by UNCITRAL to the development of efficient dispute settlement mechanisms in international commercial transactions.

ELECTION OF OFFICERS

13. Ms. TOE (Burkina Faso), speaking on behalf of the Group of African States, nominated Mr. Akam Akam (Cameroon) for the office of Chairman.

14. *Mr. AKAM AKAM (Cameroon) was elected Chairman by acclamation.*

ADOPTION OF THE AGENDA

15. *The agenda (A/CN.9/503) was adopted.*

16. *In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico), Chairman of the Committee of the Whole, took the chair.*

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION

17. Mr. SEKOLEC (Secretary of the Commission) said that the work of the Commission on the draft UNCITRAL Model Law on International Commercial Conciliation had attracted attention in many quarters of the world. For example, a recent conference on ecology in London had devoted a session to the draft and had expressed considerable support for it. In Latin America also there had been a great deal of activity in recent years with regard to mediation and conciliation. The draft Model Law had been taken as a model for national laws in a number of countries, such as Paraguay. Other related activities had been taking place in the Balkans; pilot projects had been established for mediation centres; judges were sending parties to conciliation; and training was being offered for mediators and conciliators. Those efforts were being supported by the Southeast European Cooperative Initiative and the Economic Commission for Europe.

18. The European Union, in an effort to put the topic of mediation high on the agenda, had published a green paper in which it recognized the work of the Commission. The Baltic and International Maritime Council had also included mediation in its dispute settlement method and had taken the approach of the Commission as formulated by the UNCITRAL Conciliation Rules.

19. The text about to be finalized would therefore have a significant impact and would be received with a great deal of interest in different parts of the world. The fact that the draft Model Law had been completed in only four sessions was a tribute to the efficiency and expertise of the Working Group.

20. Mr. SORIEUL (International Trade Law Branch) drew the Commission's attention to the text of the draft Model Law contained in the annex of the report of the Working Group on Arbitration on the work of its thirty-fifth session (A/CN.9/506); the draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/514); and a compilation of comments by Governments and international organizations on the draft Model Law on International Commercial Conciliation (A/CN.9/513 and Add.1 and 2).

21. Informal consultations had been held on article 15 with a view to achieving a more complete text. The secretariat would provide a summary in due course.

22. The CHAIRMAN invited delegations to make general comments on the text of the draft Model Law.

23. Mr. RENDÓN (Mexico) said that the text had been approved by consensus within the Working Group. Once adopted, the instrument would prove very useful to domestic as well as international conciliation. Not only would it avoid over-regulation, but it would also accord high priority to volition.

24. Mr. SEKOLEC (Secretary of the Commission), responding to a procedural question put by Mr. Shimizu (Japan), said that the Commission would be advised to consider the text of the draft Guide to Enactment and Use of the Model Law (A/CN.9/514) after the draft Model Law had been finalized.

25. Mr. TANG HOZHUI (China) expressed strong support for the draft Model Law. Once adopted, it would constitute one of the two pillars of international commercial conciliation, alongside the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“the New York Convention”). Although much of the draft was acceptable to his delegation, for the instrument to be fully effective its enforceability should be strengthened. In addition, mediation and arbitration—two important elements in international commercial conciliation—should be more closely linked.

26. Mr. MEDREK (Morocco) reiterated his country’s position that the draft constituted a legal platform for helping countries to introduce amendments as they adapted to current developments. In that regard, the provisions in the draft gave States wishing to incorporate the law into their domestic law the possibility of adapting and amending it in accordance with their own particular situation. As such, the draft law provided an appropriate legal mechanism for resolving disputes.

27. Ms. GETH-FLEMMICH (Austria) expressed strong support for the draft. Her Government was currently considering introducing new legislation on arbitration and was thus following the work of the Commission with particular interest. The UNCITRAL Model Law on International Commercial Arbitration (1985) had inspired legislation in many countries; her delegation was convinced that the Model Law on International Commercial Conciliation would enjoy similar success. It would also set the necessary standards in an important and rapidly evolving area.

28. The CHAIRMAN, noting that there were no objections to the proposed title, invited the Commission to proceed to a paragraph-by-paragraph analysis of the draft. He would suggest that it postpone consideration of footnote 1 pending issuance of the relevant document (A/CN.9/XXXV/CRP.3).

Draft article 1. Scope of application and definitions

29. Mr. MEDREK (Morocco) reiterated his delegation’s position that the title of article 1 should be amended to read: “Definitions and scope of application”.

30. Mr. SHIMIZU (Japan) said that it could appear from the current article 1, paragraph 1, that enacting States would be required to apply the Model Law directly to international commercial conciliation regardless of applicable law under private international arbitration rules. Since the instrument would constitute a model law rather than a convention, different versions would be incorporated into national legislation, creating a conflict of law situation. It was his own delegation’s understanding that article 1 was not, however, intended to replace or exclude the application of existing rules of international law. If the Commission shared that interpretation, it should be reflected in the draft Guide.

31. Mr. SEKOLEC (Secretary of the Commission) said that in accordance with past practice, any ruling from the Commission on Morocco’s proposal concerning the title of article 1 would be implemented by a drafting group comprising delegates working in each of the six languages and assisted by professional language revisers. Subsequently, a revised text would be submitted to the Commission for consideration.

32. The CHAIRMAN said that unless the Commission adopted a definitive wording in a particular instance, the formulation of the titles of articles was generally considered a drafting exercise to be undertaken by the drafting group. The secretariat had taken note of the comment made by the representative of Japan, which essentially related to the draft Guide.

33. Mr. KOVAR (United States of America), addressing the concern raised by the representative of Japan, said that it was not clear to his delegation in what circumstances a conflict-of-law situation might arise. Presumably, it would be a question of whether some forum law applied. If the issue was to be treated in more detail in the draft Guide, the Commission’s choice-of-law experts should be allowed sufficient time for careful consideration.

34. Mr. SHIMIZU (Japan) said that different versions of the Model Law would exist at the national level, but that the connecting factor would be that its application would be triggered if the parties to an agreement to conciliate had their places of business in different States. Confusion might thus arise as to which version of the Model Law applied in a particular case, even if the law of the forum governed the Law’s effect.

35. The CHAIRMAN said that the previous speaker’s point underlined the importance of incorporating the Model Law without changes.

36. Mr. MEENA (India) said that India’s arbitration and conciliation act was based on the UNCITRAL Model Law on International Commercial Arbitration, with a separate section on conciliation. The act did not in any way differentiate between domestic and international conciliation. The Working Group, for its part, had advised States to maintain two sets of rules governing the settlement of disputes, in order to avoid unnecessary interference with domestic laws. His delegation, however, wished to question the practicability of such an approach.

37. The CHAIRMAN said that although the Working Group had discussed the issue extensively, no agreement had been reached. A number of participants had considered that the Model Law should cover only international conciliation, while others had maintained that it should be made equally applicable to domestic and to international conciliation. In order to avoid a situation of two separate bodies of law, a compromise solution had been set out in footnote 1, offering States the option of changing certain provisions if they wished the Law to apply to both types of conciliation. In an analogous situation, Mexico, upon enacting the UNCITRAL Model Law on International Commercial Arbitration, had modified certain provisions to make the Law apply to national as well as international arbitration.

38. He took it that the Commission wished to approve draft paragraph 1 provisionally and to postpone adoption of footnote 1 pending issuance of the relevant document.

39. *It was so decided.*

40. Mr. KOVAR (United States of America), referring to draft paragraph 2, said that the draft Guide might include a provision to the effect that courts, in interpreting the paragraph, might wish to consider the conduct of parties demonstrating their understanding or expectation of being engaged in conciliation.

41. *Draft paragraph 2 was provisionally approved.*

42. Mr. MARKUS (Observer for Switzerland) said that, in his view, subparagraph (ii) of draft article 1, paragraph 3 (*b*), gave a general example of international conciliation of which subparagraph (i) was merely a specific example. It would therefore be logical to reverse the order of subparagraphs (i) and (ii) of that paragraph, so that the general principle was followed by a specific expression of that principle.

43. The CHAIRMAN suggested that the question could be referred to the drafting committee.

44. Mr. JACQUET (France) said that his delegation was reluctant to support the suggestion made by the observer for Switzerland, as it considered that subparagraphs (i) and (ii) of paragraph 3 (*b*) referred to different issues. He urged the Commission to remember that the primary goal of paragraph 3 (*b*) was not to resolve a conflict of laws, but simply to set out what made conciliation international in character. Subparagraph (i) was the simplest and most objective way of summarizing that international character. Subparagraph (ii) was more complicated, and perhaps also debatable, in that it used wording more commonly associated with resolving a conflict of laws. The delegation therefore favoured retaining the original order of subparagraphs (i) and (ii).

45. Mr. MORÁN BOVIO (Spain) said that his delegation had initially been sympathetic to the view of the observer for Switzerland, but had then found the reasoning put forward by the delegation of France to be convincing. He considered that the two subparagraphs in question adequately covered the issue of international character, and fully supported the Chairman's suggestion that the matter should be referred to the drafting committee to settle the sequence in which they occurred, particularly since the delegation of France had shown that the matter was perhaps less simple than it had seemed at first sight.

46. The CHAIRMAN said that it was true that what appeared to be a simple suggestion regarding wording could sometimes turn out to be a more complicated problem of interpretation. More exploration and guidance were perhaps warranted.

47. Mr. MÖLLER (Observer for Finland) said that he agreed with the delegation of France that the order of subparagraphs (i) and (ii) of paragraph 3 (*b*) should not be reversed. Such a step might have been logical had the primary issue been one of a conflict of laws, but it was not. The provisions had been discussed in depth in the Working Group, so making alterations as a matter of taste rather than on the grounds of compelling reasons was not advisable.

48. The CHAIRMAN said that he wished to clarify how he saw the situation: the Working Group had discussed that and other issues at great length to produce the draft Model Law before the Commission. Although it was not final, he agreed with the observer for Finland that changes to the draft needed to be backed up by compelling reasons rather than be simple suggestions. The rules needed to be clear, and he appealed for anyone with questions about such a working method to raise them with him.

49. Mr. HOLTZMANN (United States of America) welcomed the Chairman's statement of his view of the rules, and concurred with them. Thanks to the incisive analysis made by the delegation of France, he saw strong reasons to leave the wording of draft article 1, paragraph 3, as it was. Moreover, the issues were listed in the present draft Model Law in the same order that they were listed in the UNCITRAL Model Law on International Commercial Arbitration. That too had been the result of long discussion, and he saw great advantages in maintaining consistent UNCITRAL practice. He favoured leaving the wording

unchanged, but if the matter was referred to the drafting committee, he asked for that committee to consider his observations.

50. *Draft paragraph 3 was provisionally approved.*

51. The CHAIRMAN asked if there were comments on draft paragraph 4, a provision which also existed in other UNCITRAL instruments, such as the Model Law on Electronic Commerce.

52. *Draft paragraph 4 was provisionally approved.*

53. The CHAIRMAN asked if there were comments on draft paragraph 5, which allowed parties to "opt in", voluntarily applying the Model Law to conciliation procedures even if the latter were not within the Law's remit or were not international.

54. Mr. JACQUET (France) said that the wording of paragraph 5 had been thoroughly discussed, and his observation related not to substance but to form. He thought that the wording corresponded to that in the UNCITRAL Model Law on International Commercial Arbitration which allowed arbitration cases to be considered voluntarily to be international. The present Model Law posed nothing more than a problem of wording, though at the current stage of debate, issues of wording were significant. In the light of the fact that draft article 1, paragraph 1, would allow parties to enact the Model Law to apply to domestic as well as international conciliation, he asked if it was advisable to retain draft article 1, paragraph 5, as it would have no relevance whatsoever for those parties.

55. Mr. SORIEUL (International Trade Law Branch) pointed out that the Commission's discussion of footnote 1 to draft article 1, paragraph 1, should not be pre-empted. Document A/CN.9/XXXV/CRP.3, which had not yet been distributed, would explain that one of the consequences of extending the scope of the Model Law to domestic conciliation would be a change in the wording of paragraph 5. As he remembered it, that change referred to the Model Law applying to commercial conciliation "whenever the parties agreed that it should".

56. *Draft paragraph 5 was provisionally approved.*

57. The CHAIRMAN asked if there were comments on draft article 1, paragraph 6, which had the opposite effect of paragraph 5, allowing parties to "opt out" of applying the Model Law to conciliation procedures.

58. Mr. MILASSIN (Hungary) said that his delegation had submitted written remarks concerning paragraph 6, which he saw no use in repeating; it was prepared to accept paragraph 6 as it stood, but said that if no changes were made to it, agreement would have to be reached on whether the parties should be able to opt out of the whole of the Model Law or only a part of it. His delegation favoured being able to opt out of a part of the Model Law.

59. Mr. SHIMIZU (Japan) said that his delegation found it difficult to interpret paragraph 6 in the light of the existing draft article 3, which affirmed the principle of party autonomy and seemed to make paragraph 6 redundant. Furthermore, draft article 3 listed some provisions from which the parties could not agree to derogate, in other words, a restriction of party autonomy, while paragraph 6 stipulated no such restrictions. It would perhaps be best to delete draft article 1, paragraph 6, particularly as it had no equivalent in the Model Law on International Commercial Arbitration, and concern for consistency was not therefore an issue.

60. The CHAIRMAN said that his recollection from the Working Group's discussions was that paragraph 6 existed to cover the very important issue of the scope of the Model Law, providing an

opportunity to decline to apply it. If the Model Law was applied, however, draft article 3 would come into play, as would its restriction on derogations. It reflected the Working Group's desire to ensure that, once parties did apply even part of the Model Law, uniformity of interpretation would be retained (draft art. 2) and fair and equal treatment would be maintained during conciliation (draft art. 7, para. 3).

61. Ms. BELEVA (Observer for Bulgaria) said that, like the representative of Japan, she had wondered about the scope of paragraph 6, bearing in mind that the very basis for conciliation was autonomy and free will. In the light of the Chairman's explanation, however, she believed that paragraph 6 should be retained.

62. Mr. BARSY (Sudan) said that paragraph 6 was too important to delete; however, the Commission might wish to defer that decision until it had concluded its discussion and had a better overview.

63. The CHAIRMAN said he would take note of the proposal by the Sudan but, in the absence of other input, he would take it that the Commission supported the text as drafted by the Working Group.

64. *Draft paragraph 6 was provisionally approved.*

65. The CHAIRMAN invited the Commission to consider paragraph 7 of article 1.

66. *Draft paragraph 7 was provisionally approved.*

67. The CHAIRMAN invited the Commission to consider paragraph 8, including its subparagraph (a) and subparagraph (b), which would permit certain exclusions by States implementing the law.

68. Mr. SHIMIZU (Japan) asked whether subparagraph (a) could be broadly interpreted to include court-annexed procedures by which conciliation took place in Japan.

69. The CHAIRMAN said that they could be included under paragraph 7 but not paragraph 8, which described cases where the judge or arbitrator himself was involved in the conciliation proceedings.

70. Mr. GRAHAM (Mexico) said that the aim of the draft Guide to enactment was not to inhibit or prohibit the participation of a judge or arbitrator in the conciliation efforts, but to make it clear that judges or arbitrators were subject to the specific laws governing judges or arbitrators rather than to the Model Law.

71. Mr. TANG HOUZHI (China) said that although, in the Working Group, China had been in favour of deleting the paragraph, which seemed to impede the participation of judges or arbitrators in settlement proceedings, it had later realized that, on the contrary, the provision actually fostered their participation. His delegation therefore believed that the paragraph should be retained.

72. Mr. SHIMIZU (Japan) inquired about the rationale behind the paragraph and the specific elements which had determined that the Model Law should not apply in such cases.

73. The CHAIRMAN said that, as the representative of Mexico had indicated, the action that could not be taken by a judge or arbitrator should be determined by the relevant laws of civil procedure in each country. In certain parts of the world it was perfectly acceptable for the judge or arbitrator to act as conciliator, while in others it was not. The Model Law deliberately refrained from determining either the legality or the desirability of such a practice.

74. Mr. MÖLLER (Observer for Finland) fully agreed with the Chairman about the nature and purpose of the paragraph. Even if it had not been included, the content of the paragraph would be implicit in the Model Law. It was a given that judges and arbitrators could not exceed what was set out in the claims and counter-claims of a case, but the extent of their involvement was very different, depending on the legal system. For the sake of clarity, the inclusion of paragraph 8 was essential.

75. Mr. GARCÍA FERAUD (Observer for Ecuador) characterized the issue as "pedagogical". In a number of Latin American countries, such as his own, arbitral proceedings or mediation would be viewed as a preliminary phase prior to the actual conciliation of the parties. That was just one of many variations that could occur in different legal systems.

76. Mr. JACQUET (France) expressed full agreement with the interpretations given by the Chairman and the observer for Ecuador but said that the Model Law could be applied at the request of both parties to an arbitral (but not a court) proceeding, which would constitute an exception under the provisions of article 1, paragraph 5.

77. The CHAIRMAN said the comment of the representative of France would be taken into consideration in the draft Guide to enactment.

78. Mr. TANG HOUZHI (China) said that the paragraph should be retained as drafted, since it did not bar a judge or arbitrator from attempting to facilitate a settlement. Where such conciliation occurred, the Model Law would simply not be applicable. His understanding of the paragraph was slightly different from that of the Chairman or the representative of France; he believed that the paragraph was closely related to article 16, and he would elaborate further on that point at the appropriate time.

79. The CHAIRMAN said that paragraph 130 of document A/CN.9/506 contained the text of article 16, which the Working Group had decided to delete. The representative of China could propose that it should be reinstated before the Commission discussed draft article 15.

80. Mr. MEENA (India) said that his delegation had no difficulty in agreeing to the retention of paragraph 8, whereby an attempt by an arbitrator to facilitate a settlement did not constitute an act of conciliation. The parties were free to reach a compromise at any time during the course of arbitral or court proceedings. An arbitrator or court should not be prevented from acting as facilitator, should the parties opt for a compromise over a court decision on the merits.

81. Mr. JOKO SMART (Sierra Leone) said that, if a judge acted as conciliator during a court proceeding in order to facilitate a settlement, the parties' acknowledgement that it had been a mistake to come before the court could be incorporated in the judgement and the Model Law would not apply, in accordance with the final sentence of article 1, paragraph 2. Since paragraph 8 clarified and reinforced that point, it would be useful to retain it.

82. Mr. BARSY (Sudan) said that his delegation was in favour of retaining the paragraph, particularly with regard to judgements. Indeed, judges' attempts to reconcile the parties were based on domestic civil codes, which generally included conciliation procedures. If the judge brought about a settlement, it could be incorporated in his decision and there would be no problem in applying it.

83. The CHAIRMAN said that, although some delegations, seemed to construe subparagraph (a) as permitting a judge to act as conciliator in court proceedings, that was neither the import of the subparagraph nor the intention of the Working Group. Paragraph 8 merely stated that the Model Law was not applicable in

certain situations, which left States the latitude to construe it in the context of their domestic law.

84. *Paragraph 8 (a) was provisionally approved.*

85. The CHAIRMAN noted that no mention had been made of paragraph 8 (b), which could be relevant in labour law or in areas subject to domestic regulation, such as finance, insurance or stock market transactions.

86. Mr. RENDÓN (Mexico) said that the decision made at the previous session to refer to *panel de conciliadores* in the Spanish version was reflected in draft article 5, but not in draft articles 1, 7, 8, 9 and 12. He hoped the drafting group would make the necessary corrections.

The meeting rose at 12.50 p.m.

Summary record of the 740th meeting, held at United Nations Headquarters on Monday, 17 June 2002, at 3 p.m.

[A/CN.9/SR.740]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico), Chairman of the Committee of the Whole, took the chair.

The meeting was called to order at 3.10 p.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (*continued*)

1. The CHAIRMAN invited the Committee to resume consideration of the draft UNCITRAL Model Law on International Commercial Conciliation in the version contained in the annex to the report of the Working Group on Arbitration on the work of its thirty-fifth session (A/CN.9/506).

Draft article 2. Interpretation

2. The CHAIRMAN noted that the text of draft article 2 on interpretation had been inspired by article 7 of the United Nations Convention on Contracts for the International Sale of Goods and that similar wording appeared in other UNCITRAL model laws.

3. Mr. GRAHAM (Mexico) said his delegation wished to emphasize the importance of adopting the text of the draft article as it stood in order to ensure uniformity in the interpretation of the Model Law in various countries.

4. Mr. MORÁN BOVIO (Spain) said he agreed with Mexico that the draft article set forth a very important principle that was in keeping with the Commission's other work.

5. *Draft article 2 was provisionally approved.*

Draft article 3. Variation by agreement

6. Mr. INOUE (Japan) said that his delegation wished to see draft article 3, on variation by agreement, adopted in its current form and could not concur with the proposal made by France (A/CN.9/513) to include a mention of draft article 15, entitled "Enforceability of settlement agreement", among the provisions of the Model Law that parties could not vary by agreement. Since conciliation depended heavily on the principle of party autonomy, parties should not be deprived of the freedom to accord their settlement a weaker effect than that of a contract or an arbitral award.

7. Mr. JACQUET (France), referring to France's written comments on draft articles 3 and 15 (A/CN.9/513), said that his delegation did not see the value of allowing the parties to determine the level of enforceability of their settlement agreement, particularly since in most countries that would run counter to the tendency of national law. Therefore, it was appropriate to mention article 15, whatever its final form might be, as one of the provisions the parties could not derogate from.

8. The CHAIRMAN suggested to the delegations that had submitted the comments that appeared in document A/CN.9/513 and Add.1 and 2 that they should repeat their arguments orally if they wanted them to be considered in the present debate.

9. Mr. MARKUS (Observer for Switzerland) said that he did understand the position of France, since enforcement necessarily involved the mechanisms of the State. Parties could not agree on a greater degree of enforceability of their settlement than the laws of the State permitted. However, it was possible that parties might wish to agree on a lesser degree of enforceability, or conceivably even none. Therefore his delegation did not think that article 15 should be mentioned in draft article 3 as a mandatory exception to variation by agreement. Instead, in the Guide to Enactment it could be explained that the parties could not agree on a higher level of enforcement than that provided by article 15 and by national law but could agree on a lower level of enforceability.

10. The CHAIRMAN said that, without wishing to cut off debate, he might suggest that it would be better to discuss France's proposal once the content of draft article 15 had been decided.

11. Mr. TANG HOZHUI (China) said that, without a strong provision on enforceability, the Model Law would lose much of its significance. The parties should not be allowed to agree to reduce or exclude the enforceability of their settlement agreement.

12. Mr. KOVAR (United States of America) said that his delegation shared Japan's view that party autonomy was at the core of the Model Law. As the observer for Switzerland had said, it

was hard to see why parties could not settle for less than full enforceability. His delegation favoured omitting mention of draft article 15 from draft article 3 but agreed with the Chairman that it would be better to finalize draft article 15 first, and article 7, paragraph 3 as well, before making a final decision on which articles to mention in draft article 3.

Draft article 4. Commencement of conciliation proceedings

Draft article 5. Number of conciliators

13. Mr. TANG HOZHUI (China) said that his delegation had no problems with the wording of draft article 4 on commencement of conciliation proceedings but felt strongly that footnote 3 to the draft article, containing the so-called “article X” on suspension of the limitation period, should be included in the body of the draft articles. Without a suspension of the limitation period during conciliation proceedings, parties might be far more reluctant to resort to conciliation.

14. The CHAIRMAN said that the decision to put that material in a footnote had been one of the hardest compromises for the Working Group to reach.

15. Mr. INOUE (Japan) said that the wording of draft article 4, paragraph 1, stating that conciliation proceedings commenced “on the day on which the parties to the dispute agree to engage in conciliation proceedings”, was unclear because parties might agree in principle to conciliate even before a particular dispute arose. The two cases needed to be distinguished.

16. With regard to draft footnote 3, which indicated that the text of article X was suggested for States that might wish to adopt a provision on the suspension of the limitation period, the word “suggested” was too strong. A more neutral term should be found.

17. The CHAIRMAN explained that, in respect of draft article 4, the Working Group had been concerned with an agreement to engage in conciliation proceedings after a dispute had arisen, not a general agreement to conciliate, which might have been entered into prior to a dispute.

18. Mr. GARCÍA FERAUD (Observer for Ecuador) said that his delegation did not wish to reopen the entire debate but simply to recall that Ecuador, in its written comments (A/CN.9/513), had argued for the inclusion of draft article X in the main body of the Model Law rather than as an optional clause. In Ecuador itself, the option would probably be adopted as the norm. The concern was that in some countries, if no particular provision was made for suspension of limitation, the commencement of conciliation might bring about an interruption of the limitation period, which, if conciliation was unsuccessful, would begin to run again from day one.

19. Mr. JACQUET (France) said that his delegation saw difficulties with article 4, paragraph 2, according to which a party could assume that its invitation to conciliate was rejected if it received no answer within 30 days. If the parties had no prior conciliation agreement and one party invited the other to conciliate after a dispute had arisen, the clause raised no problems. If, however, the parties did, for example, have a conciliation clause in their contract and one party invited the other to conciliate, the second party would have to accept or be in breach of contract. His concern was that the paragraph might be interpreted as providing that party a loophole to escape its contractual obligation. Accordingly, he proposed that the sentence should be preceded by the words “In the event that the parties have not concluded a conciliation agreement, . . .”.

20. The CHAIRMAN said that, as the Working Group understood it, the provisions of paragraph 2 would apply whether or not

there was a prior conciliation agreement. In either case, after 30 days the first party could consider the invitation to conciliate rejected. Only the consequences of that rejection would differ, and they were outside the scope of the Model Law.

21. Mr. HOLTZMANN (United States of America) said draft article 4, paragraph 2, placed in question the obligation of a party that stated its agreement to conciliate and then failed to do so. It must be recognized that even if one party agreed to conciliate, any attempt to enforce the agreement would be subject to draft article 12, subparagraph (d), which would allow the other party simply to terminate the proceedings by resorting to the voluntary concept that lay at the heart of conciliation. Draft article 4, paragraph 2, reflected that fact. It was also consistent with current practice, because, according to article 2 of the UNCITRAL Conciliation Rules, conciliation began when one party issued an invitation and the other accepted it. His delegation therefore had no difficulty with paragraph 2.

22. Referring to the statement by the representative of Japan, he said that draft article 4, paragraph 1, if read literally, could be taken to mean that conciliation would begin on the date of the original contract, however long ago that was, if the contract contained a conciliation clause. However, a common-sense reading of that paragraph, and his own, was that it referred to the date on which the dispute arose and the parties agreed to conciliate. He therefore agreed with the Secretary that draft article 4, paragraph 1, warranted some redrafting.

23. Concerning the additional draft article X, he had no objection to including a provision to allow States to opt for suspending the limitation period, but the addition seemed to be in the wrong place. There were certain risks attached to the provision, and States should be made fully aware of them. Because conciliation was by definition informal and flexible, it was difficult to define what a conciliation procedure was, and when it began and ended.

24. The Working Group had correctly taken the approach that conciliation might be pursued in a variety of ways. A State which adopted a provision along the lines of draft article X must be aware of the need for precision about the beginning and end of the conciliation procedure, because if a dispute arose towards the end of the prescription period, the decision whether conciliation had begun or ended might determine the outcome of the dispute, one party maintaining that the claim remained alive, the other that it was dead. The resulting uncertainty would engender litigation, which, in turn, would undermine the reputation of the conciliation process.

25. The parties themselves would have no need of draft article X: a party aware that the prescription period was about to expire would be free to initiate an arbitration procedure, or proceedings in a national court, to protect its rights. States, however, should be advised of the practical effect of adopting the provision, in case their legislatures did not realize it. He suggested that could best be done by moving draft article X to the Guide.

26. The CHAIRMAN said the decision to place draft article X as a footnote had been a compromise solution devised by the Working Group; some delegations had been anxious to include it in the body of the text.

27. Mr. MARSH (United Kingdom) agreed with the representative of the United States about the need for clarity in defining the commencement of the conciliation proceedings. It was not just a matter of determining when a suspension of the limitation period began, but also of the admissibility of evidence. Draft article 11, paragraph 1 (c), referred to statements or admissions made by a party “in the course of the conciliation proceedings”, which he took to be a reference back to draft article 4, paragraph 1. Both provisions had to be clarified. He was concerned to know when

the parties could be said to “agree” to conciliate, according to draft article 4, paragraph 1. In United Kingdom practice it would be difficult to pin down a date, because the initial agreement would be informal and merely a matter of principle, the details being fleshed out later. Would the agreement take shape at the initial stage, or when the details were decided upon?

28. Mr. SEKOLEC (Secretary of the Commission) said the earlier versions of draft article 4, paragraph 1, had contained more detail on the timing of the agreement. However, the Working Group had decided it was prudent not to attempt a definition. A unified rule on the timing would not be achievable, because of the variety of solutions in national law in matters of contract. For that very reason, the United Nations Convention on Contracts for the International Sale of Goods did not include such a definition.

29. As for draft article 4, paragraph 2, he suggested that a text could be incorporated into the Guide to clarify the kind of situation which might arise if there was a pre-existing conciliation agreement and one of the parties failed to respond to an invitation to conciliate. Draft article 4, paragraph 2, stated that silence could be treated as a rejection of the invitation, but it did not define the consequences of the rejection. Depending on the national law in question and the nature of the conciliation agreement, they might include loss of goodwill and liability for damages or even for court costs, if the result was litigation. The consequences of a rejection could even be referred to in the text of the article.

30. Mr. MÖLLER (Observer for Finland) thought it would be inadvisable to define in draft article 4, paragraph 1, exactly when the agreement to conciliate was reached. He could accept both paragraphs of draft article 4 as they were; there was no need for the additional language for paragraph 2 suggested by the delegation of France, provided sufficient clarification was given in the Guide. As for draft article X, he was not in favour of placing it in the body of the text. Introducing complex arrangements for suspending the limitation period would make the Model Law less attractive to Governments.

31. Mr. INOUE (Japan) said draft article 4 dealt only with the point in time at which conciliation proceedings began. Because the commencement had legal consequences, it was also necessary to have a procedure for termination, as provided in draft article 12. He was interested in the suggestion by the delegation of France that a distinction could be drawn between contracts containing a conciliation clause and others that did not. The commencement of conciliation proceedings could be defined as the point in time when one party invited the other to conciliate, on the basis of a prior agreement. The other party would then be required to have recourse to draft article 12 in order to terminate the proceedings.

32. Mr. ZANKER (Observer for Australia) said that if paragraph 1 was ambiguous, it should be reviewed by the drafting group. He interpreted it to refer to agreements made in the context of particular disputes, not those incorporated in a prior contract. The arrangements for terminating proceedings were spelled out in draft article 12. If no other circumstances were envisaged than those in draft article 12, they could perhaps be covered in draft article 10.

33. It was difficult to define the timing of conciliation proceedings without being overly prescriptive. The prospect of litigation in which the duration of the limitation period was itself in dispute would not make the Model Law any more attractive to States. He was not in favour of including draft article X in the body of the text.

34. Ms. MANGLAYANKUL (Thailand), commenting on draft article X, agreed with the representative of the United States. The appeal of conciliation lay in its flexibility and the fact that it was

voluntary. Including a provision such as draft article X in the text of the Model Law would confer on the procedure something of a compulsory character and create other difficulties for jurisdictions such as hers, in which the limitation period was already defined in civil and commercial law. It would also have an impact on contractual relations. If a majority in the Commission wished to include draft article X, she would prefer to place it in the Guide rather than as a footnote. If that was done, she would have no difficulty with either paragraph of draft article 4.

35. Mr. GARCÍA FERAUD (Observer for Ecuador) said his country was anxious to see the draft Model Law completed as soon as possible. The explanation given by the acting Chairman made it clear that the placing of draft article X had been a compromise solution. In any case, the essence of the draft Model Law was that conciliation was voluntary, so an optional provision for suspending the limitation period, not included in the body of the text, would be appropriate. There might indeed be a risk of parties exploiting it by seeking to prolong proceedings or accepting an offer to conciliate but failing to proceed; however, it was no less risky to have no provision along the lines of draft article X.

*The meeting was suspended at 4.35 p.m.
and resumed at 5.15 p.m.*

36. The CHAIRMAN said that, following consultations with various delegations, a consensus had emerged to retain the Working Group’s proposal to include draft article X in a footnote as a suggested option and to provide guidance to States on making their decision in the corresponding section of the Guide to Enactment. Any remaining doubts concerning the interpretation of draft article 4 should also be clarified in the Guide.

37. Mr. TANG HOZHUI (China) said that even though his delegation could accept the current formulation of draft article 4, the Model Law would have been more attractive to States if draft article X had been included in the main text. There were objective reasons for its inclusion, and it had nothing to do with compatibility with Chinese law. The purpose of determining the commencement and termination of conciliation proceedings (in draft articles 4 and 12, respectively) was to indicate clearly the basis for suspending the limitation period. Without the inclusion of draft article X, the purpose of the provisions of draft articles 4 and 12 was unclear.

38. The CHAIRMAN explained that discussions would continue in the drafting group with a view to improving the notes in the Guide on the advantages and disadvantages of adopting draft article X.

39. *Draft articles 4 and 5 were provisionally approved.*

Draft article 6. Appointment of conciliators

40. Mr. MARSH (United Kingdom) said that the wording of article 6, paragraph 2, assumed that there were only two parties to the dispute, which would prevent it from being applied to disputes involving several parties. The drafting group should consider how to resolve that problem.

41. Mr. SEKOLEC (Secretary of the Commission) said that since the same problem arose in other paragraphs, the point made by the representative of the United Kingdom seemed to be more than a simple drafting question. There would need to be a comprehensive solution, either by including a catch-all provision for disputes involving more than two parties, or by redrafting each article where the problem arose.

42. Mr. MORÁN BOVIO (Spain) said that situations in which there were more than two parties to a dispute were quite common, for instance when disputes arose between more than one provider

of the same product and a manufacturer over the price of goods or sequencing of delivery. He suggested the insertion of a catch-all provision at the end of the main text, such as “whenever the text refers to two parties, it could equally apply to several parties”. That amendment would not entail extensive changes to the text.

43. Mr. SEKOLEC (Secretary of the Commission) said that draft article 6 did not concern the number of parties but the number of conciliators. Paragraphs 1, 2 and 3 should be seen as neutral as to whether the dispute involved two or several parties. The drafting group should endeavour to find a way to express the idea that paragraph 2, for instance, concerned the appointment of two conciliators, either by two or by several parties.

44. Mr. ZANKER (Observer for Australia) agreed that the point raised by the representative of the United Kingdom was more than just a drafting question. The focus of draft article 6 should be on the rights of the parties. He acknowledged that paragraph 1 was neutral, but in cases involving more than one conciliator, the provisions should focus on what the parties wanted, rather than on the number of conciliators. It should be considered whether a maximum limit of three conciliators should be established for cases involving a panel.

45. Mr. TANG HOZHUI (China) said that draft articles 5 and 6 presented no difficulties for his delegation. The provisions of draft article 5 did not conflict with those of draft article 6, paragraph 3, pursuant to which each party should appoint one conciliator in cases for which the composition of a panel was requested. However, if there were three parties to a conflict, one of which appointed a conciliator and two agreed to appoint one conciliator between them, the provisions of paragraph 3 would not apply. While his country had no experience of such cases in the area of conciliation, there were arbitration cases in which several parties constituted either the claimant or the respondent. In those circumstances, the claimant and the respondent, respectively, were each entitled to appoint a single arbitrator.

46. Mr. SEKOLEC (Secretary of the Commission) said that one of the principles on which article 4 of the UNCITRAL Conciliation Rules was based was that the appointment of conciliators depended entirely on the parties to a dispute. The same philosophy was reflected in article 6 of the draft Model Law. The problem presented by paragraphs 2 and 3 of that article with regard to cases involving more than two parties could be resolved by providing for the parties to “endeavour to reach agreement on the number of conciliators and the manner of appointing them”.

47. The CHAIRMAN proposed that the solution suggested by the Secretary of the Commission should be approved. If the parties failed even to agree on the number of conciliators and the manner of appointing them, there could be no conciliation at all.

48. Mr. GETTY (United States of America) said, with regard to draft article 6, paragraph 6, that while his delegation would have preferred a reference to “conflict of interest”, it did not see a need to amend the current text. Nevertheless, it remained concerned that the application of remedies could be hindered by the provisions of the article. If a conciliator failed to disclose a conflict of interest, with the exception of obviously intentional fraud, the corresponding settlement agreement should still be allowed to take effect. Sometimes, parties deliberately chose a conciliator with particular expertise in a given area, meaning that he or she could not be totally impartial. That issue could be explained in the Guide to Enactment.

49. The CHAIRMAN expressed concern with the suggestion made by the representative of the United States of America, a discussion of which had already been held in the Working Group. However, an explanation in the Guide that the failure to disclose a conflict of interest should not itself annul the conciliation result would not carry sufficient weight in some legal systems. In Mexico, for instance, a judge could still decide to annul a settlement under such circumstances. Members should give serious thought to the matter before the next meeting.

The meeting rose at 6 p.m.

**Summary record of the 741st meeting,
held at United Nations Headquarters on Tuesday,
18 June 2002, at 10 a.m.**

[A/CN.9/SR.741]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.15 a.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION (continued)**

Draft article 6. Appointment of conciliators (continued)

1. The CHAIRMAN invited the Secretary to read the suggested revisions to article 6 that the drafting group had been requested to prepare in order to cover the possibility of multi-party conciliation.

2. Mr. SEKOLEC (Secretary of the Commission) said that the drafting group had prepared two alternative formulations for the Commission’s consideration, each with two variants.

3. The first alternative involved retaining the original paragraph 1 and replacing paragraphs 2 and 3 with the following text:

“In conciliation proceedings with two or more conciliators, the parties shall endeavour to reach agreement on either a

joint appointment of the conciliators or on [*first variant*: the procedure for the appointment of the conciliators] / [*second variant*: the way in which the parties will appoint the conciliators].”

4. The second alternative involved replacing all three paragraphs with the following new paragraph:

“The parties shall endeavour to reach agreement on either a joint appointment of the conciliator or conciliators or on [*first variant*: the procedure for the appointment of the conciliator or conciliators] / [*second variant*: the way in which the parties will appoint the conciliator or conciliators].

5. Mr. MORÁN BOVIO (Spain) expressed support for the first alternative and first variant, which appeared to reflect the concerns raised by the representative of the United Kingdom at the previous meeting. The second variant was too vague.

6. Mr. HOLTZMANN (United States of America) joined with the previous speaker in expressing support for the first alternative, which—on first reading—appeared to allow greater flexibility. The reference to “two or more conciliators” was particularly welcome, since the assumption was all too often made that there should always be an odd number of conciliators. The word “joint” should, however, be deleted, since it gave the impression that mutual agreement was necessary for the appointment of each conciliator. Each party might instead prefer to appoint its own conciliator, regardless of the other party’s approval. His delegation could not support the second alternative since it did not allow for the possibility of two conciliators and since use of the plural form (“the parties”) implied that joint agreement was necessary.

7. Mr. MARSH (United Kingdom), also giving his preliminary reaction to the suggested revisions, said that the first alternative seemed most acceptable. It was his delegation’s view, however, that the language in the new paragraph 2 should be brought in line with paragraph 1 to refer in each case to agreement on the name of the conciliator or conciliators, not merely to their appointment.

8. Mr. TANG HOZH (China) said that he was also more in favour of the first alternative and first variant. However, it was not clear from the proposed text whether there would always be one conciliator for each party, regardless of the number of parties. In paragraph 5, the words “or third conciliator” should be deleted since there was no such concept.

9. Mr. MARKUS (Observer for Switzerland) joined fully with the representatives of Spain and the United States of America. In the draft Guide, the very sound procedure described in the current paragraph 2 could be mentioned as one important method for settling disputes.

10. Mr. MIRZAEI-YENGEJEH (Islamic Republic of Iran) said that his delegation also favoured the first alternative and first variation, which offered greater flexibility. It also supported deletion of the word “joint” and the revision proposed by the representative of the United Kingdom.

11. Mr. GARCÍA FERAUD (Observer for Ecuador) expressed strong support for the first alternative and first variant, which covered many situations not dealt with in previous texts. He also favoured deletion of the word “joint”. In addition, it should be made clear that an agreement between the parties could be constituted by more than one document, whether simultaneously or successively submitted. The deletion of paragraph 1 might also be considered.

12. Mr. MÖLLER (Observer for Finland), welcoming the first alternative and first variant, said that he could also fully support deletion of the word “joint” and the suggestion made by the observer for Switzerland. He was not, however, convinced by the

need to bring the language in the new paragraph 2 in line with paragraph 1 as proposed by the representative of the United Kingdom. The matter should be left to the drafting group.

13. Mr. ZANKER (Observer for Australia) said that the concern raised by the representative of the United Kingdom might best be met by modifying paragraph 1—replacing the word “name” with the words “procedure for appointment”—and reformulating the proposed first alternative, first variant, as follows: “In conciliation proceedings, the parties shall endeavour to reach agreement on the procedure for appointment of the conciliator or conciliators.”

14. Mr. MEENA (India) said that his delegation supported the first alternative, first variant, and the deletion of the word “joint”.

15. Mr. GRAHAM (Mexico) said that his delegation was also prepared to support that alternative and variant and would not object to the deletion of the word “joint”. It fully supported the deletion of paragraph 3, which applied more to arbitration.

16. Mr. JACQUET (France) said that it would be reasonable either to retain paragraph 2 or to modify it so that it would apply to instances in which there were two or more conciliators and more than two parties involved in a dispute. The text of paragraph 2 applied to a situation which frequently occurred and would therefore prove useful.

17. France supported the Secretary’s proposal and agreed with the view of the representative of the United States that the word “joint” should be deleted to avoid an excessively restrictive provision. If necessary the text could be slightly modified to include cases in which the parties themselves appointed conciliators, or in the event that a third conciliator were to be appointed. The current text gave the impression that there were two situations that were mutually exclusive: that either the parties would come to an agreement on the appointment of conciliators or the parties would agree on a procedure for the appointment of conciliators. In his opinion, both possibilities were viable.

18. Mr. SLATE (Observer for the American Arbitration Association) said that he supported the version of paragraph 2 as presented by the Secretary and believed that the word “joint” should be deleted.

19. Mr. MORÁN BOVIO (Spain) said that his delegation supported the proposal made by the observer for Australia on paragraph 1, and that, in an attempt to accommodate the United Kingdom proposal, it might be necessary to study the content of paragraphs 1 and 3 in terms of their similarities. His delegation was still weighing the advantages and disadvantages of keeping paragraph 2. He believed that the representative of France might be correct in his arguments in favour of retaining paragraph 2. It was also necessary to consider the issue of multi-party conciliation, as raised by the United Kingdom, taking into consideration the diversity and varying expertise of conciliators.

20. Mr. SILLAPAMAHABUNDIT (Thailand) said that his delegation wished to join the majority view in support of the first alternative; it also favoured the inclusion of provisions applying to instances involving two or more conciliators, as presented in the draft Guide to Enactment.

21. Mr. ZANKER (Observer for Australia) said that he wondered whether the concerns expressed by Finland, France, Spain and Switzerland with regard to paragraph 2 could not be addressed by a statement, within the text, that parties had the entitlement, but were not bound, to nominate a conciliator. In the case of multi-party conciliation it was conceivable that a number of parties with a common interest might be served by a single conciliator acting on their behalf. Similarly, there might be cases when each party might prefer having its own conciliator.

22. Mr. BARSY (Sudan) said that the Secretary's proposed first alternative adequately covered paragraphs 2 and 3. His delegation supported the deletion of the word "joint", and suggested that it would be fitting to add the following modification to the proposal made by the Secretary: "... the parties shall endeavour to reach an agreement either on a joint appointment of a conciliator or conciliators, or on the procedure of (sic) the appointment of one conciliator or conciliators." That alternative would cover agreement on proceedings envisaged under paragraph 1. With regard to the concerns expressed by the United States, he believed that paragraph 5 was clear and adequately covered the situation in question.

23. Mr. SHIMIZU (Japan) said his delegation was flexible but agreed with the view that the new proposals might imply a change in policy. Draft article 6 was intended to apply as a default rule in cases where parties could not reach agreement. He believed it might be wise to make a decision on policy before continuing the drafting exercise.

24. Mr. SEKOLEC (Secretary of the Commission) said that the scenario in which each party appointed its own conciliator or conciliators was not comparable to the situation existing in arbitration where a party had an independent right to appoint its own conciliator. It must be implied that such a conciliator had to be approved and accepted by the other party. That approximated the situation wherein both parties accepted both conciliators, even though the procedure for such appointment was that each party would individually appoint its own. Therefore, the distinction between the joint appointment of two conciliators and the case where each party appointed a conciliator was not very clear.

25. Paragraph 2 had earlier been criticized on the grounds that it allowed one party to impose its choice of conciliator on another party, but that was not actually the case.

26. The CHAIRMAN said it was clear from the discussion that there was much support for the first alternative proposed by the Secretary of the Commission. Within that alternative, there seemed to be a preference for the first variant. It was also clear that the word "joint" should be deleted.

27. He believed it might be timely to suspend the meeting in order for consultations to be held on new wording that would encompass the points made on various aspects of draft article 6.

*The meeting was suspended at 11.25 a.m.
and resumed at 12.25 p.m.*

28. The CHAIRMAN announced that the Commission had adopted the first alternative and the wording of the first variant proposed by the Secretary. The word "joint" would be deleted and the drafting group would have to amalgamate draft paragraphs 1 and 2. Concerns about conciliation proceedings with two or more conciliators would be dealt with in the draft Guide to Enactment. The drafting group would submit a text to the Commission by the next day.

29. The CHAIRMAN drew attention, with regard to paragraph 6, to the view of the United States that failure to disclose circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence should not systematically result in the nullification of a settlement agreement.

30. Mr. MARSH (United Kingdom) said that the paragraph should specify that a conciliator could not be held responsible for circumstances of which he or she was unaware.

31. Mr. JACQUET (France) opposed making any changes to the text of paragraph 6 and disagreed with the United States proposal to eliminate consequences where a conciliator had no

knowledge of a circumstance that should have been disclosed. For one thing, discussion of consequences in the draft Guide to Enactment was pointless when the Model Law made no reference to them. Moreover, failure to fulfil an obligation should entail consequences whether or not that was explicitly stated in the text. Excessive leniency could be frowned upon in legal circles, where the Model Law was likely to be widely disseminated. In short, he hoped that the United States proposal would not be adopted.

32. Mr. MÖLLER (Observer for Finland) supported the remarks made by the representative of France. He was also reluctant to accept the United Kingdom proposal, since it would require altering a formulation taken from the UNCITRAL Model Law on International Commercial Arbitration and, in any case, it was self-evident that a conciliator could not be held liable for a situation of which he himself was unaware.

33. Mr. GETTY (United States of America) said that there had been a misunderstanding. The issue was not whether or not there should be consequences for failure to fulfil an obligation, which was a matter of ethics, but rather whether or not the articulation of a specific ground could be interpreted as a basis for nullifying a settlement agreement that would not otherwise be nullified under normal contract law. His delegation believed that conciliators were legally and ethically obligated to disclose any circumstance that compromised their impartiality or independence; however, they should not be held liable for inadvertent technical failures to do so.

34. Mr. SEKOLEC (Secretary of the Commission) said that the Working Group had decided to incorporate the United States view by indicating in the draft Guide that paragraph 6 was not intended to add a new ground for the setting aside of a settlement agreement beyond those already contained in a State's domestic contract law. The Working Group had deliberately refrained from attempting to make any changes or additions to existing contract law, since disclosure could have a different effect under the contract law of different legal systems.

35. Mr. MORÁN BOVIO (Spain) supported the Secretary's proposal to retain the paragraph as drafted and provide an explanation in the draft Guide to Enactment, which would allay the concerns expressed by the delegates of Finland, France and the United States and also take the United Kingdom proposal into account.

36. The CHAIRMAN said that no changes would be made to the text of paragraph 6 but that an explanation would be provided in the draft Guide to Enactment.

37. *It was so decided.*

Draft article 7. Conduct of conciliation

38. *Paragraphs 1 and 2 of draft article 7 were provisionally approved.*

39. Mr. GETTY (United States of America), referring to draft paragraph 3, said that his delegation and others were of the view that the paragraph raised the possibility of the conciliation being set aside. The unanimous sentiment in the dispute resolution section of the American Bar Association had been that the paragraph could have dangerous consequences if misunderstood. Although the Commission had decided in Vienna that paragraph 3 would refer to the conduct of the proceeding only, it could have a broader interpretation in the United States of America and other countries, where a subsequent determination that the settlement agreement was unfair could imply that the conduct of the proceeding had also been unfair and thereby constitute grounds to set aside the conciliation. Thus, it would be better if the issue were decided by the contract law of the local jurisdiction.

40. His delegation preferred to see the paragraph deleted in its entirety or, if that was not acceptable to the Commission, at least to have the mandatory provisions of the paragraph removed to allow for a more flexible interpretation by agreement of the parties. The opening phrase “in any case” should also be deleted and there should be a clear statement in the draft Guide to Enactment that paragraph 3 did not seek to create a new cause of action to challenge the conciliation, that any challenge would be made in accordance with existing contract law and that the conduct, not the result, of the proceedings must be fair (since the result would almost always be subjective in the eyes of the parties).

41. The CHAIRMAN asked for reactions to the argument put forward by the delegation of the United States.

42. Mr. JACQUET (France) said that draft article 7, paragraph 3, like the other articles of the draft Model Law, had been discussed at great length by the Working Group. His delegation was disappointed that paragraph 3 had already marked a dilution of the obligation to maintain fairness expressed by the equivalent provisions in the UNCITRAL Model Law on International Commercial Arbitration but nevertheless supported the inclusion of the paragraph as a fundamental component of the present draft Model Law from which no derogation should be possible. It could see no use in an agreement that allowed conciliators to forego being even-handed.

43. Again, it opposed with regret the suggestion made by the delegation of the United States that the phrase “in any case” at the beginning of paragraph 3 should be deleted on the grounds that it followed on from the previous paragraph, which emphasized the number of ways in which conciliation could be conducted. The effect of the phrase “in any case” was to stress that whatever the variety of methods available, the method selected had to be governed by the principle of fairness.

44. Ms. RENFORS (Sweden) echoed the view of the delegation of France: she understood the concerns of the United States delegation, but did not wish to see paragraph 3 deleted. She interpreted that paragraph’s provisions as referring not to the conduct of the conciliation procedure, but to its result, and with that interpretation it would also not be advisable to delete the reference to draft article 7, paragraph 3, in draft article 3, as that would leave the parties free to agree to a derogation. It was important for the draft Model Law to include a provision referring to fair conduct of the conciliation, particularly if the forthcoming discussion of draft article 15 resulted in the conciliation procedure being made enforceable in some way. She had no objection to the United States proposal to delete the phrase “in any case” at the beginning of paragraph 3, though she did not see clearly how that could help to address that delegation’s objections.

45. Mr. MÖLLER (Observer for Finland) echoed the views of the delegations of France and Sweden, considering that paragraph 3 was a necessary component of the draft Model Law and that it applied to the conduct, not the result, of the conciliation procedure. Moreover, deleting the phrase “in any case” was counterproductive: he could not see why the parties should be able to agree that the conciliator should not be bound to maintain fair treatment or take account of the circumstances of the case. He favoured an amendment to meet the concerns of the United States delegation if necessary, but not outright deletion.

46. Mr. TANG HOZHAI (China) echoed the views of the delegations which had not favoured the proposal of the United States delegation. Firstly, paragraph 3 enshrined a fundamental principle for conciliators. Secondly, when a court came to interpret article 15 of the Model Law, it would not be able to intervene in conciliation procedures in the same way in which it could intervene in arbitration procedures. In the case of arbitration, a court could decide if there had been any shortcomings in a procedure and

could set aside an arbitration award as a result. In the case of conciliation, there was no such option for a court to set aside a settlement. Arbitration decisions were made by an arbitrator, while conciliation decisions were made not by a conciliator but by the parties themselves. In the light of the fact that the present draft Model Law did not have court-related provisions comparable to those of the UNCITRAL Model Law on International Commercial Arbitration, paragraph 3 was entirely necessary and appropriate.

47. Mr. MORÁN BOVIO (Spain) said that the issue raised by the United States delegation was one that had long been a focus of attention for the Working Group on Arbitration, as demonstrated by paragraphs 70-74 of the report on the work of its thirty-fifth session (A/CN.9/506), held in Vienna in November 2001. The wording of the draft Model Law had been the result of a consensus at that session. That history to the matter showed that it was probably one of the most sensitive in the draft Model Law. On the one hand, the need for conciliators to be fair with the parties had to be emphasized. On the other hand, as the United States delegation had pointed out, including that call for fairness in the draft Model Law left it open to challenge on the grounds that a conciliation procedure might not have been fair. The significance of the issue was further highlighted by draft article 3 of the Model Law, which prevented the parties from agreeing to derogate from that principle of fairness, and the ban on derogation was itself proof that fair treatment was regarded as a cornerstone of conciliation.

48. The principle of fair treatment could even be considered a non-negotiable part of the draft Model Law, as diluting it could jeopardize its future success and acceptance by legal and judicial authorities. While his delegation was strongly in favour of retaining draft article 7, paragraph 3, for all the reasons he had explained, the concerns voiced by the United States delegation over the practical application of that paragraph might be met by making it clear, in the body of that paragraph, that fair treatment was required “during the course of the conciliation procedure”. Although, when read in its entirety, paragraph by paragraph, draft article 7 implied that understanding in any case, more explicit wording might be advisable. That might prevent a situation in which a settlement agreement reached by conciliation was challenged because, for example, notification arrangements were not the same for all the parties involved in the procedure.

49. Mr. GETTY (United States of America) thanked the Commission for its discussion of an issue which the United States delegation had felt obliged to raise because it was causing a problem. That problem had arisen from a misunderstanding of the Working Group’s original intention: that the requirement for fairness pertained to the conduct of the conciliation and not to its result, whose fairness would always be open to debate. The United States delegation would be happy with a clear statement in the draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation that the requirement applied to the conciliation procedure, not to the settlement agreement resulting from that procedure, and that it did not vary from existing jurisdictional contract law.

50. The CHAIRMAN, in the absence of any objections, summarized the outcome of the debate as follows: draft article 7, paragraph 3, would be left unchanged, as would the reference to it in draft article 3. However, the draft Guide would indicate clearly that article 7, paragraph 3, did not refer to the settlement agreement. That was logical, as the conciliator had no control over what the parties agreed between themselves. In addition, it would be made clear that the simple fact of the conciliator failing to comply with the obligations placed on him by article 7, paragraph 3, would not provide new and independent grounds, over and above those of existing contract law, to set aside a settlement agreement.

51. *It was so decided.*

ELECTION OF OFFICERS (*continued*)

52. Mr. CACHAPUZ DE MEDEIROS (Brazil), speaking on behalf of the Group of Latin American and Caribbean States, nominated Mr. Guillermo Reyes (Colombia) for the office of Vice-Chairman.

53. Mr. REYES (Colombia) was elected Vice-Chairman by acclamation.

54. Mr. MIRZAEI-YENGEJEH (Islamic Republic of Iran), speaking on behalf of the Group of Asian States, nominated Ms. Vilawan Mangklatanakul (Thailand) for the office of Vice-Chairman.

55. Ms. MANGKLATANAKUL (Thailand) was elected Vice-Chairman by acclamation.

The meeting rose at 1 p.m.

Summary record of the 742nd meeting, held at United Nations Headquarters on Tuesday, 18 June 2002, at 3 p.m.

[A/CN.9/SR.742]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 3.15 p.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (*continued*)

Draft article 7. Conduct of conciliation (continued)

1. Mr. ZANKER (Observer for Australia), referring to paragraph 4 of article 7, suggested that the word “conciliator” should be replaced by the words “conciliator or the panel of conciliators” in order to bring paragraph 4 in line with paragraphs 2 and 3 of the same article.

2. The CHAIRMAN said that the Australian suggestion would be referred to the drafting group.

3. *It was so decided.*

Draft article 8. Communication between conciliator and parties

4. Mr. MARKUS (Observer for Switzerland) said that the phrase “unless otherwise agreed by the parties” seemed unnecessary, since that provision was already covered by draft article 3. He suggested that the matter should be referred to the drafting group.

5. The CHAIRMAN recalled that the Working Group had decided to state the common rule in draft article 3 but had felt that there were other cases in which it was appropriate to emphasize the principle it embodied. The Working Group had referred the matter to the drafting group and accepted the text produced by that group. He suggested that the drafting group should be asked once again to review the use of the phrase “unless otherwise agreed by the parties”.

6. Mr. SEKOLEC (Secretary of the Commission) pointed out that the drafting problem had arisen during discussion of the first

draft, and it had been decided to include the general rule and leave the phrase “unless otherwise agreed by the parties” in other articles for emphasis. No decision had been made regarding the whole text. He was not sure the drafting group would be the right body to consider the matter at the present stage of its work, inasmuch as it was currently concerned with the task of harmonizing the six language versions of the entire text. He suggested that the Commission should take a stand on the principle involved.

7. The CHAIRMAN recalled that in the case of draft article 13, which dealt with a very sensitive issue, the Working Group had decided that the phrase “unless otherwise agreed by the parties” should be retained. Bearing in mind the information provided by the Secretary, he suggested that the matter should be decided by the Commission rather than the drafting group.

8. Mr. TANG HOZHAI (China) said that the expression “unless otherwise agreed by the parties” should be expressly stated in all the articles where the principle was applicable, even though the general rule had already been established in draft article 3. There was no need to change draft article 8.

9. The CHAIRMAN said that, if he heard no objection, he would take it that the phrase “unless otherwise agreed by the parties” should be deleted from draft article 8.

10. *It was so decided.*

Draft article 9. Disclosure of information between the parties

11. Ms. BELEVA (Observer for Bulgaria) asked whether the use of the verb “may” in the first part of article 9 meant that the conciliator, the panel of conciliators or a member of the panel could decide whether or not to disclose the information to the other party.

12. The CHAIRMAN explained that the conciliator could receive confidential information from one of the parties and, if he or she deemed it appropriate in order to bring the parties closer together, could disclose the information to the parties either individually or in a caucus. The conciliator could not disclose the information he had received if he was not authorized to do so by the party. The other solution considered by the Working Group was that the conciliator could receive the information and was free to disclose it unless the party providing the information indicated that it should remain confidential. The Working Group had opted for the second solution because it seemed to be more in line with current practice.

13. Ms. BELEVA (Observer for Bulgaria) asked what would be done in regard to information that was not considered confidential by the party providing it.

14. Mr. ZANKER (Observer for Australia) suggested deleting the entire text after the word “panel” in the third line and replacing it by the following: “shall not disclose that information to any other party unless the party giving the information expressly consents to such disclosure”.

15. The effectiveness of conciliation depended to a large extent upon the parties to a dispute communicating privately to the conciliator their candid views on the dispute. Accordingly, there should be an absolute prohibition on the disclosure by the conciliator of anything that occurred in private meetings and in other discussions with the parties unless a party specifically authorized otherwise. The approach to disclosure in draft article 9 was derived from article 10 of the UNCITRAL Conciliation Rules, which had been developed in 1980, at a time when the process of commercial conciliation was imperfectly understood and very little practised. That formulation was inappropriate and had not been widely embraced. It certainly did not reflect current conciliation practice in Australia. Moreover, the opposite formulation currently prevailed in published commercial mediation and conciliation agreements used as a precedent in Australia and elsewhere.

16. The CHAIRMAN recalled that the wording on disclosure had been discussed by the Working Group, as reported in paragraphs 78-82 of the report of the Working Group on Arbitration (A/CN.9/506). The Working Group had decided in favour of the present text.

17. Mr. MARSH (United Kingdom) said that his delegation agreed with the Australian position. However, since the matter had been discussed fully by the Working Group and the present text had been accepted by the majority of the Group, he would be reluctant to reopen the debate. He noted that the present text needed tweaking to cover multi-party situations, and the text suggested by the Australian delegation accomplished that by using the wording “any other party” rather than “the other party”.

18. He also wished to point out that the information which was the subject of the clause was currently limited to information concerning the dispute; however, there was the possibility that a disclosure might be made in the course of the conciliation relating to a corporate practice of one of the parties that might not necessarily pertain to the dispute but that was nonetheless confidential. The phrase “information concerning the dispute” was somewhat restrictive. Also, according to the present text, the conciliator could receive “information concerning the dispute” but only pass on “the substance” of that information. The distinction between the two phrases was not clear, and the text could lead to misunderstanding.

19. Mr. MÖLLER (Observer for Finland) said that it would be counterproductive to reopen the discussion on draft article 9. Moreover, the Australian proposal would not be consistent with the UNCITRAL Conciliation Rules.

20. Mr. BARSY (Sudan) said that his delegation supported the Australian proposal. The conciliator should only disclose information with the express consent of the party giving the information. Moreover, his delegation interpreted the first sentence of the draft article to mean that the conciliator could only disclose information received from a party during the conciliation proceedings, not information the conciliator might have obtained from other sources. If the conciliator could disclose information obtained outside the conciliation proceedings, the parties concerned might not know that he had such information and would therefore not be in a position to specify that it should be kept confidential.

21. Mr. GRAHAM (Mexico) said his delegation would prefer that the Working Group’s consensus would mean that the matter should not be reopened for debate. Being in favour of the text as it stood, he would argue that it was part of the role of conciliator to be a channel of communication between the parties, and in the process the conciliator necessarily shared information that the parties had given him. If the conciliator were required to obtain permission each time to transmit information to the other party, the process would become unnecessarily cumbersome and far less effective.

22. Mr. JACQUET (France) said that his delegation was in favour of retaining the present text, despite the arguments of the Australian delegation, but by no means felt that debate should be cut off merely on the grounds that the Working Group had reached a consensus, on that or on other points. The reasons for the consensus could appropriately be reconsidered in the Commission.

23. With regard to the title of the article, “Disclosure of information between the parties”, in French “Communication d’informations entre les parties”, he would prefer to replace “communication” by “divulgarion” in the French title, partly to distinguish it from the title to draft article 8. In all language versions, he would suggest eliminating the words “between the parties”, since the thrust of the text was that the parties were not communicating directly but were receiving information through the intermediary of the conciliator.

24. Mr. REYES (Colombia) said that his delegation preferred to retain the text arrived at by consensus in the Working Group. In the Spanish title, the word “*revelación*” should be replaced by “*divulgación*” as a rendering of “disclosure”.

25. Ms. MOOSA (Singapore) said that, although her delegation agreed with Australia and had advanced the same position in the Working Group, it did not wish to reopen the debate. It was nonetheless concerned that parties might not be aware that any information they revealed would be passed along unless they specifically stated otherwise. Her delegation proposed that the Guide to Enactment should instruct conciliators to make that point clear to the parties at the outset.

26. Mr. COSMAN (Canada) said that his delegation supported the present text and agreed with Finland that, unless there was evidence that the UNCITRAL Conciliation Rules were not working, the debate should not be re-opened. In the experience of his delegation, conciliation was effective with a rule similar to that in draft article 9.

27. Mr. SHIMIZU (Japan) said that his delegation had questions about the use of the words “substance of the information” in the first sentence of draft article 9. At issue was whether it was the duty of the conciliator to disclose the information. On the assumption that the conciliator had a duty to disclose, the Working Group had introduced the word “substance” to avoid burdening the conciliator with an obligation to communicate the literal content of any information received from the parties. But according to paragraph 56 of the draft Guide to Enactment and Use of the

UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/514), the conciliator had the freedom, but not the duty, to disclose such information to the other party. On that interpretation, the word “substance” was superfluous and should be deleted, since it represented a subtle distinction that would be hard to explain to legislators.

28. Mr. MEDREK (Morocco) said that his delegation preferred not to reopen the debate on the principle expressed in draft article 9. With regard to the title, it supported the proposal of France to delete the words “between the parties” and in the French version to replace “*communication*” by “*divulgation*”.

29. Mr. TANG HOZHUI (China) said that his delegation also preferred the existing text. The arguments for the opposing principle had been thoroughly debated in the Working Group.

30. The CHAIRMAN said that the reasons for using the term “the substance of the information” could be included in the Guide to Enactment. With regard to the title of draft article 9, there was precedent for deleting the words “between the parties”, since article 10 of the UNCITRAL Conciliation Rules, with similar content, was entitled simply “Disclosure of information”.

31. Mr. MARKUS (Observer for Switzerland) said that his delegation preferred the text as it stood but was in favour of eliminating the words “between the parties” from the title. It agreed with Singapore that it was very important for the conciliator to explain to the parties at the outset that they must specify if there was information that they did wish to have disclosed. The Guide to Enactment should make that clear.

32. Mr. HEGER (Germany) said that his delegation also supported the principle expressed in draft article 9 as it stood. The point raised by Singapore and Switzerland was pertinent, but he feared that there was a danger of making the Guide to Enactment overly formalistic, whereas the thrust of draft article 9 was to promote flexibility.

33. Mr. GARCÍA FERAUD (Observer for Ecuador) said that draft article 9 dealt with disclosure of information to the parties to the conciliation, not to outsiders. It was important in the title to indicate the intended recipients. The phrase, “between the parties”, should not be deleted but amended to read “to the parties”.

34. Mr. RENDÓN (Mexico) said that the word “*contenido*” in the Spanish version was not a good rendering of the English “substance”.

35. Mr. ZANKER (Observer for Australia) said that he hoped the proposal of the United Kingdom to change “to the other party” to “any other party” in both the first and second sentences, to take account of situations in which there were more than two parties involved in the conciliation proceedings, would be given consideration.

36. The CHAIRMAN said that there seemed to be a consensus on making that change proposed by the United Kingdom and on amending the title to align it with the title of article 10 of the UNCITRAL Conciliation Rules.

37. *It was so decided.*

Draft article 10. Duty of confidentiality

38. Mr. KOVAR (United States of America) said that the mediation community in the United States was enthusiastic about the Model Law but had expressed reservations about draft article 10. The crux of the problem was expressed in the title “Duty of confidentiality”. Under United States tort law a breach of that duty would result in liability. And since the definition of conciliation

in article 1, paragraph 2, was very broad, article 10 might create a trap for those who had engaged in conciliation so informal that they were unaware that it was covered under the Model Law and might unwittingly breach the duty of confidentiality.

39. His delegation therefore proposed that the opening phrase “Unless otherwise agreed by the parties” should be changed to “Whenever agreed by the parties”. That amendment altered the situation to one in which parties must agree before assuming the duty of confidentiality. Confidentiality was indeed central to the Model Law, but the most critical confidentiality issues were those dealt with in draft article 9 on disclosure to parties through the conciliator and draft article 11 on the admissibility of evidence in other proceedings.

*The meeting was suspended at 4.25 p.m.
and resumed at 5 p.m.*

40. Mr. BARSY (Sudan) proposed inserting the words “Subject to article 9” at the beginning of article 10. That would remove any possibility of conflict between articles 9 and 10. He also proposed replacing “information relating to the conciliation proceedings”, by “information relating to the dispute”, which was a wider formulation similar to the one used in draft article 9, and would ensure harmony between the two articles.

41. Mr. JACQUET (France), commenting on the proposal by the United States representative, said he thought the fears expressed were exaggerated and the proposed remedy would be worse than the evil it was supposed to correct. It was true that according to the present wording of draft article 10, conciliators could not be released from their duty of confidentiality except by an express agreement between the parties. However, the Model Law did not impose any sanctions for a breach of confidentiality. The only sanctions available were those found in national law, where liability would most probably arise from the contract between the parties. Draft article 10 would then be only one of the factors involved in determining the gravity of a breach of confidentiality. Moreover, the duty of confidentiality was only one of a number of obligations with which a conciliator must comply, and which were not sanctioned by the Model Law.

42. The representative of the United States was anxious to protect the interests of the conciliators, which was understandable, but the law of conciliation was designed for the parties as well as for the conciliators. If conciliators were exempted from any duty of confidentiality, the parties could justifiably object that they had a right to expect information to be kept confidential. All the existing rules on conciliation stated the duty of confidentiality in express terms, and it would be odd if the Model Law, which would take pride of place for international purposes, were to exclude the requirement, however small the risk that a conciliator would pass on information acquired in the course of his duties. Since the United States representative took the view that it was the language of draft article 1 which was lacking, the rule of confidentiality should be placed there, rather than in draft article 10.

43. Mr. MIKI (Japan) supported the proposal by the representative of the United States. He shared his concern that the language of draft article 1 was too broad and vague, and tended to minimize the duty of confidentiality.

44. Mr. JOKO SMART (Sierra Leone) said that apart from the two exceptions stated in draft article 10, the duty of confidentiality was absolute. There was no need for the additional phrase proposed by the United States representative.

45. Mr. MÖLLER (Observer for Finland) said he shared the concern of the United States that the definition of conciliation in the Model Law was too broad for the purpose of framing a duty of conciliation. However, he doubted the wisdom of the proposed

solution. In most cases where parties resorted to conciliation to resolve a dispute amicably, they did so on the assumption that information would be kept confidential, but that undertaking was usually an implied rather than an express term of their agreement. Making it explicit would mean that in the absence of an agreement to that effect, there would be no duty of confidentiality.

46. One solution might be to delete draft article 10 altogether. However, confidentiality was an absolute requirement and the Model Law ought to contain some kind of provision for it. In most national legal systems, the risk of a conciliator incurring civil liability for disclosing information about a dispute was relatively slight, and the conciliator would have to be aware that his or her actions had been in that capacity.

47. The addition proposed by the United States was difficult to accept, because it would require the express agreement of the parties to preserve confidentiality, and when the need arose the parties would not necessarily know they had entered a conciliation process. He suggested either deleting the words "Unless otherwise agreed" or finding an alternative formulation.

48. Mr. MORÁN BOVIO (Spain) said the proposal by the representative of the Sudan to tie draft article 10 to draft article 9 could be useful, because it would place draft article 10 in the proper context. As for the proposal by the United States delegation, there was no doubt in anyone's mind that the duty of confidentiality was primordial. That being so, he favoured the proposal to insert the words "Whenever agreed by the parties" at the beginning of draft article 10, because those words alerted the parties to the need to take a clear position on confidentiality and would thus have the effect of strengthening it. The parties would state the duty of confidentiality in their agreement, and would in turn convey it to the conciliator.

49. Mr. HUNTER (Observer for the International Council for Commercial Arbitration) wondered if the concern expressed by the United States could be alleviated by including, in a second paragraph of draft article 10, a statement that nothing in that article would create any liability in relation to the conduct of a mediator in connection with the duty of confidentiality.

50. Mr. GETTY (United States of America) explained that his delegation was not concerned by the liability of conciliators. According to the language it proposed, conciliators in breach of an agreement not to divulge information concerning a particular dispute would be liable. Rather, its concerns were twofold. Firstly, a party to the mediation who did not know that the law made the presumption of confidentiality could be liable if he or she told a friend or neighbour about aspects of the conciliation. Secondly, in view of the broad definition of conciliation given in draft article 1, any third party invited to participate in a discussion with a view to resolving a dispute could unwittingly become subject to liability in relation to the duty of confidentiality. Even businessmen chatting over dinner could find themselves liable to a duty of confidentiality, without intending to enter into an official conciliation process. The amendment proposed by his delegation would shift the focus to protect inadvertent parties.

51. The CHAIRMAN explained the difference between draft articles 9 and 10. Whereas the former applied solely to conciliators, establishing rules governing their right to disclose information received from one party to the other, the latter article had been added by the Working Group in order to bind all the parties to a dispute to a duty of confidentiality.

52. Mr. COSMAN (Canada) said that his delegation reserved its right not to take a final decision on the amendment proposed by the United States delegation until clarification was given of whether the duty of confidentiality established by draft article 10

was intended to apply to all of the parties or just to the conciliator. In the light of the comments made by the Chairman, he assumed that the intention was to refer to all parties.

53. The CHAIRMAN suggested that the current text of draft article 10 should be approved, in the absence of clear support for the amendment proposed by the United States representative.

54. Ms. MOOSA (Singapore) said she shared the concern that draft article 10 was not explicit enough regarding the persons to whom the duty of confidentiality applied. In her understanding, it referred to all parties receiving information pertaining to a dispute, which might include conciliators, members of conciliation panels or institutions, as well as all parties to a dispute, and words to that effect should be inserted into the text.

55. The CHAIRMAN said that the current wording of the text would be retained, with the exception of the removal of the clause "unless otherwise agreed by the parties". The concerns expressed by the delegations of the United States of America and Singapore could be considered in the Guide to Enactment. He confirmed that the Working Group envisaged that draft article 10 should refer to all of the parties involved in a dispute.

56. Mr. KOVAR (United States of America) expressed surprise at the conclusion that an agreement had been reached to remove the opening clause of draft article 10. There had not been a very careful discussion of the possible consequences of that step, and only one delegation had expressed its support for the proposal.

57. He emphasized the importance of the concern raised by his delegation regarding the liability of unwitting conciliators. During drafting of the United States Uniform Mediation Act, similar concerns had been expressed over the strict regulation of an essentially informal process. He failed to understand the purpose of draft article 10, other than to create liability for breach of the duty of confidentiality.

58. The Uniform Mediation Act included a precise definition of conciliation, in order to make clear to the parties involved at what stage they could be considered to have entered a process with legal consequences. It established three alternatives for the commencement of a formal conciliation process: agreement by the parties in writing (in electronic format or otherwise), a court order to enter into conciliation or a request by the parties to engage the services of a known professional conciliator. When the general definition of conciliation had been formulated for the draft Model Law, the implications on legal liability for breach of confidentiality had not been taken into account. He reiterated his disappointment that a more sustained effort had not been made to find a solution to a problem which, for his delegation, constituted a serious obstacle to implementing the Model Law.

59. The CHAIRMAN said he had responded to the concerns of the United States delegation by holding consultations with the various representatives. However, in the absence of clear support for the proposed amendment, its concerns should not affect the main text, but would be considered thoroughly in the Guide to Enactment. Nevertheless, he invited the representative of the United States of America to continue consultations on the issue, and offered his support for those discussions. With regard to the removal of the clause "unless otherwise agreed by the parties", the tendency of the Commission since the consideration of draft article 8, in view of the provisions of draft article 3, was to remove such references. Three delegations had specifically indicated their support for that step and none had opposed it.

60. Mr. JACQUET (France) agreed with the United States representative that there had not been sufficient discussion of the implications of removing the opening clause from draft article 10. There was a difference between the provisions of draft article 3

and the insertion of the clause “unless otherwise agreed by the parties”. Draft article 3 was intended for parties wishing to take a formal decision at the outset not to apply certain provisions of the Model Law. The clause “unless otherwise agreed by the parties”, however, could refer to agreements made during the course of conciliation proceedings. Therefore it was important to provide parties with the specific option to remove the duty of confidentiality at any time during proceedings.

61. Acknowledging the problem pertaining to the definition of conciliation, he said it was nevertheless impossible to satisfy the concerns expressed, because the definition given in the draft Model Law was descriptive, rather than prescriptive. It had been decided not to include specific provisions on the nature of the agreement to enter into conciliation. Consequently, there could be no conditions on what constituted conciliation.

62. Mr. GARCÍA FERAUD (Observer for Ecuador) said that the question of confidentiality had already been discussed at length in the Working Group, and that the clause “unless

otherwise agreed by the parties” had appeared in the text since the initial drafts.

63. Mr. KOVAR (United States of America) suggested that the drafting group might remove the word “duty” from the heading of draft article 10, given that it had strong connotations relating to liability, and insert the word “formal” before “conciliation proceedings”, to make it clear that dinner-table discussions would not have legal consequences.

ELECTION OF OFFICERS (*continued*)

64. Mr. HEGER (Germany), speaking on behalf of the Group of Western European and Other States, nominated Mr. Morán Bovio (Spain) for the office of Rapporteur.

65. *Mr. MORÁN BOVIO (Spain) was elected Rapporteur by acclamation.*

The meeting rose at 6 p.m.

Summary record of the 743rd meeting, held at United Nations Headquarters on Wednesday, 19 June 2002, at 10 a.m.

[A/CN.9/SR.743]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.20 a.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (*continued*)

Draft article 11. Admissibility of evidence in other proceedings

1. The CHAIRMAN said that the United States delegation had asked for further discussion of draft article 10 of the Model Law to be deferred to allow that delegation to continue consultations and propose wording that satisfied all the delegations and observers. He proposed to move on to consider draft article 11 and invited comments, beginning with the first paragraph of that article.

2. Mr. INOUE (Japan) said that his comment centred on the range of third persons referred to in paragraph 1 of draft article 11. While paragraph 61 of the draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/514) suggested that such “third persons” were only those involved in the conciliation proceedings, paragraph 1 of draft article 11 suggested that “third persons” referred to a wider circle, not just those involved in the conciliation proceedings. Paragraph 1 also provided that, unless the parties agreed otherwise, all third persons’ evidence was inadmissible in another forum, whether they were involved in the conciliation proceedings or not. He interpreted that as meaning that the parties could agree to make inadmissible the evidence of persons who, for

example, coincidentally happened to know the content of the conciliation procedure. He therefore suggested that the phrase “or a third person” should be moved from its current location in paragraph 1 and be inserted after the first clause of that paragraph, so that it read “Unless otherwise agreed by the parties, a party or a third person that participated in the conciliation proceedings ...”.

3. Mr. SEKOLEC (Secretary of the Commission) explained that the phrase “or a third person” had originally been inserted to cover third persons—for example, administrative staff or experts—participating in conciliation proceedings, but not considered actual parties to those proceedings. He said that not much thought had been given to the location of the phrase at that time and agreed with the delegation of Japan that it could be moved.

4. The CHAIRMAN said that the change suggested by the delegation of Japan appeared to make the wording of paragraph 1 clearer and asked if there were any objections to adopting it.

5. Ms. MOOSA (Singapore) said that her doubts over the Japanese proposal related to whether or not it covered bodies such as conciliation institutions, which often provided facilities and acted as depositaries for documents, including conciliation agreements. They were not themselves participants in conciliation, and she wondered if the intention was for paragraph 1 to apply to them regardless.

6. The CHAIRMAN pointed out that the concern raised by the delegation of Singapore was not so much connected with the suggested change but with the text itself. To his recollection, when paragraph 1 was being drafted, the possibility raised by the representative of Singapore was not even contemplated.

7. Mr. MARSH (United Kingdom) asked whether his delegation had correctly assessed the impact of the Japanese proposal. If, for example, a party involved in a conciliation proceeding acquired information and relayed it to a third party not involved in that conciliation proceeding, he wondered if that third party would then be entitled to introduce the information into other proceedings. If that was indeed the case, his delegation would be concerned at the narrowing of the scope of inadmissibility, as it believed that the emphasis was not so much on the third parties, as on the information. He stressed that paragraph 5 of draft article 1 would apply in any event.

8. Mr. SLATE (Observer for the American Arbitration Association) said he wished to take up the issue of institutions' connection with conciliation proceedings. In arbitration, it was increasingly common for the personnel of arbitral institutions to be subpoenaed, or for documents to be sought, when an arbitration ended up in court. Accordingly, the inclusion of language to cover personnel involved in a proceeding or documents filed with an institution might be advisable, to extend protection to them.

9. Mr. SHIMIZU (Japan) said that, to clarify the purpose of his delegation's proposal, he wished to emphasize that the intention was not to change the substance of what had been agreed in the Working Group. He had inferred from the last sentence of paragraph 61 of the draft Guide that the phrase "or a third person" was simply intended to include individuals such as witnesses or experts in the scope of paragraph 1 of draft article 11. That being the substance of the issue, he felt that the language of paragraph 1 would be clearer if the phrase in question was moved. A further argument in favour of such a change was that it would be difficult to explain, in terms of contract law, why a third person uninvolved in any way with a conciliation proceeding should be bound by what was agreed between the parties in that conciliation proceeding. Moving the phrase "or a third person" would make it clear that the "third person" in question had to be a participant.

10. Mr. GILLEN (Observer for the International Cotton Advisory Committee), referring to the issue raised by the delegation of Singapore, echoed Mr. Slate's view that individuals involved in nothing more than administering arbitration (in other words, not involved as parties) would often be called upon to appear before a tribunal at some later date, but that in the specific case of conciliation, there might be grounds for affording such administrative personnel some protection.

11. Mr. ZANKER (Observer for Australia), returning to the issue of the Japanese proposal, wondered whether the phrase to be moved within paragraph 1 should not be "or a third person, including a conciliator" rather than simply "or a third person", in order to adhere more closely to the logic of that proposal. The other observations regarding individuals peripherally involved in a conciliation proceeding might be accommodated by adding to the amended phrase wording along the lines of "or a third person that participated in, or was associated with the administration of, the conciliation proceedings", so that they would be covered by the privileges set out in paragraph 1, subparagraphs (a)-(f), of draft article 11.

12. Mr. GETTY (United States of America) endorsed the representative of Singapore's suggestion of including conciliation institutions in paragraph 1. With regard to the issue of moving the phrase "or a third person" to another location within the existing paragraph 1, his delegation believed that the Commission needed to be as broad and inclusive as possible. Retaining the existing

wording was the best way of averting the risk that information relayed to a third party not a party in, or not present at, a conciliation proceeding might later be used or be required to be used by virtue of that third party not being an actual participant in the conciliation.

13. Mr. LEBEDEV (Russian Federation) said that his impression from listening to the opinions of the delegations of the United Kingdom and United States was that the Japanese proposal had implications of substance; it was not just cosmetic. As it stood, paragraph 1 meant that a party that was not a direct participant in a conciliation proceeding could not rely on evidence acquired from that conciliation proceeding and that no court or tribunal could therefore accept such evidence. The current wording was very broad; the risk of accepting the Japanese proposal was that the wording would become more restrictive, applying only to third parties that took part in the conciliation proceeding.

14. Before adopting or rejecting that proposal, he thought it wise for the Commission to exercise some forethought and decide what it wished paragraph 1 to achieve, how it wished the provision to be used and to whom it wished it to apply (to any third parties or only to third parties involved in the conciliation proceeding). If the desire was to restrict its scope, then the Japanese proposal should be accepted as entirely logical. If the desire was to give it the widest possible scope, the existing wording should be retained.

15. Mr. BARSY (Sudan) said that the goal was to protect the information and views presented during conciliation proceedings. The phrase "or a third person" should be retained, but a limit could justifiably be placed on which third persons were covered, depending on how they obtained information: in the instance in question, information received by submitting it during a conciliation proceeding.

16. The CHAIRMAN said his impression was that the members of the Commission favoured applying the provisions of paragraph 1 to any third party in receipt of information about a conciliation procedure, whether or not that third party had been a participant. That would include personnel of institutions that administered conciliation proceedings. If he heard no objections, he would take it that the existing wording was considered approved and the drafting group would be entrusted with formulating wording that expressed the Commission's view.

17. Ms. BRELIER (France) questioned the wisdom of leaving the matter in the hands of the drafting group, because the Japanese proposal had implications not just of form but also of substance.

18. Mr. HOLTZMANN (United States of America) requested that consideration should be given to replacing the phrase "party to the conciliation" in the English version of paragraph 1 (b) of draft article 11 with the phrase "party in the conciliation", to correct what appeared to be a typographical error.

19. The CHAIRMAN, responding to the comment made by the representative of France, said that the Commission could waste a great deal of time on drafting when it was the drafting group that had a clear mandate to perform that task. Whatever it proposed subsequently returned to the Commission for review. The solution was not being adopted to delegate a task to the drafting group but to make more rational use of the Commission's time. Responding to the comment made by the representative of the United States, he said that he and the Secretary of the Commission would examine the typographical error.

20. Mr. SEKOLEC (Secretary of the Commission) said that what the drafting group would be discussing was not the Japanese proposal (though it was consistent with the history of the provision),

but the substantive decision to broaden the scope of paragraph 1 to encompass parties to a conciliation proceeding, other participants in a conciliation proceeding and parties that, while not participants in a conciliation proceeding, were connected with it in some other way.

21. Mr. MORÁN BOVIO (Spain) agreed with the assessment of the discussion made by the Chairman and by the Secretary of the Commission and with the decision to leave the matter to the drafting group, which had a clear mandate and which would in any event be reporting back to the Commission.

22. *Paragraph 1 of draft article 11 was provisionally approved.*

23. The CHAIRMAN said that paragraph 2 of draft article 11 was a corollary of paragraph 1 and was intended to allow for the inclusion of information submitted orally or electronically.

24. *Paragraph 2 of draft article 11 was provisionally approved.*

25. The CHAIRMAN invited comments on paragraph 3, which referred to the use of the information in question by courts and tribunals and had also been discussed at length by the Working Group.

26. Ms. MOOSA (Singapore) requested clarification of the word “law” in the last sentence of paragraph 3, asking whether the intention behind it was to include court orders mandating disclosure of information. If that was indeed the case, her delegation would have concerns over the word itself and over the policy. Its view was that “law” should refer only to written law or legislation.

27. The CHAIRMAN said that his view, in the light of the first part of paragraph 3, was that “law” referred to a statute or written law. He hoped that if this interpretation was not correct, a member of the Commission would clarify it. If the matter caused a problem, it could be dealt with in the Guide.

28. Mr. REYES (Colombia) asked for the drafting group to consider replacing the two occurrences of the word “*revelar*” in the Spanish version of paragraph 3 with the word “*divulgar*”. The request was made in the interests of consistency with decisions made regarding the same concept when the Commission had discussed article 9 of the draft Model Law (A/CN.9/SR.742).

29. Mr. SEKOLEC (Secretary of the Commission) requested Commission members to mark foreign language changes by hand and submit them to the drafting committee.

30. *Paragraphs 3, 4 and 5 of draft article 11 were provisionally approved.*

Draft article 12. Termination of conciliation

31. The CHAIRMAN said that the draft article was based on practice and on the rules of arbitral institutions.

32. Ms. MOOSA (Singapore) suggested adding a catch-all phrase to cover less formal situations, such as an oral agreement between the parties, abandonment of the conciliation proceeding by one party or an apology tendered by one party and accepted by the other.

33. Mr. HOLTZMANN (United States of America), agreeing with the representative of Singapore, suggested that the word “written” should be deleted from subparagraphs (b), (c) and (d), since the requirement of a formal written statement was not specified elsewhere in the draft Model Law.

34. Mr. ZANKER (Observer for Australia) supported the United States proposal to delete “written” but wondered whether another subparagraph should be added to cover termination by abandonment and other developments which occurred at the parties’ initiative rather than through the participation of a third person.

35. Mr. REYES (Colombia) supported the proposals made by the delegations of Singapore and the United States, noting that, elsewhere in the draft Model Law (for example, in draft article 10), there was no explicit reference to written declarations and that other possibilities were covered by the phrase “by any other means”.

36. As for the title of the draft article, it would be more consistent with the rest of the draft Model Law to say “termination of conciliation proceedings”. In his country a distinction was drawn between a conciliation (or conciliation hearing), in which the parties met in an effort to arrive at a conciliation and forge a settlement, and the actual conciliation proceedings, which began with the submission of a written or oral request.

37. Mr. MORÁN BOVIO (Spain) agreed with the proposal by Singapore and the suggestion by the United States for implementing it; however, the deletion of the word “written” should not preclude recourse to written, or even notarized, declarations if warranted. The deletion of “written” also addressed the reservations expressed by the observer for Australia.

38. He supported the proposal by the representative of Colombia concerning the title of the draft article, which would bring it into line with the rest of the text. The same change should be made to the current English title “Termination of conciliation”.

39. The CHAIRMAN said that the distinction between conciliation and conciliation proceedings was not completely clear, since both terms implied some sort of settlement.

40. Mr. MÖLLER (Observer for Finland) expressed support for deleting the word “written”, even though it might have been stated expressly in previous arbitration or conciliation rules; after all, the thinking had since evolved. He was reluctant to make any further changes; for example, specifying that the conciliation had been reached through “conduct” could give rise to other problems.

41. Mr. SEKOLEC (Secretary of the Commission) suggested that the Commission should consider the consequences of a decision to allow termination by other means—such as an oral agreement, conduct or abandonment—in the wider context of articles 9, 10 and 11 or in a situation where the enacting State was contemplating suspension of the limitation period. While the conciliation rules were for the most part very flexible, the Working Group had felt that a written declaration was necessary in draft article 12 to establish absolute certainty that the proceedings had been terminated.

*The meeting was suspended at 11.25 a.m.
and resumed at 12.10 p.m.*

42. The CHAIRMAN said that, following informal consultations, most delegations appeared to favour the United States proposal but that views had been expressed on other aspects of the draft article.

43. Mr. JACQUET (France) said that, while his delegation would join the consensus on the United States proposal, its support would be less than enthusiastic. Drawing attention to subparagraph (d), he said that, where a conciliation clause had been inserted in a contract, both parties were required to make some minimum effort at conciliation; thus, a party should not be

allowed, by a mere oral declaration, to terminate proceedings that had not even begun. To avoid that undesirable eventuality, he proposed adding the words “within a reasonable time period” after the words “other party” (which was preferable to permitting the obligation to be discharged through a single meeting of the parties).

44. Mr. HEGER (Germany) said that his delegation, too, would support the United States proposal in a spirit of consensus but that it would have preferred to retain the word “written” in order to pre-empt suspension of the limitation period, which was a well-known consequence in German law.

45. Mr. LEBEDEV (Russian Federation) pointed out that the Working Group had opted, after meticulous discussions, to specify “written declarations” not only because of the wider consequences referred to by the Secretary of the Commission but also in relation to article 14, which dealt with the impossibility of initiating judicial or arbitral proceedings where the parties had already reached an agreement in conciliation proceedings. A clear-cut written declaration would be particularly important in the cases set out in subparagraphs (b), (c) and (d), where the parties could not reach an amicable settlement and judicial or arbitral proceedings would necessarily be the next step.

46. If the Commission decided to delete the word “written”—even though most Commission members were also Working Group members and had previously agreed on the importance of the term—it was highly likely that individual States, in adopting the Model Law, would find it necessary to reinstate it. That would certainly be the case for his delegation.

47. In subparagraph (d), an indication of absolute certainty would also be necessary in cases where, as the observer for Australia had hypothesized, one of the parties was persistently passive (for example by not responding to letters and otherwise remaining silent) and hence the declaration of termination was, in effect, a unilateral statement by one party.

48. Mr. MARADIAGA (Honduras) said that he wished it to be placed on record that he was not convinced it would be appropriate to eliminate the word “written”. Under Germanic Roman law much importance was placed on the existence of a document that faithfully reflected the content of agreements.

49. Mr. GRAHAM (Mexico) said that even though his delegation had agreed that the word “written” should be deleted, it assumed that professionals in conciliation proceedings would normally wish to ensure that a written declaration was made.

50. With regard to the concept of abandonment of proceedings, he suggested that slight adjustments could be made to subparagraphs (b) and (d) to take the reasonable intent of parties to carry out consultations into consideration, without the need to insert an additional subparagraph. In his opinion, subparagraphs (b), (c) and (d) already provided an adequate structure and clearly identified the three variants.

51. Mr. HOLTZMANN (United States of America), in reference to the issue of abandonment of conciliation proceedings or conduct of parties, said that one possible solution would be to leave the word “written” in subparagraphs (b), (c) and (d) and to insert a subparagraph (e) referring to the conduct of the parties in the event that one or more parties considered the conciliation terminated. If that additional subparagraph were not inserted, then the word “written” should in fact be deleted from subparagraphs (b), (c) and (d).

52. With respect to the suggestion made by the representative of France on contractual agreements requiring parties to conduct

conciliation proceedings for a period of time, he said that the parties to a dispute had the option to make such contracts, at their discretion, but he believed that it would not be appropriate for the draft Model Law to attempt to specify such time periods. In order for conciliation to be effective, all parties must have the will to ensure that it produced positive results; otherwise, the exercise would prove futile.

53. Commenting on the German delegation’s support for retaining the word “written” in subparagraphs (b), (c) and (d), he said his delegation agreed that there was often a need to precisely state the timing of termination, in particular for States that had adopted article X, the footnote article to article 4. Likewise, there was also a need for precision in the definition of the commencement of proceedings. He hoped that the draft Guide to Enactment would point out that States wishing to adopt article X should give careful consideration to precisely defining the commencement and termination of proceedings.

54. The representative of the Russian Federation had pointed out that although subparagraph (b) required that the conciliator should consult with the parties, the provisions of that subparagraph would cease to operate in the event that one of the parties refused to appear for consultation. His delegation believed one possible solution would be to replace the phrase “after consultation with the parties” with “after inviting the parties to conciliate”.

55. Mr. MÖLLER (Observer for Finland) welcomed two of the United States proposals: firstly, that subparagraph (b) should be amended, inviting the parties to conciliate; and secondly, that the Model Law should not specify a time period for conciliation. However, his delegation strongly opposed the addition of subparagraph (e) if the word “written” were to be retained, as that would lead to the potential difficulties as raised earlier by the Secretary of the Commission.

56. Mr. BARSY (Sudan) said that the word “written” in subparagraphs (b), (c) and (d) was very important because it gave precision to the termination of the conciliation proceedings. Moreover, the suggestion with respect to inviting the parties to consult could pose certain difficulties. For instance, undue delays could arise in the event that communications inviting the parties to such consultations did not reach their intended destination in a timely fashion.

57. The CHAIRMAN said that in spite of some objections expressed by delegations, the prevailing view was that the word “written” should be deleted. On the other hand, the proposal to add a subparagraph on conduct of the parties had not garnered much support, even though there was some concern for situations in which one of the parties to a dispute might refuse to cooperate with the proceedings. In that regard, discussion was expected to continue on the proposal that subparagraph (b) should be modified to enable a conciliator or panel of conciliators to invite the parties to hold consultations.

58. Moreover, one comment had been made to the effect that, in the presence of a conciliation agreement, proceedings could not be terminated before a minimum period had elapsed and a certain amount of effort had been exerted. In reaction to that comment, it had been suggested that the consequences of the failure to comply with a conciliation agreement related to contract law and therefore fell outside the purview of the draft Model Law.

59. Mr. MARKUS (Observer for Switzerland) said he wished to endorse the views expressed by the observer for Finland and especially to state his strong opposition to the addition of a subparagraph on conduct or abandonment of proceedings. Furthermore, he favoured the deletion of the word “written”. It was

important to find a middle ground between excessive formality and uncertainty. He entirely agreed with the idea of maintaining consistency throughout the Model Law: if it were determined that time limitations should be specified with respect to the termination of proceedings, then a similar clause should be introduced in article 4.

60. As for the French proposal, if an agreement had been reached, article 14 might appropriately have been used to enforce such agreement. Otherwise, it would be impossible to force parties to meet if either party was unwilling to do so.

The meeting rose at 1 p.m.

**Summary record of the 744th meeting,
held at United Nations Headquarters on Wednesday, 19 June 2002, at 3 p.m.**

[A/CN.9/SR.744]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 3.15 p.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION** (*continued*)

Draft article 12. Termination of conciliation (continued)

1. Mr. JACQUET (France) said that he understood the concern that the reasonable period of time proposed by his delegation with regard to draft article 12, subparagraph (d), was unacceptable, since it was a matter for the contract, not for the draft Model Law. However, in his view, it was unwise to make such a clear distinction between the contract between the parties establishing conciliation and the conciliation process covered by the draft Model Law. There were two situations in which parties could abandon conciliation, presenting an irritating problem for the draft Model Law. Firstly, if a party refused to participate from the outset, draft article 4 provided for a failure to respond to an invitation within 30 days to be treated as a rejection of the invitation to conciliate, without elaborating on the consequences of rejection. Secondly, if a party abandoned without warning a process that had already begun, the situation would be covered by the provisions of draft article 12, subparagraphs (b) or (d). The proposal by the observer for Finland to insert the words “after inviting the parties to conciliate” into subparagraph (b) was superfluous, because draft article 4, rather than draft article 12, would contain the relevant provisions if conciliation had never even begun.

2. The CHAIRMAN said that there was a consensus to retain the version of draft article 12 formulated by the Working Group, with the exception of removal of the word “written”. The Guide to Enactment would contain an explanation that the consequences of failure to fulfil an agreement to conciliate would derive from the law applicable to that agreement. The Finnish proposal to amend subparagraph (b) was likely to create confusion in the light of the identical provisions of article 15 of the UNCITRAL Conciliation Rules.

3. *Draft article 12 was provisionally approved.*

Draft article 13. Conciliator acting as arbitrator

4. Mr. ZANKER (Observer for Australia) said that the clause “unless otherwise agreed by the parties” was superfluous. In line with the practice followed in previous articles, it should be removed.

5. Mr. MARSH (United Kingdom) said that the description of “another dispute that has arisen from the same contract or any related contract” was slightly too narrow. It was possible for another dispute to arise from the same factual situation, without necessarily having any contractual relationship, in accordance with the provisions of draft article 1, paragraph 2, which referred to disputes relating to a contractual or other legal relationship.

6. Mr. SHIMIZU (Japan) asked whether the words “another dispute” referred to disputes between the same or different parties.

7. The CHAIRMAN explained that the Working Group intended the words “another dispute” to cover disputes between the same as well as different parties.

8. Mr. TANG HOZHUI (China) said that, in the view of his delegation, the words “unless otherwise agreed by the parties” were extremely important. It should be possible for parties, having failed to reach a settlement after conciliation, to agree to pursue the process with the same person as arbitrator. The draft Model Law should respect the right of the parties to make such private agreements. If draft article 13 could not be retained in its entirety, it should be deleted altogether.

9. The CHAIRMAN explained that the deletion of the clause “unless otherwise agreed by the parties” did not mean that draft article 13 was therefore mandatory. The provisions of draft article 3, allowing parties to vary the text by agreement, could still be applied. He asked delegations to bear in mind that such changes were merely cosmetic.

10. Mr. HOLTZMANN (United States of America), supporting the view expressed by the representative of China, said that it was useful to remind parties of their right to vary the provisions of draft article 13 by agreement, instead of requiring them to discover that right by reading a different article. It was particularly important for China, given that in hundreds of cases each year under its jurisdiction, arbitration was combined with a conciliation in the same procedure. That process lay at the core of dispute resolution in China and played a key role in facilitating international trade. Moreover, the current version of the text had after all been established following detailed discussion in the Working Group, and no strong reasons had been offered to justify changing it.

11. In response to the point made by the representative of the United Kingdom, he suggested amending the text to read “another dispute that has arisen from the same or related contract or legal relationship”.

12. Mr. RENDÓN (Mexico) asked whether it was advisable to change the wording of article 19 of the UNCITRAL Conciliation Rules in the formulation of draft article 13. While they were almost identical in other respects, the words “or as a representative or counsel of a party in any arbitral or judicial proceedings” had been omitted from the current version of draft article 13.

13. The CHAIRMAN said that, while he failed to recall the reason for the omission, the matter had been properly discussed in the Working Group.

14. Mr. REYES (Colombia) agreed that there should be a good reason for departing from the wording of article 19 of the UNCITRAL Conciliation Rules in draft article 13. Moreover, the heading of draft article 13 was inappropriate. Rather than “Conciliator acting as arbitrator”, the heading should be closer to “Ineligibility of the conciliator as arbitrator”, since the current heading did not reflect the content of the article.

15. The CHAIRMAN said that paragraphs 117 and 118 of the report of the Working Group on its thirty-fifth session (A/CN.9/506) contained an explanation for the omission of the words referred to by the representative of Mexico.

16. Mr. GARCÍA FERAUD (Observer for Ecuador) said that even though article 3 allowed for the possibility of changing the rules, the phrase “unless otherwise agreed by the parties” should still be included in other articles. Although draft article 13 established a general rule to the effect that the conciliator should not act as an arbitrator, the fact was that, in practice, an agreement by the parties to allow a conciliator to become an arbitrator would be an indication of their confidence in the conciliator’s competence and ethical behaviour. With regard to the incompatibility of dealing with matters pertaining to the same contract or any related contract, it might be useful to refer not only to the possible legal relationship with the matter previously dealt with in the conciliation process but also to the legal situation itself. He suggested that the last part of draft article 13 should read as follows: “in respect of another dispute that has arisen from the same contract or any other contract or legal relationship or situation”.

17. Mr. MORÁN BOVIO (Spain) pointed out that paragraph 117 of the report of the Working Group (A/CN.9/506) explained the reasons that had led the Working Group to adopt the present text of draft article 13. That text, including the phrase “unless otherwise agreed by the parties”, should be retained. The phrase might perhaps be extended with a reference to positive law, that is, a stipulation that the provision must be permitted by the applicable rules, since there might be cases in which the rules of the bar association or a similar organization would preclude the action envisaged. In any event, the opening phrase “unless otherwise agreed by the parties” should be retained.

18. His delegation agreed with the delegations of Ecuador, the United States and the United Kingdom that the scope of draft article 13 should be extended to cover not only the contract or any related contract but also any other legal relationship. That was particularly important since the first part of the draft article allowed for the possibility of the parties agreeing to allow the conciliators to continue as arbitrators, as appeared to be the tradition in China.

19. Mr. MÖLLER (Observer for Finland) said that the scope of draft article 13 should be limited to the matter of the conciliator acting as an arbitrator and not deal with the question of his acting

as a representative. For the sake of clarity, the phrase “unless otherwise agreed by the parties” should be retained. The suggestion made by the United Kingdom, to refer to “the contract or any related contract”, might be too narrow. One possibility would be to add, as suggested by the United States, the words “or legal relationship”. It might be better, however, to say “the same contract or any related contract” or “the same legal relationship”. He did not have strong feelings on the matter.

20. Mr. MARKUS (Observer for Switzerland) said that the draft article should focus on the arbitrator and not on the representative. With respect to the phrase “unless otherwise agreed by the parties”, he noted that there was broad support for leaving it in the text; however, he wished to stress that the reason he felt it should be deleted was that it could give the mistaken impression that there were two different degrees of party autonomy. The principle of party autonomy was a holistic one; the reader of the text might think that other articles not introduced by the phrase in question were more mandatory than, for instance, article 13. The issue could be resolved by leaving the phrase in draft article 13 but explaining in the Guide what was meant and why it had been retained, namely, only for the reasons explained by the United States delegation.

21. With respect to the United Kingdom proposal, he suggested that the text should refer to closely related disputes instead of contractual relationships and other legal relationships. That wording would cover both the contractual relationship and other closely related legal relationships. In some legal systems, there might also be a relationship between contracts and torts. He therefore suggested that the text should read as follows: “. . . conciliation proceedings or in respect of another dispute which is closely related to that dispute”.

22. Mr. MARSH (United Kingdom) said that his delegation was in favour of retaining the phrase “unless otherwise agreed by the parties”.

23. The CHAIRMAN noted that the Working Group had been strongly in favour of retaining the phrase “unless otherwise agreed by the parties”. There was also broad support for the United Kingdom proposal to change the ending of draft article 13 to read “of another dispute that has arisen from the same or a related contract or legal relationship”. As requested by the observer for Switzerland, the Guide would include an explanation of the relationship between draft article 13 and the provisions that included the phrase “unless otherwise agreed by the parties”. Reference would also be made to the practice in certain countries, such as China, where a conciliator could also act as arbitrator.

24. Mr. ZANKER (Observer for Australia) suggested that, instead of referring to disputes arising out of the same contract or any related contract or legal relationship, the text might simply refer to a dispute that had arisen out of the same factual circumstances.

25. Mr. BARSY (Sudan) said that the phrase “any related contract” was very broad; it would be better to change it to refer to any contract that might be related to conciliation or perhaps a contract already mentioned during conciliation. The phrase “of a dispute that was or is the subject of the conciliation proceedings” was not clear. Did it refer to a dispute between the same parties or between other parties? It would be better to say “in a dispute between the two parties in question”.

26. The CHAIRMAN, referring to the first point raised by the representative of the Sudan, pointed out that there had already been agreement to accept the amendment proposed by the United Kingdom. The second point raised by the Sudan had been considered by the Working Group, which had reached the conclusion

that the scope of draft article 13 should cover not just the parties to the dispute but also other parties. The matter had already been discussed at length.

27. *Draft article 13, as amended, was provisionally approved.*

Proposal submitted by China

28. Mr. TANG HOZHUI (China), drawing attention to original draft article 16 (A/CN.9/506, para. 130), entitled “Arbitrator acting as conciliator”, recalled that, although there had been no opposition to the content of that paragraph, the Working Group had deleted it and decided that an explanatory note would be included in the Guide. Some delegations had argued that the provision should be included in the model law on arbitration rather than in the one on conciliation. China did not agree with that position because at least four articles in the draft model law on conciliation mentioned arbitration; therefore, it could not be argued that arbitration was irrelevant.

29. In addition to China, there were some 20 or 30 countries whose domestic law and practices allowed arbitrators to act as conciliators in the process of arbitration, including Oriental as well as Western countries. The World Intellectual Property Organization (WIPO) and the Society of Maritime Arbitrators also allowed for such a possibility. There were many other countries that did not allow arbitrators to act as conciliators. Deleting the original draft article 16 (A/CN.9/506, para. 130) would not be conducive to the development and improvement of the law in those 20-plus countries, including China. His delegation suggested that, instead of treating the original article 16 as a formal article, it should be included as an optional article. It would thus be placed in a footnote as article Y.

The meeting was suspended at 4.30 p.m. and resumed at 5.10 p.m.

30. Mr. MILASSIN (Hungary) said that his delegation was willing to support the Chinese proposal to reintroduce former draft article 16 as a footnote to the present draft article 13, even though it dealt with an arbitration situation. In Hungary, as it happened, the national rules governing conciliation fell within the rules of procedure of arbitral courts. Hungarians had little experience with conciliation but foresaw that it would be useful in the future.

31. Mr. JOKO SMART (Sierra Leone) said that initially his delegation had thought that a model law on conciliation was not the place to deal with the competence of a conciliator to act as an arbitrator. However, in view of the trend towards encouraging conciliation in the context of arbitration, his delegation would support the Chinese proposal.

32. Ms. MOOSA (Singapore) said that her delegation supported the Chinese proposal because it was consistent with her country’s legal framework on arbitration. The inclusion of the text of former draft article 16 would be a useful compromise.

33. Mr. MIKI (Japan) said that in earlier discussions his delegation had thought that the proper place for former draft article 16 was in a law on arbitration, not on conciliation, but it had no problems with the provision’s inclusion in a footnote. It would seem more appropriate, however, to place it in a footnote to article 1, paragraph 8 (a), which referred to the same situation, where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempted to facilitate a settlement.

34. Ms. GÖTH-FLEMMICH (Austria) said that her delegation had sympathy for the Chinese position but did not see how draft article 13 and former draft article 16 could appear in the same text, even with the latter in a footnote, since they were

contradictory. Perhaps a better solution would be to eliminate draft article 13. Countries that had adopted the UNCITRAL Model Law on International Commercial Arbitration would have no need for it; any party who did not wish to accept a former conciliator as an arbitrator could challenge the appointment.

35. The CHAIRMAN said that the two draft articles had been exhaustively debated in the Working Group, and there had been broad agreement that draft article 13 should be in the text.

36. Ms. CHADHA (India) said that her delegation supported the Chinese proposal because it suggested another mode in which an arbitrator might sponsor conciliation and was not inappropriate.

37. Mr. HOLTZMANN (United States of America) said that his delegation regretted that it must demur when so many delegations had spoken in support of the Chinese proposal. Former draft article 16 had been extensively discussed at both the thirty-fourth and thirty-fifth sessions of the Working Group on Arbitration and rejected as being out of place in a model law on conciliation. His delegation was concerned about having it included even in a footnote, because it could create traps for the unwary. Those countries that might consider incorporating it in their national legislation on conciliation should be aware of the potential hazards their nationals might encounter in other jurisdictions where the principle ran counter to national laws and codes of ethics. For example, the International Bar Association’s Rules of Ethics for International Arbitration provided that, if an arbitrator acted as a conciliator, the normal result would be that the arbitrator would become disqualified from any future participation in the arbitration. Such discrepancies might have the effect of discouraging international conciliation. His delegation felt that if the provision was to be left in at all, it should only be in the Guide to Enactment, accompanied by the appropriate caveats.

38. Mr. GRAHAM (Mexico) said that Mexican law had nothing to say about arbitrators acting as conciliators or vice versa. The wording of what was currently draft article 13 had evolved over time towards a more liberal interpretation. The rule that a conciliator should not later be an arbitrator in the same matter was not mandatory. The opening phrase, “unless otherwise agreed by the parties”, ensured that the option considered desirable by some other delegations was not excluded. However, the inclusion of text in a footnote setting forth a rule that dealt with the area of arbitration could create confusion.

39. Mr. HEGER (Germany) said the representative of Japan was correct in linking former draft article 16 with article 1, paragraph 8 (a); the two provisions were indeed about the same topic, but on examination they were contradictory. Draft article 1, paragraph 8 (a), stated that the Model Law did not apply to cases where an arbitrator attempted to facilitate a settlement, whereas former draft article 16 sought to formulate a rule for just such a situation.

40. Draft article 13 and former draft article 16 seemed to be contradictory in principle, even though they dealt with somewhat different situations. In draft article 13, the conciliator was barred from acting as an arbitrator in the same matter subsequent to failed conciliation proceedings, whereas former draft article 16 postulated the situation in China and some other countries where it was normal for an arbitrator, in the midst of arbitration proceedings, to act as a conciliator. However, as Mexico had pointed out, the rule in draft article 13 left room for flexibility, since it was preceded by the phrase “unless otherwise agreed by the parties”.

41. Mr. LEBEDEV (Russian Federation) emphasized the complexity of the problems raised by the Chinese proposal. The previous draft article 16 had been deleted from the text of the Model Law following discussion, at two previous sessions of the

Commission, of the difficulties it would cause. However, a large number of countries appeared to have a provision of that kind in their existing law, so there was no objection in principle to States incorporating such a provision when adopting the Model Law. The main problem currently was to find a compromise formula to reflect the provision in the text of the Model Law. To ignore it altogether would be the easy way out but would not square with the Commission's endeavours to find solutions acceptable to a majority of States. Like the representative of the United States delegation, he would prefer to place it in the Guide to Enactment. That would perhaps satisfy the interests of China and other countries in having the Commission adopt a text which reflected their own practice and which they could in future incorporate in their own law. It would not affect countries such as his own and India, whose arbitration law prohibited the practice of combining conciliation with arbitration.

42. Mr. JACQUET (France) acknowledged that the legal systems of a number of countries, in addition to China, admitted the practice of combining conciliation with arbitration. He was therefore sympathetic to the Chinese proposal and felt the Commission should strive for a synthesis that reflected as many trends as possible. However, the technique of including footnotes or optional articles was undesirable and should not be followed in the present instance because it would detract from the meaning and force of the Model Law. It was already clear that the minimalist approach of including in the Guide to Enactment a comment on the practice of combining arbitration and conciliation would be widely acceptable but not to China. The only other alternative would be a footnote to draft article 1. However, the former draft article 16 could not be reincorporated in that guise because it was a statement of a rule. Any footnote must be purely descriptive, indicating merely that some countries admitted the practice of combining arbitration and conciliation.

43. Mr. MARKUS (Observer for Switzerland) said he was reluctant to endorse the proposal to have the former draft article 16 included as a footnote either to article 1, paragraph 8, or to article 6, since that could cause problems for the scope of application of the Model Law. According to draft article 1, paragraph 8, the Model Law did not apply to cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempted to facilitate a settlement. That exclusion had been decided upon by the Working Group because, in such cases, the rules in the Model Law would be inappropriate. It did not however mean that conduct of that kind by an arbitrator would be prohibited. Local arbitration rules, or those of the International Bar Association, might prevent an arbitrator from acting as a conciliator, but the Model Law itself was completely neutral on the question. It would therefore be highly problematic to place the former draft article 16 in a footnote. To do so might also create a conflict with draft article 13. Moreover, the former draft article 16 was about arbitration, not conciliation, and did not belong in the Model Law. He therefore agreed with the United States representative that it would be best to deal with the problem in the context of the Guide to Enactment.

44. Mr. ZANKER (Observer for Australia) said he agreed with the remarks by the representative of the United States and the observer for Switzerland. He did not support the Chinese proposal.

45. Mr. CORREIA (Observer for Portugal) said he sympathized with the position of the Chinese delegation, but of two possible scenarios—a conciliator being prohibited to act subsequently as an arbitrator, and an arbitrator acting as a conciliator having already begun an arbitration procedure—the Model Law was concerned only with the first. When the former draft article 16 was under discussion, it had been decided not to include it in the Model Law for the very reason that it dealt with arbitration

proceedings. He therefore endorsed the views of the representative of France and the observer for Switzerland. Draft article 13 should be left as it was. He could however agree to the inclusion in the Guide to Enactment of a note explaining the practice of combining arbitration and conciliation, in the context of article 1, paragraph 8.

46. Mr. REYES (Colombia) said that in view of the rule in draft article 1, paragraph 8, a footnote along the lines proposed by China would prove confusing. For the sake of meeting the concerns of that delegation, he could support the proposal to clarify the problem in the Guide to Enactment, including a reference to draft article 1.

47. Mr. COSMAN (Canada) said there appeared to be a mistaken notion that his jurisdiction admitted the practice of combining mediation with arbitration; it did not. Nor did he support the notion of reviving the former draft article 16 in the form of a footnote.

48. Mr. MIRZAEI-YENGEJEH (Islamic Republic of Iran) said draft article 13 was a statement of a standard rule prohibiting the combination of two contradictory practices. He was attracted by the compromise solution suggested by the representative of France. A footnote could perhaps be included to draft article 13, merely stating as a fact that some countries did admit the practice. The title of draft article 13 should be reviewed by the drafting group. "Conciliator acting as arbitrator" seemed to be unsuitable wording, given that the purpose of the article was to prohibit conciliators from doing so.

49. The CHAIRMAN said the title would be reviewed by the drafting group.

50. Mr. MARSH (United Kingdom) said he agreed with the remarks by the United States representative, noting that they had been supported by other delegations. If a reference to the problem was included in the Guide to Enactment, the best place for it would be in the commentary to article 13, rather than the commentary to article 1. Article 1 dealt with the scope of application of the Model Law, not with matters of practice or what conciliators and arbitrators could and could not do.

51. Mr. BARSY (Sudan) said he could not support the Chinese proposal. The former draft article 16 ran directly counter to the provision in draft article 1, paragraph 8.

52. Mr. TANG HOZHAI (China) said he understood that the Commission had to take a neutral position on the question and was anxious to promote the development of international conciliation in commercial matters. However, to the best of his recollection, when the Working Group was discussing draft article 16 no objections had been raised to its content. The decision to leave it out of the Model Law had been made because the role of arbitrators was not supposed to be dealt with in the text. However, at least four of the draft articles did mention arbitrators, so there seemed to be no valid reason why they should not be mentioned as in the former article 16. To his knowledge, over 20 countries had an interest in the relationship between arbitration and conciliation. The two practices went hand in hand and should both be taken into consideration in the Model Law.

53. The CHAIRMAN said the matter had been thoroughly discussed in the Working Group, which had offered, as a compromise, to include in the Guide to Enactment a statement explaining that some countries allowed the roles of conciliator and arbitrator to be combined. It was not the Commission's policy to prohibit that practice.

The meeting rose at 6 p.m.

**Summary record of the 745th meeting,
held at United Nations Headquarters on Thursday, 20 June 2002, at 10 a.m.**

[A/CN.9/SR.745]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.15 a.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (*continued*) (A/CN.9/506, A/CN.9/513 and Add.1-2 and A/CN.9/514)

Article 10. Duty of confidentiality (continued)

1. The CHAIRMAN invited the Commission to resume consideration of article 10, which had been left pending.

2. Mr. KOVAR (United States of America) said that the title, "Duty of confidentiality", implied liability if confidentiality were breached, particularly when coupled with the very general definition of conciliation provided under article 1, paragraph 2. His delegation thus wished to propose a compromise solution that would reconcile his delegation's own concerns in respect of domestic implementation under common law with the Commission's desire to maintain strong confidentiality language. The words "Duty of" would be deleted, reflecting the title of article 14 of the UNCITRAL Conciliation Rules, and the following paragraph would be inserted in the draft Guide to Enactment (A/CN.9/514):

"It is the intent of the drafters that in the event a court or other tribunal is considering an allegation that a person did not comply with article 10, it should include in its consideration any evidence of conduct of the parties that shows whether they had, or did not have, an understanding that a conciliation existed and consequently an expectation of confidentiality. A State that enacts the Model Law may wish to clarify article 10 to reflect this interpretation."

3. The CHAIRMAN, urging the Commission to consider the proposal in a spirit of flexibility, said that it was traditional practice for it to seek imaginative solutions when a State expressed grave concern as to the acceptability of a provision within its national law.

4. Mr. MARSH (United Kingdom), after expressing overall support for the modifications proposed by the United States representative, said that he would be in favour of deletion of the final sentence, which appeared to suggest that the Model Law as drafted did not clearly reflect the intention of the drafters.

5. Mr. LEBEDEV (Russian Federation) said that his delegation was ready to accept the proposed change to the title, on the understanding that the conciliator and the parties were obliged to keep the conciliation proceedings confidential. It was indeed important to ensure that the result of the Commission's work was acceptable to a variety of legal systems, which was why he supported the text proposed for inclusion in the draft Guide. It was also important to retain the final sentence of that text, which merely indicated to enacting States that the matter might require further clarification.

6. Mr. MÖLLER (Observer for Finland), said that his delegation fully supported the proposed modifications and favoured retention of the final sentence, which could serve a useful purpose for certain States.

7. Mr. MORÁN BOVIO (Spain), joining with the previous two speakers, said that his delegation unreservedly supported the United States proposal. The sentence in question should be retained for inclusion in the Guide, since it clarified the lack of unanimity on the issue within the Commission and alerted States to the importance of dealing carefully with the precept.

8. Mr. GARCÍA FERAUD (Observer for Ecuador) said that he supported the change in title but was concerned that the proposed paragraph, as currently worded, might go beyond the proper purview of a model law. Since it was clearly aimed at arbitrators or judges who might be called upon to consider an act of breaking the obligation of confidentiality, it concerned procedures governed by other normative systems.

9. Ms. MOOSA (Singapore) said that she had no objection in principle to the proposal. The proposed text befitted the Guide, its intention being to draw the attention of States to the possible ramifications of the provision.

10. Mr. SHIMIZU (Japan) said that although his delegation had no objection to the proposal and welcomed the accommodating spirit in which it had been made, further clarification would be appreciated. Since the problem raised by the United States representative was evidently related to the broad definition of conciliation under article 1, the proposed text could be said to be applicable whenever there was a question of whether conciliation had taken place.

11. Ms. RENFORS (Sweden) welcomed the fact that the text was being proposed for inclusion in the Guide, not the Model Law itself. In the hope of accommodating the concerns expressed by the representative of the United Kingdom and the observer for Finland, her delegation wished to propose a modification of the final sentence as follows: "When enacting the Model Law, certain States may wish to clarify article 10 to reflect this interpretation."

12. Mr. KOVAR (United States of America) said that he had no objection to the modification proposed by the previous speaker. With regard to the question raised by the representative of Japan, his delegation had in fact suggested in connection with article 1, paragraph 2, that the Guide should include a reference to clarifying the circumstances in which a conciliation would be deemed to have existed. It felt particularly strongly that the point should be re-emphasized in respect of article 10.

13. Ms. BRELIER (France) proposed that the title of article 10 should read "Confidentiality of conciliation".

14. The CHAIRMAN said he took it that there was no objection to the revision of the title of article 10 as proposed by the United States representative and modified by the representative of France and that the Commission also agreed to include the text proposed by the United States representative in the draft Guide, as modified by the representative of Sweden. In the same article, the words "Unless otherwise" would be retained since there had been an objection to their deletion.

15. *It was so decided.*

Draft article 14. Resort to arbitral or judicial proceedings

16. Mr. GRAHAM (Mexico), referring to paragraph 2, proposed that the words “in its sole discretion” should be deleted to ensure that the initiation of arbitral or judicial proceedings was governed by objective criteria alone and that the protection provided in paragraph 1 was not rendered ineffective.

17. Mr. KOVAR (United States of America) said that it was unclear whether the party must comply with the court order. Revision of the standard contained in article 16 of the UNCITRAL Conciliation Rules had inadvertently given rise to ambiguity by creating such a strong juxtaposition between, on the one hand, the rights of the parties and, on the other hand, the role of the court or tribunal in enforcing the terms of an agreement to conciliate. The conflict between the two paragraphs would be eliminated if they were joined into one paragraph and the words “A party may nevertheless initiate arbitral or judicial proceedings where, in its sole discretion, it considers such proceedings necessary” were replaced with the following formulation: “except to the extent necessary for a party, in its opinion”. Such a modification might also address the concern raised by the previous speaker.

18. Mr. JACQUET (France) asked whether the first sentence of paragraph 2 could be understood as targeting juridical proceedings on the basis of a provisional or protective measure.

19. Alongside the rule that conciliators could not be arbitrators and the rule that conciliation must be confidential, the article under consideration embodied one of the most important principles at stake in the Model Law, namely that conciliation was incompatible with arbitral or judicial proceedings. It was regrettable that the rule was thus being presented in a truncated version. The original version (A/CN.9/506, para. 124) had contained an additional first paragraph to elucidate the general principle, but that paragraph had been deleted on the spurious grounds that it was “too broadly stated”. Since the article could not be fully understood without the deleted text, his delegation was in favour of reinstatement of the original first sentence, namely: “During conciliation proceedings the parties shall not initiate any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, and a court or arbitral tribunal shall give effect to this obligation.”

20. As the article currently stood, no response was provided to the question of what was to be decided when parties had agreed to conciliate but had not expressly undertaken not to initiate arbitral or judicial proceedings during a specified period of time. Judges—to whom article 14 was surely also addressed—would currently not find a response to the question of whether to declare themselves competent when a party in a conciliation turned to the courts. That question could not be left wholly unanswered in the Model Law. The original first sentence had provided the principle required by States in order to determine to what extent the conciliation should be recognized and turned over to domestic jurisdiction. Without that sentence, the provision risked being used in a curiously regressive manner that would be contrary to the UNCITRAL Conciliation Rules and to most of the conciliation rules in force in the world.

21. Mr. SEKOLEC (Secretary of the Commission), responding to the question of the delegation of France, said that the philosophy of the earlier draft had been to have the Model Law recognize an agreement (if such an agreement existed) between the parties in conciliation not to initiate arbitral or judicial proceedings. In that respect, the Model Law did not seek to protect the parties from themselves. Once the parties had actually embarked on conciliation, the circumstances under which arbitral or judicial proceedings could be initiated were different.

22. Mr. LEBEDEV (Russian Federation), referring to the United States proposal to merge paragraphs 1 and 2 of draft article 14, asked whether the changes to the wording of that provision would include deleting the last sentence of paragraph 2, as that would mean that after agreeing not to start arbitral or judicial proceedings, any party initiating such proceedings could be deemed not to have ended its agreement to engage in conciliation or to have terminated the conciliation proceedings.

23. Mr. SILLAPAMAHABUNDIT (Thailand) said that the phrase “until the terms of the undertaking have been complied with” in the last sentence of draft article 14, paragraph 1, worried his delegation, as it appeared to be tantamount to suspending the jurisdiction of a court. That agreement was an agreement between the parties to the conciliation proceedings and was an obligation on them, not on a court or arbitral tribunal. He favoured the wording used in article 16 of the UNCITRAL Conciliation Rules.

24. Mr. MORÁN BOVIO (Spain) said that three separate issues had been raised in connection with draft article 14. First was the concern of the representative of Mexico to make paragraph 2 less subjective by removing the phrase “in its sole discretion”, a proposal that his delegation felt uncomfortable with because of the difficulty of achieving complete objectivity. Second was the suggestion of the United States delegation to merge paragraphs 1 and 2, which he had not fully understood and called for a further explanation. Third was the proposal of the French delegation to return to a text that the Working Group had since changed, on which he saw little need for action on the grounds that other similar agreements posed no problems. He urged those issues to be considered separately to avoid neglecting any of them.

25. Mr. KOVAR (United States of America) agreed with the previous speaker that the three issues should be dealt with separately. With regard to the first issue, raised by the delegation of Mexico, he said that he agreed with the representative of Spain that complete objectivity would be impossible to achieve. With regard to the second issue, his own delegation’s proposal, he responded to the question from the delegation of the Russian Federation by pointing out that the intention was not to change the substance of the existing text, but merely to reduce what seemed according to that text to be a conflict between the obligation of a court or arbitral tribunal to enforce any undertaking by the parties not to take arbitral or judicial action, and the right of a party to take arbitral or judicial action to preserve its rights. In his view, having separate paragraphs 1 and 2 reinforced that perceived conflict, while merging them reduced it. The last sentence of paragraph 2 was unaffected by the proposed amendment.

26. With regard to the third issue, raised by the delegation of France, he said that the Working Group had thoroughly discussed the wording covering resort to arbitral or judicial proceedings and had seen no reason to include a separate obligation on the parties not to start judicial or arbitral action if they had not specifically agreed to refrain from doing so in advance.

27. Mr. HEGER (Germany) said that the French proposal had surprised him in the light of the discussion of the Chinese proposal regarding the reinstatement of article 16 of the draft Model Law (A/CN.9/SR.744), where it had been regularly argued that the draft Model Law was regulating conciliation rather than arbitration or court action. In spite of that assertion, draft article 14 seemed to be targeting exactly that sphere.

28. Mr. TALPIS (Observer for the North American Free Trade Agreement Advisory Committee on Private Commercial Disputes), referring to the French proposal, pointed out that parties were unlikely to elect to use conciliation in an international dispute unless there was a legal framework for such conciliation which excluded competing procedures, wherever the latter might take place. That was a provision commonly found in arbitration

agreements. Draft article 14, paragraph 1, seemed to ensure the enforcement of the agreement to engage in conciliation, but perhaps did not go far enough in doing so, as enforcement depended upon the parties having agreed not to initiate judicial or arbitral proceedings for a certain period or until after a particular event had taken place. To guarantee enforceability, parties would have to bear in mind the need for such an express condition and agree on its content.

29. In practice, however, agreements to enter into conciliation were not always negotiated by lawyers and did not always contain such conditions. As a result, draft article 14 appeared to leave the fate of those agreements' intent in the hands of national laws: they might be enforceable in one country but not in another. He asked the Commission to consider adding to draft article 14, paragraph 1, or to the Guide, wording to the effect that even without such conditions, judicial or arbitral authorities' proceedings would be stayed until after a good-faith attempt at settlement had been made.

30. Mr. GRAHAM (Mexico) said he wished to clarify the reason for his delegation's suggestion that the phrase "in its sole discretion" should be removed from draft article 14, paragraph 2. Doing so would provide an interval during which judicial or arbitral proceedings could not be started. That was significant in view of the fact that in some jurisdictions, Mexico included, judicial proceedings were difficult to initiate because they required the case to be thoroughly prepared. The risk was that a party contemplating such proceedings would spend time preparing them rather than giving conciliation a chance to work. Removing the reference to "sole discretion" would emphasize that good reasons had to exist to initiate such proceedings.

31. Mr. MARKUS (Observer for Switzerland) said he had several comments deriving from the question of the French delegation. First, in his view, paragraph 2 allowed a party that thought it needed to preserve its own rights to initiate interim measures of protection or any other proceeding short of full court proceedings. In fact, in many legal systems, such interim measures were expected to lead on to actual court proceedings within a particular period of time, failing which the interim measures would lapse.

32. Second, he favoured retaining some degree of subjectivity in the right to initiate judicial or arbitral proceedings and therefore supported the proposal of the United States delegation to specify that a party's decision to do so would reflect its own assessment of the situation (through the phrase "in its opinion").

33. Third, his desire to retain some subjectivity in a party's decision to begin judicial or arbitral proceedings stemmed from the possibility that one party in a conciliation proceeding might halt progress simply by remaining passive, leaving the other party with no alternative but to launch such proceedings. He proposed that that eventuality be added to the list of circumstances in paragraph 76 of the draft Guide that might require arbitral or judicial proceedings to be started.

34. Fourth, with regard to the French proposal to block arbitral or judicial proceedings even when the parties had made no express agreement to refrain from them, he thought that such a far-reaching step was risky because it had implications that might even affect constitutional rights in countries where such rights included entitlement to access to the courts.

35. The CHAIRMAN said that a number of issues had been raised but no clear opinion was emerging. He proposed to suspend the meeting for consultations.

The meeting was suspended at 11.35 a.m. and resumed at 12.15 p.m.

36. Mr. MÖLLER (Observer for Finland) said he had several comments on draft article 14. First, regarding the remarks of the German delegation that the article was out of place in a Model Law that dealt with conciliation, he disagreed: the provision was in fact necessary. Second, with regard to the comments by the delegation of France, he considered the reference to an express undertaking not to initiate arbitral or judicial proceedings in paragraph 1 to be necessary, as the Working Group had decided. Third, regarding the drafting change proposed by the United States delegation, he thought that it introduced a clear improvement. Adding the phrase "in its opinion" reflected the wording of article 16 of the UNCITRAL Conciliation Rules. Fourth, with regard to the risk referred to by the observer for Switzerland that one party might stall the conciliation proceedings by remaining passive, forcing the other party to take arbitral or judicial action, he said that the solution lay in draft article 12; the undertaking not to start judicial or arbitral proceedings was closely interlinked with the agreement to engage in conciliation.

37. Mr. SEKOLEC (Secretary of the Commission) said that he did not want to interrupt the discussion under way, but that the secretariat had received a question regarding the draft Model Law from the construction industry, where clauses in contracts often provided that, for a predetermined period after a dispute arose, the parties would attempt to resolve that dispute with an engineer. During that proscription period, the parties would not take judicial action except to apply for interim measures of protection. The industry had asked whether draft article 14 in its current form invalidated such clauses. The secretariat had replied that it did.

38. Mr. HOLTZMANN (United States of America) said that, while the secretariat's response to the construction industry had been correct, such a contract would constitute a variation of the law under article 3. As for draft article 14, paragraph 2, his delegation preferred the phrase "in its opinion" to "in its sole discretion"; in any case, some such phrase was necessary for the practical reason that a court's determination as to whether it was necessary for a party in conciliation to bring a lawsuit near the end of the limitation period could be both time-consuming and unpredictable. In order to forestall abandonment by that party and ensure the continuation of the conciliation proceedings, the parties' rights must be preserved. The wording proposed by his delegation did not change the substance of the Working Group's draft, and he was pleased that delegations considered it an improvement.

39. While the French proposal was interesting, his delegation, regretfully, could not support it. His delegation believed that, ultimately, party autonomy was the best policy: both parties must be fully cognizant of what they were undertaking and there must be no "traps for the unwary" in any portion of the text. That could best be achieved through an agreement.

40. Ms. RENFORS (Sweden) said she supported the principle of party autonomy but felt that the broadly formulated text of draft article 14 at once upheld and impeded it by giving the parties latitude to deviate from the agreement and institute judicial proceedings. Perhaps a clarification in the draft Guide to Enactment would be sufficient to resolve the contradiction. Her delegation preferred the phrase "in its opinion" precisely because it allowed less room for deviation.

41. She also wondered how article 14 was supposed to operate in relation to article 3. Since article 14 was not mentioned in article 3, the parties could agree that article 14 should not apply. Some clarification was needed.

42. Mr. GARCÍA FERAUD (Observer for Ecuador) expressed full support for the Mexican proposal. While parties in the conciliation should be able to preserve their rights, any language that

was discretionary or subjective, or which relaxed the parties' obligation to abide strictly by the law, should be deleted in order to maintain objectivity. Hence, the first sentence of paragraph 2 should read: "A party may nevertheless initiate arbitral or judicial proceedings where such proceedings are necessary to preserve its rights."

43. He stated that, in the interest of ensuring the continuation of the conciliation proceedings, the emphasis should be less on the parties' right to abandon such proceedings through an express declaration than on restricting their latitude to initiate arbitral or judicial proceedings. He recalled the Commission's decision not to incorporate article X on suspension of limitation period as a feature of the draft Model Law but rather to relegate it to a footnote and its judgement that the need for such a suspension must be clearly demonstrated. In that context, the Mexican proposal became extremely relevant.

44. He noted that the representative of Sweden had a sound basis for questioning the relationship between article 14 and article 3. He believed that article 14 should be mentioned in article 3.

45. Mr. MARSH (United Kingdom) expressed strong support for the inclusion of subjective language in the draft article and endorsed the United States formulation "in its opinion". It had to be assumed that the term "necessary [to preserve its rights]" applied to both matters of law and commercial judgement, and the latter could only be exercised subjectively. His delegation very much hoped that one effect of the Model Law would be to encourage businesspeople not only to engage in conciliation but also to include conciliation clauses in contracts. However, if the impact of doing so would mean sacrificing their decision-making power over what was commercially necessary, that would act as a disincentive.

46. Mr. TANG HOZHAI (China) said that the paragraph as currently drafted should remain intact; it was very comprehensive and reflected a wide range of views. He saw no major difference between the phrases "in its sole discretion" and "in its opinion", except, perhaps, that the former afforded the parties slightly more latitude. If necessary, either of those phrases could be deleted, since the criteria for recourse to arbitral or judicial proceedings were very complex and a determination could not be made subjectively. However, he believed that a decision by the parties themselves as to the appropriateness of instituting arbitral or judicial proceedings to preserve their rights was not necessarily a violation of the conciliation agreement and that, in initiating such proceedings, they were not necessarily waiving the conciliation agreement or terminating the conciliation proceedings.

47. Mr. COSMAN (Canada) said that his delegation supported the United States amendment to draft article 14, which provided useful clarifying language while maintaining the substance of the original text.

48. Mr. BARSY (Sudan) said that his delegation supported the expression "in its sole discretion", although it had no strong objection to the expression "in its opinion" and saw the value of both expressions. He wondered what the United States position would be if arbitral or judicial proceedings were not necessary to preserve a party's rights and the other party could adduce evidence to that effect. If a court or arbitral tribunal applied paragraph 1 of draft article 14, the conciliation agreement would not be implemented and the party that had initiated the proceedings would bear the consequences. He also wished to ascertain whether arbitral or judicial proceedings would continue simultaneously with the conciliation proceedings once a party's rights had been preserved since, in his delegation's view, they would be necessary in view of their relation to the conciliation agreement.

49. The CHAIRMAN noted the general support for the Working Group's draft, with the amendment proposed by the United States, which did not alter the substance of the Working Group proposal but rather clarified it. He said that the relationship between articles 3 and 14 could be considered when the Commission reviewed the entire text of the draft Model Law. Concerns regarding the relationship between the Model Law and the conciliation laws of individual States could be addressed in the draft Guide to Enactment.

50. Mr. JACQUET (France) said that, if there were no longer any obstacles to instituting arbitral or court proceedings—save express agreement by the parties—all the subtlety of paragraph 2 would be for naught. That would create a substantive problem that would be extremely damaging to the draft Model Law and would not resolve most of the practical difficulties that could arise. The only substantive argument he had heard against his delegation's original proposal was the need for party autonomy highlighted by the United States delegation and the possibility that the parties in the conciliation could fall into a trap. Ironically, the greatest trap was the article itself, as currently drafted, which led the parties to believe that they were protected from court proceedings when they actually were not.

51. His delegation, too, supported party autonomy; however, it had to be applied properly and only in very specific circumstances. He failed to understand how, in the name of "party autonomy", the Commission could forgo a sound rule that could be tempered, if necessary, by party autonomy, and leave the parties without any protection against arbitral or judicial proceedings. His delegation would like to see a reference to party autonomy included in the title of the article, which would then be tempered by paragraph 1 as currently drafted, the parties' option to end the conciliation proceedings, and paragraph 2, regardless of its final formulation.

52. The CHAIRMAN said that consideration would be given to the French proposal if time allowed and that, if not, the views of the representative of France would be reflected in the report of the Commission.

The meeting rose at 1.05 p.m.

**Summary record of the 746th meeting,
held at United Nations Headquarters on Thursday, 20 June 2002, at 3 p.m.**

[A/CN.9/SR.746]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 3.15 p.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION (*continued*)**

Draft article 15. Enforceability of settlement agreement

1. The CHAIRMAN said the question of the enforceability of settlement agreements had been discussed in some detail at the previous session of the Commission, and the present wording represented the maximum degree of consensus that could be achieved at that time. An exchange of views had taken place by electronic mail in the meantime, but it had been inconclusive.

2. Mr. SEKOLEC (Secretary of the Commission) said the nature of the settlement agreement had been left open-ended. As presently drafted, the text of draft article 15 did not make clear that such agreements were enforceable as contracts, although there was broad agreement in the Commission that they were. Some members had queried the meaning of the words “binding and enforceable”, and there was a notion that those words implied the force of a judicial decision. It would be appropriate to provide some clarification, at least in the draft Guide to Enactment.

3. Mr. JACQUET (France), referring to the written observations submitted by his delegation, suggested deleting the words “and enforceable”. If that was done, the enforceability of the agreement, in a judicial sense, would depend on the local law. He suggested the following wording: “The enforceability of the agreement will depend on the law applied by the competent authority of the State where the agreement is invoked.”

4. Mr. SEKOLEC (Secretary of the Commission) said that would be the law of the enacting State. Because the Model Law was not a treaty, it could not establish a regime outside the country that adopted it.

5. Mr. JACQUET (France) agreed to the phrase “the law of the enacting State”, which was a standard formula in model laws adopted by the Commission.

6. *Draft article 15 was provisionally approved.*

*Draft article 3. Variation by agreement (*continued*)*

7. The CHAIRMAN said it was necessary to revert to draft article 3 in order to determine which articles of the Model Law, in addition to article 2 and article 7, paragraph 3, were not subject to variation by agreement between the parties. It had already been suggested by the representative of Sweden that draft article 14 should be included in the scope of draft article 3.

8. Mr. MÖLLER (Observer for Finland) said he was not in favour of including a reference to draft article 14. Even if the parties had expressly undertaken not to resort to arbitral or judicial proceedings for a specified period of time, they should be allowed to make alternative arrangements.

9. Ms. RENFORS (Sweden) said she was not insisting on a reference to draft article 14 in draft article 3. However, some action must be taken to resolve the uncertainty surrounding the relationship between the two articles. As matters stood, the effect of the amendment to draft article 14 would be that parties to a conciliation who had agreed they would not be allowed to have recourse to arbitral or judicial proceedings could nevertheless go to court to preserve their rights.

10. The CHAIRMAN said the inconsistency could be removed by including in the agreement a clause to waive the provision in draft article 14 which enabled a party to have recourse to the courts.

11. Mr. MARKUS (Observer for Switzerland) said he agreed with the representative of Sweden that draft article 14 would have a strange effect if it were non-mandatory. It would be saying that effect must be given to an agreement by the parties not to go to court until a certain period had elapsed but would at the same time be limiting that effect for the sake of preserving a party's rights. If the intention was to limit the effect of article 14 in that way, the rule in it must be a mandatory one. The Model Law was a mixture of contractual and procedural provisions, but most of its rules were contractual and rules of that kind were always subject to party autonomy. Draft article 14 was one of the few procedural rules in the Model Law because by defining the limit to be set it was telling the courts whether an action by one of the parties should be admitted. Draft article 14 should therefore be mandatory.

12. The CHAIRMAN raised the question whether draft article 11, on the admissibility of evidence in other proceedings, should also become mandatory.

13. Mr. JACQUET (France) was not in favour of including in draft article 3 a reference to draft article 14. Logically speaking, draft article 14 was an optional clause. It empowered the parties to have recourse to arbitral or judicial proceedings if they so chose. To attempt to make it mandatory would be a grave mistake.

14. Mr. GRAHAM (Mexico) said that he, too, opposed the idea of including in draft article 3 a reference to draft article 14, but for a different reason. It would be inconsistent to seek to attribute a binding effect to a rule that could only take effect by virtue of an agreement between the parties.

15. Mr. HEGER (Germany) said he believed it would be a good idea to include in draft article 3 a reference to draft article 14. The situation was one in which parties were to be protected from the consequences of their own errors. In that sense, the possibility of recourse to judicial proceedings was a matter of principle that had more to do with constitutional law than with procedural law. He was far from sure that, from a logical point of view, there were no circumstances in which it would be unnecessary for draft article 14 to be mandatory.

16. Mr. MORÁN BOVIO (Spain) said he did not agree that article 14 should be mentioned in draft article 3. The free will of the parties should be paramount. Given that draft article 14 only entered into force by agreement of the parties and was therefore derogable by its very nature, it made no sense to make it non-derogable by virtue of draft article 3. Article 14 did not belong in the same category as article 2 and article 7, paragraph 3.

17. Mr. MARSH (United Kingdom) said that, in his understanding, draft article 14 was intended to ensure that whenever parties made a commitment to use conciliation, they could not, to the extent provided for, renege on that commitment. While that objective was laudable, reference to article 14 in draft article 3 would mean that, even when both parties no longer decided that conciliation was appropriate, they would be forced to continue with it nevertheless. That would be a strange and unfortunate provision.

18. Mr. HOLTZMANN (United States of America) said that parties making an agreement under the provisions of draft article 14 ought to be permitted to change that agreement. It should be recalled that, in a conciliation procedure, any party was entitled to stop conciliating at any given moment. By removing the freedom of parties to change an agreement, the inclusion of article 14 in draft article 3 would simply result in more parties pulling out of conciliation altogether. He urged strongly for article 14 not to be referred to in draft article 3.

19. Mr. BARSY (Sudan) said that his delegation could not agree to a reference to article 14 in draft article 3. Parties should be free to change their minds about the usefulness of arbitral or judicial proceedings, with a view to facilitating the swift resolution of disputes.

20. Mr. SEKOLEC (Secretary of the Commission) asked delegates to consider a situation in which a party, having agreed not to resort to arbitral or judicial proceedings during a conciliation period of 60 days, decided to alter that position before the end of the agreement period. According to the second part of draft article 14, that party would still be entitled to go to court to preserve its rights. Yet, by virtue of draft article 3, parties might have agreed for that right to be removed, and such an agreement would have to be respected. In that case, it would be unclear which provisions prevailed: those in draft article 14 or those in draft article 3.

21. The CHAIRMAN, speaking in his personal capacity, said that one interpretation was that parties agreeing to a period of 60 days for conciliation were implicitly derogating from the provisions of draft article 12, which established conditions for the termination of conciliation. Another was that by agreeing not to resort to arbitral or judicial proceedings for a period of 60 days, parties were agreeing to a cooling-off period, during which legal action would not be taken even if conciliation should fail. That provision existed in bilateral investment treaties, for instance, whereby parties agreed to a period of six months without recourse to arbitration.

22. Mr. MORÁN BOVIO (Spain) said, in response to the question raised by the Secretary of the Commission, that the general principle underlying the draft Model Law ought to be party autonomy. Despite having committed themselves to a period without arbitration or legal proceedings, parties should be free to alter their position if they deemed it necessary to defend their interests. For example, one of the parties might fail to demonstrate satisfactory sincerity with regard to the conciliation process, leading the other either to consider or to initiate legal action, while at the same time continuing to conciliate. Parties must be able to protect their rights in such circumstances. It should also be recalled that, owing to the complexity of commercial relationships, the decision by one party to take legal action should not necessarily affect the conciliation process between the remaining parties.

23. Mr. MARKUS (Observer for Switzerland) said that there was an inherent contradiction in failing to make draft article 14 non-derogable. Without including the second part of article 14 under the terms of draft article 3, it would be possible for parties to agree to a cooling-off period of 60 days and to commit themselves not to go to court even if they deemed it necessary to preserve their respective rights. In his view, it was impossible to allow the restriction of the right to initiate legal proceedings without rendering the second part of draft article 14 meaningless.

24. Ms. RENFORS (Sweden) said that, in the situation described by the Secretary of the Commission, the provisions of draft article 14 should prevail. Only the second half of draft article 14 should be non-derogable, since clearly the freedom to enter into an agreement could not be made mandatory.

25. Mr. HEGER (Germany) said that the example given by the observer for Switzerland showed very clearly the consequences of failing to include draft article 14 under the terms of draft article 3.

26. Mr. MORÁN BOVIO (Spain) asked whether a party which, having entered into an agreement not to resort to judicial proceedings during a period of conciliation and subsequently discovered enough about the other party's financial situation to consider that it had a duty to initiate bankruptcy proceedings against that party, should be prevented from doing so by virtue of the initial agreement.

27. Mr. SHIMIZU (Japan) said that if draft article 3 contained no reference to draft article 14, in the situation described by the Secretary of the Commission, the rules contained in draft article 3 concerning the free will of the parties would prevail. The provisions of draft article 14 were intended to fill in the gaps where the intention of the parties remained unclear. It assumed that an agreement in which the parties expressly undertook not to litigate did not exclude the possibility of going to court to protect their rights. The constitutional problem raised by the representative of Germany lay outside the scope of the draft Model Law and should be resolved within the general framework of the relationship between contractual law and public policy.

28. The CHAIRMAN said that, unless any objections were raised, draft article 3 would remain as it appeared in the text, without the insertion of a reference to article 14.

29. Mr. JACQUET (France) said that it had yet to be decided whether or not article 15 would be referred to in draft article 3.

The meeting was suspended at 4.25 p.m. and resumed at 5.05 p.m.

30. Mr. JACQUET (France) said it would be detrimental to the consistency of the Model Law for the agreement reached by the parties following conciliation to be interpreted differently in different countries. Article 15 should be among those articles that could not be changed.

31. Mr. TANG HOUZHI (China) said he agreed with the French representative that draft article 15 should be mandatory and should be included in draft article 3.

32. Mr. GARCÍA FERAUD (Observer for Ecuador) said he agreed that draft article 15 should be included in draft article 3. The conciliation exercise would be weakened if the end result was left up to the will of the parties. Moreover, the Model Law was intended to promote conciliation, and that could best be done by ensuring that the settlement agreement would be enforceable.

33. Mr. GETTY (United States of America) said that his delegation was opposed to the inclusion of draft article 15 in draft article 3. By its very nature, draft article 15 invited enacting States to specify methods of enforcement. Under the principle of party

autonomy, parties might agree that they wished to have enforcement in accordance with the laws of a specific State and not with those of another. Draft article 15 invited a variation based upon a difference in laws. In the United States, for example, the article would probably be considered binding and enforceable as a contract; in other jurisdictions it might be enforceable as a judgement; and in yet others, as an arbitral award. All of those possibilities were valid ways that States might choose to have enforcement. It would be inherently contradictory to say that draft article 15, which could be varied by individual States, could not be varied by the parties.

34. The CHAIRMAN said that as he understood it, the French delegation had argued that the parties could not deny the mandatory effect of agreements that were legally valid, while the United States delegation had raised the point that the parties could agree that the enforcement procedure was a matter of choice of forum. In that case, the two positions were not in opposition to each other.

35. Mr. MARKUS (Observer for Switzerland) said that he supported the French proposal with one reservation. The enforceability of a conciliation agreement was based on a State monopoly, inasmuch as it was the State that made the proceedings available. The parties would never be able to agree on enforcement beyond the terms stipulated in the State's procedural laws. For that reason, he supported the French proposal. On the other hand, it should always be possible for the parties to partially or completely give up those elements of enforcement. They might wish to decide that a conciliation agreement would only bind them in certain aspects. It might be worthwhile to mention that possibility in the Guide, in connection with article 3 or article 15. It was important to respect the principle of party autonomy.

36. Mr. MARSH (United Kingdom) said that his delegation had considerable reservations about the inclusion of draft article 15 within the articles referred to in draft article 3. The nature of the conciliation process was such as to encourage and enable the parties to reach their own settlement. It followed from that that the parties would put into the settlement whatever it was that they wanted to see in it. One such provision might well be that they did not wish the settlement agreement to be binding. One example might be that of three joint venture partners from different countries who had a disagreement about a matter of strategy or business priority. There was no reason why they should not use a conciliator to help them resolve the matter. In doing so, they would be seeking assistance in reaching a business strategy for the future; they would not be looking to create legally binding obligations. They would not expect to be bound by contractual obligations. He saw no reason why they should not be entitled to use the conciliation process. For pragmatic reasons and so as not to limit the use of conciliation in situations such as that, his delegation was in favour of excluding draft article 15 from the references in draft article 3.

37. Mr. JACQUET (France) said that the example just provided by the United Kingdom was inconclusive and did not fall within the scope of draft article 1 of the Model Law. It was not clear why the parties in that example would see a need to have recourse to a decision that would be binding. Their dispute would not be legal in nature but would simply be an issue of commercial strategy.

38. He did not understand why the United States delegation had remained silent on the French proposal for a new wording of draft article 15. What the representative of the United States had just said was precisely what the French delegation had proposed, namely, that, when a conciliation agreement had been reached, the parties were free to choose the country in which they wanted the legal consequences of their conciliation agreement to take effect. The rationale of the conciliation agreement was that the parties ended up with a contract; that was what France had proposed. In

fact, France had proposed that in draft article 15 there should be a period after the word "binding"; beyond what was binding, the parties would move on to domestic law. That was the position that had been expressed by the United States representative and thus there was no contradiction between the two positions. There was no strong reason to oppose the inclusion of draft article 15 in draft article 3. It was unfortunate that the situation had not become clear earlier; the problem he saw currently was that article 15 was more binding than the United States delegation wanted it to be. If the text was amended to end with the word "binding", then the article could stand on its own. The inclusion of the term "enforceable" created problems because it would have meaning only with respect to national legislation.

39. Mr. LEBEDEV (Russian Federation) said that the issue was a very complex one because currently there was no article 15 but only the introduction to the article. It was his understanding that so far no decision had been taken to amend the three lines of the draft article. According to that text, the States adopting the Model Law would have to establish the conditions and procedures to be followed in implementing the international agreement between the parties. It was very difficult, without knowing what laws the individual States would enact, to take a decision as to whether the article should be classified under the binding or non-binding rules of the Model Law.

40. Another issue, which might appear to be purely academic but which nevertheless must be considered, was the situation that would arise if the conciliation procedure took place in a particular State in which the Model Law was applicable and the parties agreed that the conciliation agreement should be implemented in the territory of another State where different rules applied. If it was felt that article 15 was binding or mandatory, then the problem was to decide whether the parties could agree not to apply article 15 in a particular State but rather to apply it in another State.

41. The solution might be to refer to the matter in the Guide instead of including article 15 in article 3. That way, each State could decide for itself, when adopting the law, whether to include a reference to article 15 in article 3. Another possible scenario would be to include article 15 in article 3 and to add a footnote to the effect that, when adopting the law, States might decide for themselves whether or not to maintain the reference to article 15 in article 3.

42. Mr. SEKOLEC (Secretary of the Commission) said that it appeared from the discussion that the English text of draft article 15 said something different than the French text. The French text spoke of "executory force", which had to do with a procedural aspect of the settlement agreement, whereas the English text spoke of the binding and enforceable nature of a contract. It might be necessary to change the French text.

43. Mr. ZANKER (Observer for Australia) said that he had thought that draft article 15 was complete as it stood, ending "that settlement agreement is binding and enforceable". The words "as a contract" had been dropped, but the terms used implied a contract. For the reasons stated by the United Kingdom and the United States, his delegation was not in favour of a reference to draft article 15 as a mandatory provision in draft article 3.

44. Mr. MÖLLER (Observer for Finland) said that, if draft article 15 was considered to be in a partial state, requiring completion by the particular State, that was another reason for not mentioning it as mandatory in draft article 3, since the Commission could not know what it would contain in its final form. The absence of a reference would not make a practical difference. If the parties did not wish to have a settlement agreement that was binding and enforceable, any arrangement they made was not a settlement agreement in the strict sense of the term.

45. Mr. SHIMIZU (Japan) said that his delegation was opposed to the inclusion of a reference to draft article 15 in draft article 3. It had been left to the particular State to decide whether draft article 15 should be mandatory or not. An explanation in the Guide to Enactment should resolve the problem.

46. The CHAIRMAN suggested that a solution might be reached by analysing the elements of draft article 15 separately to determine whether they might be subject to variation by agreement or not. To say that the settlement agreement was binding was merely to follow the law of contracts and could hardly be altered. To say that it was enforceable might lead to a consideration of legal procedures, although in Mexican law “ejecutorio” meant little more than “vinculante”; “ejecutivo” would have stronger implications.

47. Mr. BARSY (Sudan) said that it seemed natural to refer to draft article 15 in draft article 3. Parties resorted to conciliation when a dispute had arisen under law, with the intention that a settlement agreement should be enforceable; otherwise, conciliation was meaningless. No cases had come to his attention in which the parties did not want to have an enforceable agreement.

48. Mr. TANG HOUZHI (China) said that his delegation strongly supported the inclusion of a reference to draft article 15 in draft article 3. The essential purpose of elaborating a model law was to make a conciliation settlement agreement enforceable; that was what made conciliation worthwhile. He himself had not encountered cases in which the parties did not wish their agreement to be enforceable. The example cited by the United Kingdom delegation of parties’ bringing in a third party to help them work out a strategy did not involve a dispute and could not be considered a conciliation proceeding. Some delegations argued that making enforceability mandatory might discourage some parties from resorting to conciliation, but he felt that, on the contrary, parties would be dissuaded from conciliation if the resulting agreement was not binding and enforceable, because of the waste of time and energy involved.

49. With regard to consistency between language versions, the Chinese version, at least, was clear and gave an accurate rendering of the English terms “binding and enforceable”. It was his understanding that the wording of draft article 15 had been approved, even though the matter in brackets would be left to each State to fill in. Therefore, there was no reason to defer a decision on a reference to it in draft article 3. Failure to make draft article 15 mandatory would deprive the Model Law of much of its significance. To ensure consistency, draft footnote 4, which said that an enacting State might consider the possibility of an enforcement procedure being mandatory, should perhaps be looked at again.

50. Mr. HEGER (Germany) said that, given the uncertainties surrounding draft article 15, his delegation did not think that a reference to it should be included in draft article 3.

51. Mr. KOVAR (United States of America) stressed that, in the view of his delegation, to deny the parties the option of entering into any kind of settlement agreement they wanted would undermine the purpose of the Model Law. The essence of conciliation was that it was a voluntary process, intended to enable parties to reach their own resolution of their dispute. They might simply agree, for example, to take certain steps to restore confidence in their business relationship. The situation described by the United Kingdom delegation could well arise from a contract dispute and be considered conciliation. If every accord reached by the parties had to take the form of a binding contract or the equivalent of an arbitral award or judgement, it would severely limit party autonomy, which was the essence of conciliation.

52. His delegation was unclear about the link between the choice of law problem raised by France and variation by agreement, but he suspected that it was a point that should be addressed under national law. As other delegations had pointed out, draft footnote 4 left an enacting State the option of making enforcement procedures under draft article 15 mandatory.

The meeting rose at 6 p.m.

**Summary record of the 747th meeting,
held at United Nations Headquarters on Friday, 21 June 2002, at 10 a.m.**

[A/CN.9/SR.747]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.15 a.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION** (*continued*)

1. Mr. SEKOLEC (Secretary of the Commission), summarizing the most recent changes to the draft Model Law, said that a definition of “conciliator” had been added to article 1. Articles 5 and 6, as they appeared in the annex to document A/CN.9/506, were to be merged as article 5 under a new title: “Number and appointment of conciliators”.

2. In the italicized text of the new article 14 (former article 15), contained in conference room paper A/CN.9/XXXV/CRP.2, the words “may insert” had replaced the word “inserts” in the earlier text. Extensive discussion of the phrase “binding and enforceable” had revealed that those concepts were not interpreted uniformly in enacting States. In some regimes, “binding and enforceable” were qualities that characterized any type of contract, whereas elsewhere the expression had an executory connotation, suggesting that a plaintiff could go directly to an official charged with enforcing judgements or awards.

3. In the former article 15 (A/CN.9/506, annex), some delegations considered the mention of the word “sign” to be superfluous as there was no requirement, for instance under common law, that a settlement agreement should be signed. It was therefore decided that the words “reach and sign” should be replaced with the word “conclude”.

4. The CHAIRMAN recalled that during earlier informal consultations a few delegations had insisted that the requirement of a signature should appear in the text of the draft Model Law. In the same vein, other participants had attached great importance to the concept of “binding and enforceable”. He urged the Working Group to express their opinions on both the inclusion of “enforceable” and on the requirement that the agreement should be signed.

5. Mr. MORÁN BOVIO (Spain) said he agreed that delegations that had been involved at earlier stages of negotiation should provide clarification on the genesis of article 15, specifically with respect to discussions held on the signing of the agreement and on the concepts of enforceability or executability.

6. Mr. LEBEDEV (Russian Federation) said that in earlier discussions it had been considered useful to retain the concept of enforceability, along with the term “binding”. It could be debated that “enforceable” might not be the most appropriate legal terminology but, in the opinion of those delegations which favoured its retention, the term would be useful to States enacting national laws based on the draft Model Law and would enable them, at their discretion, to establish special provisions and rules to ensure “enforceability” of such settlement agreements.

7. He fully agreed that the provision on “enforceability” and, by extension, the ability to implement settlement agreements were ultimately the goals of conciliation proceedings. He believed the term should not be replaced, nor was it rational to raise the issue of excluding it.

8. Mr. GARCÍA FERAUD (Observer for Ecuador) said that the discussion on the deletion of the word “sign” hinged on differences of interpretation between judicial systems. In some regimes, signature was regarded as extremely important, and it enabled a process to advance on the basis of an instrument that was executory in nature. It was, however, very difficult to reconcile various judicial systems that had evolved from different roots in resolving the same issues. In order to alleviate the concerns raised, he suggested the following wording: “The settlement agreement should be signed if this is necessary in order to ensure its enforceability in respective judicial systems.”

9. Mr. SEKOLEC (Secretary of the Commission) said that, as currently formulated, the suggestion might be appropriate for a treaty or guide to enactment, but not for a national law, which could not include wording to the effect that the agreement should be signed “if necessary”.

10. Mr. TANG HOZHAI (China) said that signature of a document was very important in Chinese law on procedure and arbitration. However, under contract law, contracts that had been concluded orally were equally valid and there was no requirement for a contract to be signed. Such conflicts existed in Chinese legislation. Since the draft Model Law was intended to operate internationally, his delegation believed that the word “conclude” would be appropriate.

11. As for the use of the expression “binding and enforceable”, he said that the word “binding” referred to an effect on parties, whereas the word “enforceable” related to whether an agreement could be enforced by a court. A settlement agreement would naturally carry binding effect but would not necessarily be enforceable. A party to a contract might choose not to implement

the terms of the agreement and, if the case were brought before a court, that court would need to investigate whether a breach had been committed. If a settlement agreement were not enforceable, parties would question the usefulness of recourse to a conciliator rather than to a court. The word “enforceable” was quite appropriate and reflected the opinions of most delegations during the discussions of the Working Group. The former article 15 itself, as contained in document A/CN.9/506, was applicable to a number of situations and could therefore be usefully retained.

12. Mr. GRAHAM (Mexico) agreed that the interpretation of the expression “binding and enforceable” differed among legal systems and said that the expression agreed upon should take into consideration either a broad defence for the party against which enforcement is being sought or a more limited defence. Based on the experience of serious proposals put forward by delegations, it was probably not possible to reach agreement on the wording at the beginning of the former article 15, as legislative differences created stumbling blocks for such agreement.

13. In the absence of a compromise, his delegation suggested that any party could present agreements before a judge seeking enforcement. To that end, he proposed the following text: “If the parties reach [and sign] an agreement settling a dispute, any of the parties is entitled to submit the agreement before a court for its enforcement.” In the draft Guide to Enactment the Working Group would indicate possible defences and the types of procedure involved.

14. Ms. BELEVA (Observer for Bulgaria) said she agreed with the observer for Ecuador that the reference to signing should be retained, since in some legal systems, a written agreement was a *sine qua non*. Although many States had entered reservations in that connection to the United Nations Convention on Contracts for the International Sale of Goods, the Commission was drafting a model law, not a convention, and flexibility was thus of the essence. A reference to national legal systems could be included in the Guide, and it would thus be for legislators to determine how best to ensure enforceability.

15. Ms. MANGKLATANAKUL (Thailand) said that Thai contract law mostly required a signature, whether handwritten or electronic. She would thus be in favour of retention of the reference to signing, whether in the formulation “conclude and sign where necessary”, in an explanatory footnote or in the Guide.

16. Mr. BARSY (Sudan) said that he would not object to deletion of the word “sign”, since it would still be for the State to determine the conditions for enforceability. It was important to recall that other national laws might also be applicable. If a conciliation agreement required enforcement by a court or tribunal, a number of problems would arise, not least if one of the parties had reached the agreement by fraudulent means. A conciliation agreement submitted to a judge would, moreover, be treated as would any contract between the parties, thus reducing the usefulness of the Model Law.

17. Mr. COSMAN (Canada) said he agreed with the representative of China that signing provided important proof that a settlement agreement had been reached. However, his delegation favoured the term “conclude”, since it was important not to limit States in whose jurisdictions oral agreements were also binding. Although the representative of Mexico had described one possible means of enforcing an agreement, his proposed formulation should be placed in square brackets. The enacting State would then be left to determine the precise modalities.

18. Mr. HEGER (Germany) said that he fully supported the Mexican proposal, since it allowed States to decide the question of enforcement, a matter normally governed by national law.

19. Mr. MARKUS (Observer for Switzerland) said that translation of the term “enforceability” was not the only problem; the issue was further complicated by the multiplicity of procedures for enforcement that existed in different countries. Since enforceability was ultimately determined by national law, his delegation could, however, accept a degree of ambiguity in the provision. The formulation proposed by the representative of Mexico was acceptable, provided the term “enforcement” rather than the term “execution” was used. As for the formulation proposed by the observer for Ecuador, it might also be included in square brackets, provided the word “ensure” was replaced with the idea of supporting or strengthening.

20. The CHAIRMAN said that national legal systems had different mechanisms for enforcement, and the terminology problem made standardization virtually impossible. In some systems, the word “enforceable” was synonymous with the word “binding”; in others, it implied enforcement by a court or arbitral tribunal. He suggested that the meeting should be suspended for informal consultations.

The meeting was suspended at 11.25 a.m. and resumed at 12.10 p.m.

21. Mr. SEKOLEC (Secretary of the Commission), summarizing the outcome of the informal consultations, said that various approaches to drafting the provision had been suggested.

22. One approach was that even if an effort was made to improve the translation of the phrase “binding and enforceable”, those concepts would inevitably assume different connotations within different legal systems. That fact could, however, be explained in the Guide, on the understanding that it would be for the legislators to determine the precise meaning of article 15.

23. It was undisputed that in many legal systems, a settlement agreement could be in any form in order for it to be binding and enforceable. Reference had been made to sales contracts, which could also be concluded in any form. Significantly, States that had entered a reservation to the United Nations Convention on Contracts for the International Sale of Goods to the effect that sales contracts must be in written form were in the minority. Moreover, such reservations did not require that the sales contract must be signed. It had also been pointed out that in some legal systems, depending on the content of the enforceability, a signature might be required.

24. A compromise formulation would read “If the parties conclude an agreement settling a dispute”, with an explanation included in the Guide to the effect that in some legal systems there were form requirements and gradations of those form requirements, with a signature requirement in some cases.

25. Ms. BRELIER (France) said that the first sentence of article 15 should remain unchanged. The formulation proposed by the representative of Mexico might constitute the second sentence.

26. The CHAIRMAN said that the proposed formulation would be submitted to the drafting group for consideration, on the understanding that it would be included in square brackets.

27. *It was so decided.*

28. Mr. HOLTZMANN (United States of America) said that his delegation was reluctant to support the Mexican proposal, as it left the parties able to refer enforcement to a court, but ignored the cases in which, for example, enforcement could be achieved through a notary. The issue of entitlement to enforcement, and the issue of the vehicle for such enforcement, could best be accommodated at the end of article 15, where the enacting State had the opportunity to specify enforcement arrangements. If the term

“enforceable” was problematic from the point of view of a number of languages and legal systems, he suggested that it should be deleted.

29. Mr. MÖLLER (Observer for Finland) echoed the reluctance of the United States delegation to support the Mexican proposal, saying that the method of achieving enforcement was a matter for individual States’ legal systems. It was better to tackle the issue of how and where enforcement would be achieved through the opportunity for the enacting State to add detail at the end of the article, or by inserting details in the Guide. He also supported deleting the term “enforceable”, since, if it remained in the text, each State would place its own interpretation on it.

30. Mr. BARSY (Sudan) said that, although some legal systems did not provide for settlement agreements to be voluntarily enforceable, others did. The Commission needed to establish the conditions under which courts would have a role, and it was better to use the opportunity to add country-specific details at the end of the article in question than to adopt the Mexican proposal, as it failed to accommodate national differences in enforceability conditions.

31. Mr. TANG HOZHAI (China) said that in the interests of expediting the Commission’s work, his delegation had several observations. Firstly, it strongly felt that the term “enforceable” should not be deleted, as that would be tantamount to deleting the whole of article 15. Secondly, the issue of the term “enforceable” itself was one of form rather than substance. If the settlement agreement was treated as a contract, and there were enforcement variations, no difficulties would be created. Thirdly, as the UNCITRAL Secretary had pointed out, the text on the table had been discussed at length by the Working Group, so changes should only be made for compelling reasons.

32. Mr. JOKO SMART (Sierra Leone) said that he supported the United States proposal to delete the term “enforceable”, as some languages and legal systems would give it one meaning, while other legal systems and languages would give it another. It was not the business of the Model Law to determine which agreements should be enforceable; that task was performed by whatever national law was applicable. China’s concern at that proposed deletion was not justified: leaving the term “binding” would be sufficient, and the courts could determine what steps were needed.

33. Mr. JACQUET (France) said that he was very grateful for the United States delegation’s suggestion in favour of deleting the term “enforceable”, showing that it understood the difficulties it held for French-speaking countries. However, after some thought, the troublesome French translation “exécutoire” had been abandoned in favour of “susceptible d’exécution”, which rendered the sense of “enforceable” without posing problems of interpretation.

34. Mr. LEBEDEV (Russian Federation) advocated keeping the term “enforceable” in draft article 15, as the problems of translating it into French, Spanish and Russian in a way that did not cause problems of legal interpretation seemed to have been solved. The Commission was not trying to decide how to translate the principle into action, but simply to make the principle itself obligatory.

35. Mr. LEFEBVRE (Canada) said that his delegation shared the view of the United States and other delegations of the Mexican proposal. The problem was that other public officers, such as notaries, and not just the courts, could be involved in enforcing agreements. The French proposal to use an alternative French translation of “enforceable” had his support.

36. Mr. MEENA (India) said that before judging the words used, the Commission should look at their legal consequences.

“Binding” meant “binding between the parties to the agreement”, while “enforceable” referred to the fact that, in cases of non-compliance, a party could go to court to force compliance. As the parties had elected to submit their dispute to conciliation, it would be pointless to go to court unless such action was unavoidable.

37. Mr. MARKUS (Observer for Switzerland) said that he agreed with the French solution of using an alternative translation of “enforcement”.

38. Mr. HOLTZMANN (United States of America) said that his delegation had only suggested deleting the term “enforceable” to eliminate the problems of linguistic and legal interpretation that seemed to have arisen. If those problems had been eliminated, it was happy to withdraw its previous suggestion. It backed the Commission Secretary’s proposal to replace the term “sign” in draft article 15 with the term “conclude”.

39. The CHAIRMAN said that the original text proposed by the drafting group would be retained, but the term “sign” would be replaced with the term “conclude”. The drafting committee would tackle the issue of translating the term “enforceable” in a suitable way, and explanations would be inserted in the Guide where appropriate. The Commission returned to consideration of retaining a

footnote to article 15, or adding article 15 to the list of articles contained in article 3 which could neither be excluded nor varied.

40. Mr. JACQUET (France) said that he wished to further develop his delegation’s argument for adding article 15 to the list of articles which could neither be excluded nor varied. The first argument in favour of such a step was logic. The content of article 15 as it currently stood made it unique, as it made settlement agreements between parties “binding and enforceable”. Allowing it to be excluded or varied by not including it in the list in article 3 was like saying that something was obligatory in one breath and saying that it was not obligatory in the next.

41. The second argument in favour was substance. Conciliation could have a variety of outcomes, of which genuine agreements were only one. A balance needed to be struck between leaving options open for the parties (the principle of party autonomy) and eliminating the impact of article 15. If the parties wished to consider that the settlement they had reached was not an agreement within the meaning of article 15, they should be free to state that. However, that did not mean that article 15, which did cover a substantial number of settlement agreements, should be stripped of its significance: on the contrary, it should be strengthened.

The meeting rose at 1 p.m.

Summary record of the 748th meeting, held at United Nations Headquarters on Friday, 21 June 2002, at 3 p.m.

[A/CN.9/SR.748]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico), Chairman of the Committee of the Whole, took the chair.

The meeting was called to order at 3.10 p.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (continued)

Draft article 3. Variation by agreement (continued)

1. The CHAIRMAN invited the Commission to resume consideration of France’s proposal to include a reference to draft article 15 in draft article 3, making enforceability of the settlement agreement one of the mandatory provisions, which parties could not vary by agreement.

2. Ms. MOOSA (Singapore) said that, on reflection, her delegation could not agree with the French proposal because it would undermine the principle of party autonomy and would be inconsistent with footnote 4 of draft article 15.

3. Mr. SHIMIZU (Japan) said that his delegation was reluctant to see a reference to draft article 15 included in draft article 3. Draft article 15 had intentionally been left open to State interpretation. Footnote 4 provided that an enacting State might consider the possibility of making a procedure for the enforcement of settlement agreements mandatory. Since the nature of draft article 15 was left open, the decision whether to include a reference to it in draft article 3 should also be left to a State’s discretion. A footnote to draft article 3 might be drafted explaining that a reference to draft article 15 would depend on the decision of the enacting State with regard to draft article 15.

4. Mr. MARKUS (Observer for Switzerland) said that his delegation could support the French proposal with the reservations previously stated, namely, that although the parties could not give their settlement agreement a greater degree of enforceability than national laws allowed, they might agree to exclude its enforceability in whole or in part.

5. Ms. MOOSA (Singapore) pointed out, with reference to Switzerland’s position, that it was not necessary to stipulate that parties could not give their settlement agreement a greater degree of enforceability than national laws allowed, because from a practical standpoint the mechanisms for enforcement simply would not exist. As another point in favour of flexibility, there might be circumstances in which a dispute was settled merely by one party tendering an apology and the other accepting it. It was hard to imagine how such a settlement could be enforced.

6. The CHAIRMAN said that, despite some support for the French proposal, the majority of the members seemed to be in favour of leaving draft article 3 as it stood.

7. Draft article 3 was provisionally approved.

Footnote 1 of draft article 1

8. Mr. SEKOLEC (Secretary of the Commission) introduced conference room paper A/CN.9/XXX/CRP.3, setting forth

proposed changes in the text in the event that States wished to enact the Model Law to apply to domestic as well as international conciliation. Paragraph 1 of A/CN.9/XXXV/CRP.3 presented a proposed draft text for incorporation in footnote 1 of draft article 1, and paragraph 2 contained a proposed draft text for inclusion in paragraph 47 of the draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/514).

9. The conference room paper was the result of a compromise whereby the body of the Model Law would apply only to international conciliation but the footnote would help countries to adapt it if they wished to apply its provisions domestically. A change in the proposed text for inclusion in paragraph 47 of the draft Guide was necessary in order to bring it into line with the paragraph of the Model Law to which it referred. The reference to a sole or third conciliator in paragraph 5 of draft article 6 on appointment of conciliators had been removed as being too reminiscent of arbitration. Therefore, in the proposed text for paragraph 47, wherever the words "with respect to a sole or third conciliator" appeared, they should be replaced by the words "where appropriate". Naturally, all paragraph and article references would be corrected to match the final version of the Model Law.

10. The CHAIRMAN drew the Commission's attention to the need to choose between two alternatives in footnote 1 in relation to paragraph 5 of draft article 1. The first option was merely to delete the paragraph. The second option was to replace the paragraph with the words "This Law also applies when the parties so agree".

11. Mr. MORÁN BOVIO (Spain) said that the proposed text would be helpful to States that did not already have legislation on domestic conciliation and wished to adapt the Model Law to their needs. With regard to the alternatives mentioned, his delegation thought the second alternative was clearer and extended the effect of the Commission's work.

12. Ms. MOOSA (Singapore) said that her delegation supported the second alternative, but she proposed an amended wording to make it more evidently parallel to the wording of draft article 1, paragraph 5: "This Law also applies to a commercial conciliation when the parties agree to the applicability of this Law."

13. Mr. MARKUS (Observer for Switzerland) said that he wondered what cases were envisaged in which the parties could agree to the applicability of the Model Law. If the Law applied strictly to international conciliation, the parties could agree, pursuant to article 1, paragraph 5, that the conciliation was to be regarded as international or that the Law should apply irrespective of the domestic nature of the conciliation. However, if the Law applied to both domestic and international conciliation, the need for such an agreement fell away. At an earlier stage the decision had been made in the Working Group to rule out applicability to private international law. The only possibility that suggested itself was that the parties might agree that the Law should apply even if their dispute was non-commercial in nature.

14. Mr. SEKOLEC (Secretary of the Commission) said that the drafting of the second alternative had been based on two considerations. First, in very informal conciliations, there might be some doubt whether the Model Law applied, unless the parties agreed that it was applicable. Second, the place of conciliation was often hard to determine, so that agreement by the parties would supply the choice of law. Applicability to non-commercial conciliation had not been considered.

15. Ms. RENFORS (Sweden) said that it was important not to give the impression that the Model Law applied to non-commercial conciliation.

16. Mr. SEKOLEC (Secretary of the Commission) said that the question of whether parties to non-commercial disputes might

agree to the applicability of the Law was not one the Law itself should resolve. That was a matter of public policy in the country concerned. However, the formulation suggested by Singapore might answer Sweden's concern.

17. Mr. HOLTZMANN (United States of America) said that there might be borderline situations in which parties were in doubt whether their transaction fell within the definition of commercial contained in footnote 2 of draft article 1, and an agreement between parties would remove all doubt. There was a value in allowing parties to opt in to the Law, and for that very reason Singapore's formulation was less attractive.

18. Ms. MOOSA (Singapore) said that in the light of the remarks by the representative of the United States, she withdrew her proposal. She had noted that there was no reference to "commercial" conciliation in the remainder of the text.

19. The CHAIRMAN suggested the Commission approve the text of conference room paper A/CN.9/XXXV/CRP.3, with the second alternative wording in paragraph 1: "Replace paragraph 5 of article 1 with the words 'This Law also applies when the parties so agree.'"

20. Mr. SHIMIZU (Japan) said he had difficulty in understanding the observation by the United States representative, namely, that that wording would enable the parties to apply the Model Law in cases where they were unsure about the nature of the conciliation. On an objective judgement, a conciliation must be either commercial or non-commercial. If it was the former, there would be no need for a separate agreement; if the latter, the Model Law could apply by agreement, but was that really the intention in the draft?

21. The CHAIRMAN said the problem did not lie in the footnote; it had arisen in connection with draft article 1, paragraph 5. It might need some elucidation in the Guide to Enactment.

22. Mr. HEGER (Germany) said it was apparent that the Model Law was intended to apply in cases where the parties agreed it should. However, according to draft article 1, paragraph 1, it was supposed to apply only to commercial conciliations. He was puzzled over why it was now being proposed that the parties should have the power to decide that their conciliation would be subject to the Model Law even though the dispute was not a commercial one.

23. Mr. SEKOLEC (Secretary of the Commission) said that, according to footnote 2 to the draft Model Law (A/CN.9/506, annex), the term "commercial" was to be given a wide interpretation. Because the relationships to be regarded as commercial fell into different categories, some conciliations might well fall into a grey area, so it would be useful to provide some certainty. If the wording of draft article 1 was adopted without the proposed footnote, the Model Law would apply to both international and domestic commercial conciliations. If the proposed footnote were approved, the words "to a commercial conciliation" in draft article 1, paragraph 5, should be deleted. That would be in line with the Model Law on International Commercial Arbitration, whereby the parties could agree that a relationship was international if they were unsure whether it was or not.

24. Mr. LEFEBVRE (Canada) thought it would be best to take a pragmatic approach, leaving it to the parties to decide whether the Model Law would apply. Courts should not have to determine whether a dispute was commercial in nature.

25. The CHAIRMAN said that the effect of deleting paragraph 5 of draft article 1, while retaining the proposed footnote,

would be that countries that adopted the Model Law could bring non-commercial conciliations within its reach.

26. In reply to a query by Mr. Jacquet (France), he confirmed that that was in fact what the Commission was now considering.

27. Mr. JACQUET (France) pointed out that draft article 1 dealt entirely with international conciliations and would have to be significantly amended as a result, as would draft article 2. He emphasized that the latter required the Model Law to be interpreted bearing in mind its international origin, for the sake of ensuring uniformity of interpretation.

28. The CHAIRMAN said that the Model Law on International Commercial Arbitration had been incorporated into Mexican law to apply equally to domestic and international arbitrations. However, the legislators now felt they had made a mistake in omitting an interpretation clause from the Mexican arbitration law. Without draft article 2, the effects of the Model Law could differ as between domestic and international proceedings; with it, uniformity of interpretation could be achieved by reference to the “international origin” of the Law.

29. Mr. KOVAR (United States of America) said it was important to clarify the issues under discussion. The Commission was dealing with two possible alternative formulations for draft article 1, paragraph 5, but was unclear about the consequences of choosing the second option. Did it mean that a dispute, in order to be conciliated, need not be commercial in character because the parties could opt for conciliation anyway or that the requirement of a commercial character would continue to apply? If paragraph 5 were deleted and replaced by the wording “This Law also applies when the parties so agree”, that would mean that the domestic application of the Law would not necessarily require the commercial standard to be met. If that was not the Commission’s intention, some redrafting would be necessary.

30. The CHAIRMAN said the secretariat was proposing the replacement of paragraph 5 of draft article 1 by: “This Law also applies to commercial conciliations when the parties so agree”. The interpretation of paragraph 5 could be elucidated in the Guide to Enactment. Meanwhile, a decision had to be made between the two alternative wordings, as set out in the proposed footnote (A/CN.9/XXXV/CRP.3).

31. Mr. SHIMIZU (Japan) said his delegation preferred the first of the two options for paragraph 5, because paragraph 7 allowed parties to exclude the application of the Model Law.

32. The CHAIRMAN said a possible solution would be to delete paragraph 5 altogether.

33. Mr. HEGER (Germany), supported by Mr. MARKUS (Observer for Switzerland), Mr. ZANKER (Australia), Ms. RENFORS (Sweden) and Mr. JACQUET (France) agreed with the representative of Japan in preferring the first option. The second option would open the possibility of the Model Law applying to non-commercial conciliations, which did not properly fall within its scope.

34. The CHAIRMAN said he took it that the Commission approved the footnote to draft article 1, as amended, and decided to delete paragraph 5 of draft article 1.

35. *It was so decided.*

36. Mr. KOVAR (United States of America) asked whether there was any need to revise draft article 2, paragraph 1, in the light of the domestic applicability of the Model Law.

37. The CHAIRMAN said that both the Model Law on Electronic Commerce and the Model Law on Cross-Border Insolvency

contained provisions enabling the text to be applied to both domestic and international cases. It would be very regrettable if the articles of the new Model Law were given a different interpretation in the two contexts.

38. Mr. MORÁN BOVIO (Spain) said the emphasis on the international origin of the text was intended to avoid differences in the jurisprudence of countries which adopted it. That emphasis should be retained, to ensure a unitary approach to the application of the Model Law.

The meeting was suspended at 4.20 p.m. and resumed at 5.05 p.m.

Draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation

39. Mr. SEKOLEC (Secretary of the Commission) said that the draft Guide to Enactment and Use (A/CN.9/514) had been based on the draft text of the Model Law that appeared in the annex to document A/CN.9/506 and would require redrafting in the light of the changes made at the current session. Based on the recommendations of the Commission, the final text would be prepared and published subsequently by the secretariat. It would not come before the Commission for adoption. Earlier model laws had been accompanied by guides to enactment, which had been addressed solely at legislators. The expanded name “Guide to Enactment and Use” reflected the fact that it was also designed to help those using and interpreting the text.

Purpose of the Guide (paras. 1-4 of the draft Guide)

40. Mr. HOLTZMANN (United States of America) said that paragraph 4 would need to be amended to reflect the fact that the Guide was not due to be adopted by the Commission.

Introduction to the Model Law (paras. 5-25 of the draft Guide)

41. Mr. HOLTZMANN (United States of America) said that the definition of conciliation given in paragraph 5 failed to include the key element of the request made by parties for a third person to assist them in settling a dispute. In paragraph 6, it should be clarified that the degree of control that parties retained over the process differed from one part of the Model Law to another. Under some but not all provisions, one party might be entitled to act alone, and according to other provisions, the conciliator controlled the procedure unless the parties stated otherwise. Even though the phrase “alternative dispute resolution” was sometimes taken to include arbitration, the definition given in paragraph 7 excluded it completely. If a definition of the phrase was given at all, it should at least be a more accurate reflection of the two interpretations.

42. The material in paragraphs 5-10 should be reorganized with a view to emphasizing the advantages of conciliation. There were a variety of reasons why conciliation could be presented as an attractive alternative, but they needed to be brought out more clearly in the Guide. In paragraph 9, it was inaccurate to state that the admissibility of evidence could be governed by sets of rules such as the UNCITRAL Conciliation Rules. Only laws could guide the courts in determining questions of admissibility.

43. Mr. JACQUET (France) said that, in his view, it did not encourage parties to use conciliation to refer to it as “alternative” or “non-adjudicative” dispute resolution. While the definition given in paragraph 7 was not totally inaccurate, it could be redrafted to present conciliation as a more attractive alternative.

44. Mr. HOLTZMANN (United States of America) said that it was debatable whether the Model Law would help to increase stability in the market place, as suggested in paragraph 13, even

though conciliation presented a number of other advantages, such as friendliness and cost efficiency. Similarly, it was an exaggeration to describe the objectives of the Model Law as essential for international trade, and paragraph 14 should be amended accordingly. Too much historical detail was given in paragraphs 16 and 17, particularly in relation to arbitration, which tended to constitute a distraction from the focus of the Guide.

45. Mr. MORÁN BOVIO (Spain), commenting on the suggestion made by the United States delegation, said that although the section on background and history could be shortened somewhat, it should include a summary of the key moments in the history of the text. A historical overview would be very helpful to legislators who might wish to seek further information on the UNCITRAL web page, look for specific documents or consult with national delegates. It would also be helpful in that it would show a timeline of the Commission's work on the Model Law.

46. Mr. ZANKER (Observer for Australia) said he agreed with the United States delegation that paragraphs 16 and 17 distracted attention, and it would be better to leave them out. If material relating to the development of texts was to be included, it would be better to show it in tabular form and place it at the back of the document. The table could include cross-references to the papers that had been generated by the Working Group in the course of its discussions.

47. Mr. HOLTZMANN (United States of America) said that the section on structure of the Model Law should be redrafted to focus on avoiding spillover, in other words to deal with what happened with information that was elicited during conciliation if the conciliation did not succeed. That emphasis could be inserted somewhere in paragraphs 20-23, perhaps paragraph 22.

Article-by-article remarks

Article 1. Scope of application (paras. 26-35 of the draft Guide)

48. Mr. KOVAR (United States of America) recalled that in the discussions on article 1, paragraph 2, his delegation had stressed the importance of clarifying whether a particular series of events constituted a conciliation within the definition of article 1, paragraph 2. A court should consider any evidence that the parties did or did not have an understanding that conciliation existed and that there was a consequent expectation that the provisions of the Model Law would apply.

49. Under the terms of article 1, paragraph 7, the Law would apply to a conciliation conducted by a court. Under paragraph 8, the law would not apply to cases where a judge or an arbitrator, in the course of a court or arbitral proceeding, attempted to facilitate a settlement. In the discussion of article 1, paragraph 8, of the Model Law, paragraph 35 of the draft Guide did not reproduce the wording "attempts to facilitate a settlement" but rather spoke of the court undertaking "a conciliatory process". The Guide should reflect the difference between the situation in which a court or judge acted not as a conciliator but rather as a facilitator of a settlement and the situation where a judge or arbitrator acted as a conciliator. In the case where a judge did not act as a conciliator, the law did not apply; however, when he put on the hat of a conciliator, the law did apply. The difference could be determined by the fact that in the circumstance of paragraph 8, the court acted on its own initiative or at the request of one party perhaps, but not of both parties. If a court, acting on its own motion, attempted to facilitate a settlement, it was not acting as a conciliator; however, the moment the two parties came to the judge and requested assistance, the judge then became a conciliator, and he then was governed by the provisions of the Model Law. The matter should be clarified in the Guide.

50. Mr. SHIMIZU (Japan) suggested that the following wording should be included in paragraph 31: "Article 1 is not intended to interfere with the operation of the rules of private international law."

51. Mr. TANG HOZHAI (China) said that his delegation agreed with the content of article 1, paragraph 8. The Model Law did not apply to procedural questions such as the number of conciliators that were needed or how they should be designated. It was important to stress the neutrality of the Model Law on procedural questions. He suggested that the following sentence should be included in paragraph 35 or some other appropriate place in the Guide: "The Model Law is not intended to indicate whether or not a judge or an arbitrator may conduct conciliation in the course of court or arbitration proceedings."

52. Mr. ZANKER (Observer for Australia) noted that in paragraph 27 it was stated that the term "commercial" was defined in footnote 2 to article 1, paragraph 1; later, however, in that same paragraph it was stated that no strict definition of "commercial" was provided in the Model Law. In order to avoid confusion, it would be preferable to stick to the "illustrative list" terminology instead of using the word "definition" in referring to the footnote.

53. Mr. SEKOLEC (Secretary of the Commission) asked the United States delegation for clarification of his remarks regarding the second sentence of paragraph 35. In the course of drafting the Model Law, it had been established that the process of facilitating a settlement could be carried out by a judge either at the request of the parties or in the exercise of the judge's prerogative; in other words, on his or her own motion. He was not sure whether he had understood correctly that the United States had suggested that article 1, paragraph 8, should be restricted only to cases where the judge acted on his or her own motion.

54. Mr. HOLTZMANN (United States of America) responding to the Secretary's request for clarification, said that, as he recalled the discussion on article 1, paragraph 8, the phrase "to facilitate a settlement" had been used in order to avoid using the word "conciliation". That had been done because when a judge or arbitrator put on the hat of a conciliator, he or she was subject to the Model Law while performing the functions of a conciliator. Under the Chinese system, the arbitrator could become a conciliator for a while and then go back to being an arbitrator. Whether the provisions of the Model Law relating to spillover, confidentiality and related provisions applied or not depended on which hat the judge or arbitrator was wearing. When he was wearing the hat of one who attempted to facilitate a settlement, he was wearing the hat of a judge or arbitrator.

55. The text called for a difference, and the difference was found in the definition of conciliation in article 1, paragraph 2. That definition meant that, if both parties requested and the judge or arbitrator said "yes", then the judge's action fell within the scope of conciliation and all the provisions of the law that governed and protected parties in the event of conciliation applied. But if the elements of the definition were not met, then the provisions of the Model Law did not apply. It was useful to alert parties, judges and others that the phrase "facilitate a settlement" had a different meaning than "conciliation" and that reference must therefore be made to the definition of "conciliation". His delegation agreed with the Chinese delegation that it should be clearly established that the Model Law did not prevent an arbitrator from changing hats back and forth. Practices differed in different systems, and the Model Law was neutral on that point. That should be noted later on in connection with draft article 13, on the conciliator acting as arbitrator.

The meeting rose at 6 p.m.

**Summary record of the 749th meeting,
held at United Nations Headquarters on Monday, 24 June 2002, at 10 a.m.**

[A/CN.9/SR.749]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam-Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.10 a.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION** (*continued*)

*Draft Guide to Enactment and Use of the UNCITRAL Model Law
on International Commercial Conciliation* (A/CN.9/514)

*Article 1. Scope of application (paras. 26-35 of the draft Guide)
(continued)*

1. Mr. INOUE (Japan) asked for clarification of article 1, paragraph 8: he wished to know whether the Model Law was considered not to apply to what was termed “court-annexed conciliation”, which did not match the definition of conciliation given in article 1, paragraph 2.

2. The CHAIRMAN said that that issue was discussed in paragraph 14 of addendum 1 to the draft report on the thirty-fifth session (A/CN.9/XXXV/CRP.1/Add.1) and that it could be referred to the secretariat in the light of discussions in the drafting group if necessary.

Article 3. Variation by agreement (para. 38 of the draft Guide)

3. Mr. JACQUET (France) pointed out that paragraph 38 referred both to the principle of party autonomy and to leaving to the parties almost all matters that could be set by agreement. For the sake of consistency, he suggested that paragraph 38 should instead state that the parties had a general power of derogation over all the articles of the Model Law. That power of derogation was not quite the same as party autonomy, a concept that he thought was best reserved for those articles of the Model Law which contained the phrase “unless otherwise agreed”. Operating that distinction would ensure that using the phrase “unless otherwise agreed” was not construed as invalidating article 3 of the Model Law.

4. The CHAIRMAN said he had understood from his law studies that “derogation” was a term reserved for the legislative authorities, and that the phrase might have to be expanded using a qualifier such as “derogation by the parties” to distinguish it from derogation carried out by the legislative authorities.

5. Mr. JACQUET (France) said that the issue which the Chairman had raised was covered by the title of the article itself (“Variation by agreement”); all he wished was to see the body of paragraph 38 of the Guide reflect its own title and use the terms in that title, rather than refer only to party autonomy.

6. The CHAIRMAN pointed out that the term “derogation” seemed confined to the French-language version of the draft Model Law and draft Guide. Other languages did not use that term (Spanish used “modificación mediante acuerdo”).

7. Mr. HOLTZMANN (United States of America) raised several issues in connection with the French delegation’s remarks.

First, he disagreed with the view that the exercise of party autonomy and the ability to vary the terms of the draft Model Law were two separate matters. He believed that variation was simply an example of exercising party autonomy. Second, with regard to the term “derogation”, article 1 of the UNCITRAL Arbitration Rules offered an example of several terms being used to denote the same concept: the first paragraph stated: “. . . such disputes shall be settled in accordance with these Rules subject to such modification as the parties may agree in writing”, while the second stipulated that the Rules should apply “except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail”. As UNCITRAL documents used a variety of terms to describe that phenomenon, he considered that the provisions of the draft Guide were fully adequate, though he was not opposed to further explanation being added to it.

8. Third, he wished to point out that phrases such as “unless otherwise agreed” had been included in some articles and not in others simply for reasons of user-friendliness: the parties would not have to have uppermost in their minds the fact that article 3 of the Model Law applied very nearly across the board. The intention had certainly not been to weaken article 3 but rather to remind the parties of its existence. He suggested that paragraph 38 of the Guide should explain that where the phrase “unless otherwise agreed” was used in an article of the Model Law, it in no way implied that article 3 of the Model Law failed to apply to those articles from which it was absent.

9. The CHAIRMAN said that the secretariat would take account of the remarks made when deciding on the wording of the Guide. He had been advised by the secretariat that the positions of the representatives of France and the United States might not be compatible with each other. There was no technical difference between the general rule set out in article 3 of the draft Model Law and the specific phrase “unless otherwise agreed” added to some of the articles to make them clearer.

10. Mr. JACQUET (France) said that his only concern was clarity. Article 3 specified that the parties could agree “to exclude or vary” (“écarter ou modifier”) any of the provisions of the Model Law. He would be satisfied if paragraph 38 of the draft Guide made it clearer that those two options existed. The word “exclude” denoted “variation by agreement” proper, while the word “vary” denoted an alteration that the parties had adopted independently.

*Article 4. Commencement of conciliation proceedings
(paras. 39-44 of the draft Guide)*

11. Mr. HOLTZMANN (United States of America), referring to the draft footnote to article 4, which proposed an article X regarding the suspension of the limitation period for the claim to which a conciliation proceeding related, said that in earlier discussions it had been suggested that the Guide should alert parties to the fact that if they adopted article X, additional stipulations might be

unavoidable in order to cope with potential future difficulties. Such difficulties included determining the exact start and end of the suspension of the limitation period for the claim, since the Model Law, having been left deliberately flexible, contained no such details. Parties would have to weigh up the advantages and disadvantages of adopting an article on suspension of the limitation period, as it would bring adverse consequences, namely, less flexibility and more need for additional stipulations. The Commission should remain neutral but should still point out that adopting an article X was not without implications.

12. The CHAIRMAN said that he had serious doubts about the United States proposal. The Commission had decided that the Guide should set out the pros and cons of article X, which was a commitment between the parties and therefore did not lend itself to being treated as a derogation. He also found it difficult to reconcile placing in a guide covering an UNCITRAL text that had been agreed upon, and that was intended for adoption as a model, a suggestion that that very text might be imprecise or in need of change. Paragraphs 21 and 22 of addendum 1 to the draft report on the thirty-fifth session (A/CN.9/XXXV/CRP.1/Add.1) had thoroughly covered the arguments regarding article X, and a decision had been taken accordingly.

13. Mr. HOLTZMANN (United States of America) said that his delegation had not wished to suggest that the existing text of the Guide was in any way imprecise or in need of change. Its point was that the text was flexible and that the Guide should contain a balanced discussion on the subject of article X, as it did on other subjects. His recollection was that the Commission had concluded that if article X was included in a footnote to article 4, the Guide should contain a balanced assessment of the kind his delegation was suggesting. He said that his delegation's reasoning and that advanced by the Chairman were not incompatible, and that the secretariat could take them into account.

14. Mr. GARCÍA FERAUD (Observer for Ecuador) said that, in his view, the agreement reached following the Commission's discussion of article X should be adhered to. That discussion had certainly revealed doubts about the wisdom of providing, in a footnote, for the option to adopt article X, but the opposite point of view had also been expressed: not providing for the approach offered by article X would have had the effect of leaving the limitation period on claims handled through conciliation to run out, with no prospect of halting that period. He urged that there should be no break with past practice, and that the Commission should remain neutral.

15. Mr. HEGER (Germany) said that in his view paragraph 44 of the draft Guide could be considered to have covered the balanced argument favoured by the United States representative, and he did not see how the text could go any further.

16. The CHAIRMAN said that the secretariat would take into account the remarks made, paragraph 44 of the draft Guide and paragraphs 21 and 22 of addendum 1 to the draft report on the thirty-fifth session (A/CN.9/XXXV/CRP.1/Add.1), in order to present a neutral and balanced picture of the advantages and disadvantages of article X in the Guide.

Article 5. Number of conciliators; article 6. Appointment of conciliators (paras. 45-48 of the draft Guide)

17. Mr. HOLTZMANN (United States of America), referring to the first line of paragraph 47 of the draft Guide, dealing with article 6, questioned the use of the phrase "has to be had". In his opinion, the phrase should be modified, as it currently suggested that there was a strict requirement for reference to an institution or third person. If parties did not reach an agreement on the appointment of a conciliator, they might choose to seek assist-

ance, or they might determine that they did not wish to conciliate since an agreement could not be reached on a conciliator. Furthermore, they could also agree to proceed with two conciliators, since it was already established practice that, in conciliation, an even number of conciliators was not essential.

18. His delegation agreed that provisions in article 6, paragraph 6, on disclosure, were not intended to establish new grounds over and above what was provided under existing contract law, and that there was indeed a need to establish that fact within the text of the draft Guide. His delegation also supported the inclusion of the proposed text, contained in paragraph 2 of conference room paper A/CN.9/XXXV/CRP.3, for inclusion in paragraph 47 of the draft Guide.

19. Mr. MARSH (United Kingdom) recalled that an earlier version of the article dealing with the appointment of conciliators had operated on the basis that each party would choose between two conciliators. In multiparty disputes, it had been agreed that a joint approach would be taken. It appeared that paragraph 46 of the draft Guide reflected the previous, and not the current, principle. A substantial degree of amendment was therefore required.

20. He also questioned the wording of paragraph 46, as it seemed to suggest that, in discussions on the preparation of the draft Model Law, an approach in which each party appointed its own conciliator was inherently better. It would be inappropriate to retain such wording, as that particular approach had not been adopted as a feature of the draft Model Law.

21. Ms. RENFORS (Sweden) endorsed the views expressed by the United Kingdom representative with respect to the need for paragraph 46 to be modified in order to reflect the changes made to the article dealing with the appointment of conciliators.

Article 7. Conduct of conciliation (paras. 49-53 of the draft Guide)

22. Mr. HOLTZMANN (United States of America) drew attention to the first line of paragraph 51, which stated that the draft Model Law "does not set out a standard of conduct". He believed, on the contrary, that the Model Law did just that. He further stated that although the second sentence accurately reflected the discussion which had ensued, it should be deleted. The draft Guide should not appear to give instructions to States, or imply that paragraph 3 could be used as grounds for upsetting an award. Similarly, paragraph 52 should be deleted, as there was no need to focus on UNCITRAL Conciliation Rules or to enter into a discussion on national laws.

23. Mr. SORIEUL (International Trade Law Branch) drew attention to the fact that the current discussion was based on conference room papers A/CN.9/XXV/CRP.1/Add.1 and 2 and that addenda 3, 4 and 5 had already been issued. Changes to the draft Guide had derived from substantive discussions of the text.

24. The CHAIRMAN recalled that a decision had been taken to retain, in the draft Guide, language that would indicate that the draft Model Law was not creating new grounds for setting aside a conciliation settlement (A/CN.9/XXXV/CRP.1/Add.2).

25. If he heard no objection, he would take it that paragraph 52 of the draft Guide should be deleted.

26. *It was so decided.*

Article 8. Communication between conciliator and parties (paras. 54-55 of the draft Guide)

27. Mr. ZANKER (Observer for Australia), drawing attention to the first line of paragraph 55, said that he wished to question the

mention of “equal treatment” since, in his recollection, the only reference to standard of conduct discussed in the preparation of the draft Model Law had been in the context of fair treatment of the parties by the conciliator. He believed that paragraph 55 was not particularly useful and could therefore be omitted entirely.

28. Mr. HOLTZMANN (United States of America) said he supported the view expressed by the observer for Australia that paragraph 55 should be deleted. If it had to be retained, however, it would be more appropriately placed within the context of the discussion on article 7, paragraph 3. He believed that details on the conduct of conciliation should be left to the discretion of the conciliator.

29. Mr. JACQUET (France) said that he strongly favoured the retention of paragraph 55, as it was particularly useful. The conciliator was not required to adhere to a mathematical calculation of equality of treatment and of time set aside for each of the parties. He conceded that the first sentence could be regarded as ambiguous, but he was of the view that the rest of the paragraph served to clarify the nuances in the interpretation of article 8.

30. The CHAIRMAN recalled that doubts had been raised when the subject was discussed in the Working Group, but that it had been considered worthwhile to include paragraph 55 in the draft Guide.

31. Mr. ZANKER (Observer for Australia) said that, even after taking the entire paragraph into consideration, he returned to the conclusion that paragraph 55 should be deleted. He found nothing in conference room paper A/CN.9/XXXV/CRP.1/Add.2 or article 8 that dealt with the issue of time. The issue at hand involved the principle of meetings between the conciliator and the parties, either collectively or separately.

32. The CHAIRMAN suggested that there had been considerable debate on those issues in the Working Group and that further examination of document A/CN.9/506 might be appropriate.

33. Mr. SOREUIL (International Trade Law Branch) referred the Commission to the report of the Working Group on Arbitration on the work of its thirty-fourth session (A/CN.9/487), in particular to paragraph 129, which summarized the discussion surrounding introduction of the reference to “equal treatment” in draft article 8. A note of caution had been struck about introducing an operative rule that might result in the imposition of excessive formalism.

34. Mr. KOMAROV (Russian Federation) said that his delegation supported the comments made by the representative of France. Paragraph 55 of the draft Guide should be retained for the benefit of legislators. It was important to stress that equal treatment should be a matter not only of form, but also of substance.

35. Mr. MARSH (United Kingdom) said that the reference to equal treatment would be more appropriate to article 7 (Conduct of conciliation), since a party would be more likely to look to that article to provide the basis for a complaint in that regard.

36. Mr. TANG HOZH (China) said that the paragraph should not be deleted, since it reflected the considered view of the Working Group. Equal treatment was an important principle of natural justice, on which the success of any conciliation process depended.

37. Mr. HOLTZMANN (United States of America) said that his delegation wished to propose a compromise solution. The words

“The conciliator should afford the parties equal treatment, which however” should be replaced with the words “This provision”.

38. Mr. TANG HOZH (China) said that no further compromise solution was necessary, since the text had already been agreed by the Working Group.

39. Mr. GARCÍA FERAUD (Observer for Ecuador) said that paragraph 55 as currently drafted was justified, since it alerted the conciliator to the importance of ensuring that the parties did not doubt the fairness of the conciliation process. Mistrust in such situations was common.

40. The CHAIRMAN said that, according to paragraph 129 of the report of the Working Group on its thirty-fourth session (A/CN.9/487), the Working Group had agreed at that session that a reference to the equality of treatment to be given by the conciliator to both parties would be better reflected in draft article 7 (Conduct of conciliation). He thus took it that the reference in question should be included in the draft Guide under article 7.

41. *It was so decided.*

Article 9. Disclosure of information between the parties (para. 57 of the draft Guide)

42. Ms. MOOSA (Singapore), supported by Mr. MARSH (United Kingdom), said that the final sentence of paragraph 56 of the draft Guide was overstated. In some countries, including Singapore, the practice of requiring a party’s consent before information could be given to the other party had been found to be conducive to conciliation, since it encouraged both parties to be more forthcoming to the conciliator.

43. Mr. SEKOLEC (Secretary of the Commission) suggested that a reference could be made to the fact that practices such as the ones described by the representative of Singapore that were enshrined in the mediation or conciliation rules of various providers of such services would be valid if agreed upon, and that the Model Law as drafted would not impede such practices or such agreements, although the default position was the one established in the Model Law.

44. Mr. INOUE (Japan) said that the meaning and importance of the term “substance” should be clarified in the draft Guide.

45. Mr. ZANKER (Observer for Australia), expressing support for the views of the representative of Singapore, drew attention to paragraph 30 of conference room paper A/CN.9/XXXV/CRP.1/Add.2, which stated that the draft Guide should contain a clear recommendation to conciliators that they should inform the parties that information communicated to a conciliator might be revealed unless the conciliator was specifically instructed otherwise. The draft should thus be modified accordingly. In Australia, confidentiality was observed in all cases by conciliators, contrary to the practice laid down in the Model Law.

46. Mr. HOLTZMANN (United States of America) said that his delegation appreciated the comments made by Singapore, the United Kingdom, Japan and Australia and associated itself with them. The title of article 9 was confusing in that it referred to information between the parties, whereas the article dealt mainly with communication between the parties and the conciliator, not between the parties themselves. He suggested, therefore, that the Secretariat should reconsider the sentence in paragraph 56 that read “The intent is to foster open and frank communication of information between parties”, as it did not seem to reflect the thrust of the article.

47. Ms. MOOSA (Singapore) expressed appreciation to the Secretary of the Commission for his suggestion, which was acceptable to her delegation. It was very important to have that statement, as the practice was becoming increasingly popular.

48. Mr. MARSH (United Kingdom) welcomed the Secretary's suggestion on amending the final sentence of paragraph 56. It seemed to go farther, however, than merely suggesting that what was regarded as a best practice should be relegated to the default position. While he did not wish to undermine the agreed wording of the article, he wondered whether a way might be found to suggest in the Guide that the practice could be an acceptable alternative.

49. Mr. TANG HOZHAI (China) said that his delegation supported the statement made by Singapore and requested the secretariat to improve on the paragraph.

50. The CHAIRMAN said he took it that there were no objections to adopting either the Singaporean proposal or the secretariat's suggestion.

51. Mr. SEKOLEC (Secretary of the Commission) drew attention to the discussions in the Working Group on Insolvency Law, which was preparing a legislative guide on national insolvency law. Several references had been made in those discussions to non-judicial settlement of disputes that arose in the context of insolvency proceedings or efforts to avoid the initiation of such proceedings. Recent positive experience showed the usefulness of mediation and conciliation as a means of facilitating the resolution of disputes that arose in the context of or preceding insolvency proceedings involving commercial enterprises. He therefore proposed to insert in the Guide the following draft text:

"Experience in some jurisdictions suggests that the Model Law would also be useful to foster the non-judicial settlement of disputes in multiparty situations, especially those where interests and issues are complex and multilateral rather than bilateral. Notable examples of these are disputes arising during insolvency proceedings or disputes whose resolution is essential to avoid the commencement of insolvency proceedings. Such disputes involve issues among creditors or classes of creditors and the debtor or among creditors themselves, a situation often compounded by disputes with debtors or contracting parties of the insolvent debtor. These issues may arise, for example, in connection with the content of a reorganization plan for the insolvent company; claims for avoidance of transactions that result from allegations that a creditor or creditors were treated preferentially; and issues between the insolvency administrator and a debtor's contracting party regarding the implementation or termination of a contract and the issue of compensation in such situations."

52. The CHAIRMAN said that, if he heard no objections, he would take it that the Commission wished to adopt the secretariat's recommendation, taking into account that it was based on the views of another expert group.

53. Mr. BARRACO (Italy) requested the Chairman to clarify his understanding that, at a previous meeting, the Commission had adopted a French proposal to change the title of article 9 to "Disclosure of information by the conciliator". The proposal of Singapore made more sense with that title.

54. The CHAIRMAN said he recalled that there had been such an agreement, but as the text currently before the Commission was the one prepared by the Working Group, it reflected the previous title.

55. Mr. ZANKER (Observer for Australia) drew attention to paragraph 25 of conference room paper A/CN.9/XXXV/CRP.1/Add.2, wherein it was stated that, as the title of the draft article inadequately reflected the scope of the provision, it should, in line with article 10 of the UNCITRAL Conciliation Rules, read "Disclosure of information".

56. Mr. TANG HOZHAI (China) said it was to be hoped that the secretariat would make the appropriate changes.

57. Mr. KOVAR (United States of America) said that his delegation generally supported the wide use of conciliation and would be pleased to see the Model Law applied to a wide variety of commercial situations. However, as the proposal had just been presented, his delegation would appreciate an opportunity to consult with insolvency experts on details of the text.

58. The CHAIRMAN said that the request by the United States to have time for consultations was entirely appropriate; it meant, however, that the Commission could not take a final decision on the proposal at the current meeting. It would be helpful if the United States and other delegations that found themselves in a similar situation could communicate their response to the secretariat by the end of the day.

59. Mr. MARSH (United Kingdom) said that, while the secretariat's suggestion was extremely useful, he was concerned at the possibility that providing an example from only one field, namely, insolvency, might create an impression that the use of conciliation was limited to that field. Currently, only a small percentage of commercial conciliations dealt with insolvency issues, whether at the international or at the national level.

60. The CHAIRMAN said that, having drafted the first Mexican insolvency law, he could state that it would have been very helpful to be able to refer to the Model Law, together with the Guide and commentaries, as well as the paragraph proposed by the secretariat, even though it referred to only one example.

61. Ms. BRELIER (France) requested clarification from the secretariat as to where the draft text was to be inserted. Her delegation associated itself with the reserved attitude shown by the United Kingdom and the United States regarding the reference to the discussions in the Working Group on Insolvency Law. It was impossible to foresee what the consequences of such a reference might be; she wondered, however, whether it might pose the risk of a proliferation of extrajudicial remedies.

62. Mr. TANG HOZHAI (China) said that, in his country, insolvency disputes had to be resolved in court, as no conciliation regime existed; however, there was no law against resolving such disputes through conciliation procedures. The World Trade Organization attached importance to such procedures because of their flexibility.

ELECTION OF OFFICERS (*continued*)

63. Ms. VIRBICKATE (Lithuania), speaking on behalf of the Group of Eastern European States, nominated Mr. Milassin (Hungary) for the office of Vice-Chairman.

64. Mr. MILASSIN (Hungary) was elected Vice-Chairman by acclamation.

The meeting rose at 1 p.m.

**Summary record of the 750th meeting,
held at United Nations Headquarters on Monday, 24 June 2002, at 3 p.m.**

[A/CN.9/SR.750]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Akam Akam (Cameroon), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 3.15 p.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION** (*continued*)

*Draft Guide to Enactment and Use of the UNCITRAL Model Law
on International Commercial Conciliation* (A/CN.9/514)

1. The CHAIRMAN said that the secretariat had asked for guidance from the Commission as to how it wished to proceed with the drafting of the Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation.

2. Mr. SEKOLEC (Secretary of the Commission) recalled that, at the beginning of the discussion on the draft Guide to Enactment, the tentative conclusion seemed to have been that the final drafting of the Guide would be entrusted to the secretariat. However, since the discussions of the last two days had showed that the delegations were concerned with matters of specific wording, the secretariat found itself in a difficult position. As he saw it, there were two possible solutions. One was for the Commission to retain full control over the text of the Guide to Enactment, in which case it could not be adopted at the present session, and it would not be published until the final text had been approved. The other alternative was to trust the secretariat to produce a text that reflected the wishes of the Commission to the best of its understanding. In the latter case, the secretariat would need to have freedom to make changes, to include texts that the delegations had not seen and to be ultimately in control of the final content of the Guide.

3. Mr. JACQUET (France), Mr. HEGER (Germany), Mr. MIKI (Japan), Ms. MOOSA (Singapore) and Mr. TANG HOZHUI (China) said that they would prefer to leave the actual drafting of the Guide up to the secretariat. They were confident that it would do an excellent job.

4. The CHAIRMAN said that if he heard no objection, he would take it that the Commission wished to entrust the secretariat with the task of drafting the Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation. The Secretary would take note of any proposals and suggestions that delegations might wish to make but would not be required to respond or to include them in the final text.

5. *It was so decided.*

Article 10. Duty of confidentiality (paras. 58-60 of the draft Guide)

6. Mr. HOLTZMANN (United States of America) said that the words “duty of” should be deleted from the title of the article; he trusted that would be done when the final version of the Model Law was issued. He also reminded the secretariat that the United States had read into the record a statement (A/CN.9/SR.745) to be

inserted in the Guide with respect to draft article 10 indicating that it was the intent of the drafters that in the event a court or other tribunal was considering an allegation that a person did not comply with article 10, it should include in its consideration any evidence of conduct of the parties that showed that they had or did not have an understanding that a conciliation existed and that consequently there was an expectation of confidentiality. A State that enacted the Model Law might wish to clarify article 10 to reflect that interpretation. It was his understanding that that interpretation had been approved and that it would be included in the draft to be produced by the secretariat.

Article 11. Admissibility of evidence in other proceedings (paras. 61-68 of the draft Guide)

7. Ms. RENFORS (Sweden) said that the last sentence of paragraph 61 seemed to reflect the wording in the previous text of the article. It needed to be adapted so as to reflect the wording that had been approved during the previous week.

8. Mr. HOLTZMANN (United States of America) suggested that in dealing with paragraphs 62-67, the secretariat should make it clear that the draft Model Law provided for two mechanisms with respect to the use of evidence relating to the conciliation in other proceedings. On the one hand, there were the provisions that were similar to those in the UNCITRAL Conciliation Rules, according to which a party was not to rely on the evidence. That represented an obligation on the party not to do something. That was as far as the rules could go because the rules could not tell the court (or an arbitrator) what it could or could not admit. The Conciliation Rules dealt with those matters of evidence listed in draft article 11 in terms of what “a party will not rely upon”. In addition, there was a second method, whereby a court or arbitrator “will not admit”. There was the concept of reliance and the concept of admissibility. He hoped the secretariat would make it clear in the Guide that article 11 of the Model Law provided for both reliance and admissibility.

9. Mr. CHAN (Singapore) recalled that there had been considerable discussion of what was meant by the words “the law” in paragraph 3. It had been agreed that the phrase “the law” in that paragraph meant legislation. Thus, if legislation so prescribed, the information in question could be disclosed; a court or an arbitral tribunal or a competent government authority could order that the information be disclosed.

10. It had been understood by the Working Group that the words “under the law” did not mean a subpoena issued by the court. A subpoena issued by a court was an order made pursuant to law and could conceivably fall within the exception to the obligations imposed by the article on courts and arbitral tribunals and other authorities not to compel the disclosure of such information. Since his delegation’s point had been raised late in the day, it had been decided that it could be dealt with in the Guide.

11. However, the reference to the matter in paragraph 7 of conference room paper A/CN.9/XXXV/CRP.1/Add.4 did not clearly explain his delegation's position on article 11, paragraph 3. He wished to request that in the preparation of the Guide, the secretariat should pay some attention to explaining that the words "the law" in paragraph 3 were not to be construed to mean orders made pursuant to the law by a court, a tribunal or some other authority but referred only to existing legislation that provided for the compellability of such information. Otherwise, the entire purpose of the provision, which was to maintain confidentiality and thus enable parties to have certainty as to the circumstances under which such information would be kept confidential, would be undermined.

12. Mr. SEKOLEC (Secretary of the Commission) said he fully understood that the Commission's desire was to make sure that article 11 was as watertight as possible. However, any court decision entailed interpreting the law. The decision of an Australian court in the *Esso* case, for example, had cast a new light on the issue of the confidentiality of arbitration. As he understood it, to say that the words "the law" meant only legislation would still imply that it meant legislation as interpreted by courts. It would be hard to tell the courts that they could not interpret their law. He fully understood the position expressed by the representative of Singapore but was not sure how to express it in the text of the Guide.

13. Mr. CHAN (Singapore) said that he had not used the words "court decisions" but rather "a subpoena issued by the court". The mischief that his delegation wished to prevent was a situation in which one party, who might or might not be involved in the conciliation, might apply to the court for a subpoena compelling the disclosure of information obtained during the conciliation that would otherwise be confidential in order to use it in other proceedings involving the same or other parties. He was not talking about a situation where a court, after full argument and consideration, decided that certain information that had been obtained in conciliation was or was not compellable. If the court decided that it was, notwithstanding arguments to the contrary, then that was the law. That had been the situation in the *Esso* case.

14. What must be avoided was the situation where a person went to the court with an affidavit and a document requesting the court to take action and got the court to issue a subpoena in order to compel that information to be produced at proceedings in which the parties to that particular conciliation did not expect such information to be made public. He recognized that where legislation provided for such information to be compellable in evidence or when a court decided that such information was compellable, then that was in fact the law. But he was concerned that the use of the phrase "the law" might be extended to a situation where a subpoena was issued without full consideration by the court, merely on an application by one party.

15. Mr. HOLTZMANN (United States of America) pointed out that draft article 11, paragraph 3, stated that the disclosure of the information referred to in paragraph 1 of that article could not be ordered by an arbitral tribunal or a court. A subpoena was an order to disclose certain information; in his delegation's view, the wording "shall not be ordered by an arbitral tribunal or a court" in paragraph 3 covered the problem that concerned the delegation of Singapore. However, he would have no objection to the Guide making clear that the paragraph in question covered subpoenas.

16. His delegation also wished to suggest that the discussion of article 11 in the Guide should include wording to the effect that the phrase "similar proceedings" included discovery and deposition.

17. In paragraph 67 of the Guide, the penultimate sentence should be redrafted to insert the phrase "including documents prepared solely for the conciliation proceedings" after the word "statements".

18. Mr. SEKOLEC (Secretary of the Commission) asked the United States representative whether he intended to say that subpoenas were covered by paragraph 3. Was he endorsing the statement made by the representative of Singapore?

19. Mr. HOLTZMANN (United States of America) said that in his view, a court could not issue a subpoena for something covered by article 11 any more than a judge could order it to be heard in court. Those items were to be kept confidential. When a State adopted the Model Law, it adopted that provision and changed any contrary provision in its own law that might give the court unrestricted powers with respect to a subpoena.

20. Mr. SEKOLEC (Secretary of the Commission) said that a subpoena would always be issued on the basis of a law. What the delegation of Singapore had said was that subpoenas might be legitimate grounds for disclosure arising from conciliation but that such subpoenas should be only those that had been fully argued in court.

21. Mr. CHAN (Singapore) said that the first sentence of paragraph 3 clearly stated that the information of the kind indicated in paragraph 1 was not compellable as evidence. However, the second sentence allowed an exception to that rule "to the extent required under the law". It should be made clear in the Guide that by "law" was meant written law and not the general power of the court to compel evidence. Otherwise, the whole point of the first sentence would be undermined, and abuses could occur in which parties were granted a subpoena in disregard of article 11.

22. His delegation was not saying that all subpoenas were impermissible. But a subpoena should be based on written laws governing the compellability and admissibility of evidence. Moreover, there was a greater need to compel evidence in a criminal case than in a civil case; that distinction should be made clear.

23. Mr. MARKUS (Observer for Switzerland) said that it was true that the phrase "required under the law" was too broad and needed to be clarified. The view of the delegation of Singapore was that the expression should be qualified on the basis of formal criteria: the law in question should be in writing, should deal specifically with admissibility of evidence and so forth. However, in some legal systems based on case law or precedent, the laws of evidence might not be in writing. The key distinction, in his opinion, lay in the purpose or aim of the kinds of laws that could trigger an exception to inadmissibility of evidence. The Guide was too brief on that point, and the purposes indicated in the draft article itself, "implementation or enforcement of a settlement agreement", were too vague to be a sufficient guide.

24. Mr. GARCÍA FERAUD (Observer for Ecuador) said that under some legal systems both legislative acts and court precedent together created a body of binding jurisprudence. The words "under the law" had to be interpreted according to the particular legal system of the country. It should be noted, by the way, that the two reasons given in the paragraph for making an exception to the inadmissibility rule were separate and distinct; on the one hand, there might be exceptions required under the law and, on the other, there might be exceptions for the purposes of implementation or enforcement of a settlement agreement. Moreover, he feared that the discussion was focusing on the wording of the draft article, which had already been agreed on, rather than the wording of the Guide.

25. Mr. SEKOLEC (Secretary of the Commission) said that paragraph 67 of the draft Guide did give many examples of the type of exceptions the Commission had in mind. Perhaps the key distinction was between the public interest and the interests of a party. Exceptions to the inadmissibility rule should not be allowed merely in the interest of a party but should be allowed for reasons of public policy.

26. Mr. KOVAR (United States of America) said his delegation agreed with the representative of Singapore that the phrase “required under the law” was too vague but did not believe that the test could turn on whether a subpoena was involved or whether the proceeding was *ex parte*. Paragraph 67 of the draft Guide was helpful but could be further expanded to clarify the issue.

Article 12. Termination of conciliation (para. 69 of the draft Guide)

27. Mr. KOMAROV (Russian Federation) said that, since the Commission had decided not to require a written declaration for termination of conciliation and had deleted the adjective “written” modifying “declaration” in subparagraphs (b), (c) and (d) of draft article 12, the Guide should stress the importance of a written declaration in determining the precise date of termination of conciliation proceedings in the event that a State opted to adopt a provision modelled on draft article X on suspension of the limitation period in footnote 3 of draft article 4. Moreover, despite the deletion of the word “written” from draft article 12, the Guide still referred to article 6 of the Model Law on Electronic Commerce for a broad definition of the phrase “information in writing”.

28. Mr. HOLTZMANN (United States of America) said that the Chairman had earlier very sensibly remarked in connection with the words “after consultation with the parties” in article 12, subparagraph (b), that the requirement of consultation was met if a party was given an opportunity to consult but chose not to do so; his delegation thought it would be useful to have that interpretation reflected in the Guide. On another point, the agreements referred to in paragraph 69 of the Guide could be concluded orally if the applicable law permitted. Since the declarations mentioned in subparagraphs (b), (c) and (d) of draft article 12 need not be in writing, it might be useful to explain in the Guide that a declaration could be expressed by conduct. A refusal to communicate or respond, for example, was tantamount to a declaration. Lastly, the quotation in footnote 4 of draft article 12 appeared in the Model Law on Electronic Commerce in the context of a definition of “data message”; it might be useful to give a brief explanation of a data message in the Guide.

29. Mr. HEGER (Germany) said that his delegation agreed with the Russian Federation that, since a declaration no longer needed to be in writing, the Guide should describe the implications for a State wishing to provide for a suspension of limitation period for the duration of conciliation proceedings.

30. Mr. ZANKER (Observer for Australia) said that his delegation agreed with Germany that the Guide should warn States about the need for precision about the date of termination of conciliation proceedings if a State decided to include a provision on suspension of limitation period. He also questioned whether footnote 4 was necessary at all if the declarations mentioned in draft article 12 did not need to be in writing.

31. Mr. JACQUET (France) said that his delegation agreed with the United States proposals concerning paragraph 69 of the draft Guide except for the suggestion that conduct should be considered equivalent to a declaration. In a matter as important as the

termination of conciliation proceedings, that would be inappropriate. The United Nations Convention on Contracts for the International Sale of Goods provided an important precedent; although it gave much attention to conduct, it clearly distinguished conduct from statements.

32. Mr. ZANKER (Observer for Australia) said that the Commission had, in fact, thoroughly rehearsed the issue of conduct being assimilated to a declaration. The point had been made that a party could not be forced to make a declaration. The reality was that a party frequently chose to ignore proceedings, and in that case its conduct would have to be taken to mean that the party was no longer participating in the conciliation. His delegation therefore supported the United States proposal.

*The meeting was suspended at 4.30 p.m.
and resumed at 5.05 p.m.*

33. The CHAIRMAN suggested, in view of the difficulty of determining when conduct such as abandoning the conciliation might constitute a termination of the proceedings, that the secretariat should be asked to elucidate the question when finalizing the report.

34. Mr. JACQUET (France) was concerned at the apparent acceptance by the Commission of the notion of abandonment as a ground for terminating a conciliation. The question of abandonment had indeed been discussed but only as a purely factual situation that ought to have a place in the Model Law. Termination of a conciliation by the conduct of a party had nothing to do with either draft article 12 or with the draft Guide. It was not abandonment which put an end to conciliation. The text of the Model Law already provided sufficient scope for a conciliator to put an end to the conciliation procedure, through the prescribed declaration, if one of the parties had neglected to pursue it. Indeed, a party that found itself the victim of an abandonment could itself make such a declaration. There was no need for the Guide to elaborate on the question.

35. The CHAIRMAN said it was not feasible to conclude the discussion on draft article 13, or on paragraphs 70-74 of the draft Guide, until the secretariat had had an opportunity to clarify the implications of the Commission’s decisions on draft article 12. Adoption of that article as it stood would imply that abandonment of the conciliation would be a ground for terminating it. However, as yet there was no comment in the draft Guide to cover that point.

36. Mr. KOVAR (United States of America) said abandonment was not the issue; the issue was whether the conduct of the parties might indicate that conciliation had come to an end. The lengthy discussion of that question that had taken place in the Working Group ought to be reflected in the Model Law and in the Guide.

37. Mr. SEKOLEC (Secretary of the Commission) recalled that the delegation of the Russian Federation had proposed including in the draft Guide a reference to the possibility that an enacting State might wish to specify a requirement for the written form. Since the draft Model Law made no provision for such a requirement, the Commission should decide whether to include it in the draft Guide, as a legitimate solution to the problem raised.

38. Mr. HOLTZMANN (United States of America), supported by Mr. ZANKER (Observer for Australia), said the provision for a requirement of the written form should appear in the context of the suggested article X (Suspension of limitation period) (footnote 3),

not that of draft article 12. That was one of the circumstances in which it might be appropriate, where a State had decided to adopt article X. Otherwise, the Commission would be inviting States to depart from its own basic policy, which was that conciliation was fundamentally informal and flexible in nature, and that its beginning and end did not require the written form. That was why it had been decided to delete the qualifier "written" in draft article 12.

39. The CHAIRMAN said the proposal by the Russian Federation had been made in the context of the suggested draft article X.

40. Mr. HEGER (Germany) said it was his understanding that the delegation of the Russian Federation had intended its proposal to be subsumed in draft article 12, on termination of conciliation, and that the Commission had not objected.

41. The Chairman said that if he heard no objection to that proposal, he would take it that the Commission wished to adopt it.

42. *It was so decided.*

Article 13. Conciliator acting as arbitrator (paras. 70-74 of the draft Guide)

43. Mr. KOVAR (United States of America) said it would be useful to include in the draft Guide a mention of the fact that, in some systems, it was considered appropriate for a conciliator to act as an arbitrator, although in others it was not. The Commission should emphasize that it was entirely neutral on that score. It should also, in the draft Guide, remind the reader that the issue in draft article 13 was that of a conciliator acting as an arbitrator, not an arbitrator who subsequently became a conciliator; that was a situation on which the Model Law was entirely silent. A distinction should be drawn between the two situations.

44. The CHAIRMAN recalled that when the Working Group had been dealing with the issue of a conciliator acting as an arbitrator, it had been suggested that a conciliator could not be a judge. It was however felt that the Model Law should not be prescriptive in that regard. Speaking on behalf of the Mexican delegation, he recalled the suggestion by that delegation that the draft Guide should refer to the possibility of national legislatures dealing with the question as part of their legislation concerning the judiciary.

45. Mr. TANG HOUZHI (China) said his delegation was satisfied that paragraph 70 reflected the consensus achieved in the Working Group. Paragraphs 70-74 were all acceptable.

Article 15. Enforceability of settlement agreement (paras. 77-81 of the draft Guide)

46. Mr. TANG HOUZHI (China) said that the opening sentence of paragraph 79, which introduced an example concerning the Chinese system, did not correspond to the situation in China. Whereas the description could apply to several other countries, such as Croatia, the Republic of Korea and Hungary, the practice in China was not as straightforward. There were two kinds of conciliation in his country. According to the first model, parties who had settled a dispute were entitled to request an arbitration tribunal to rule in accordance with the settlement reached. According to the second, a court conducted the conciliation process, after which both parties could request the judge to issue a ruling in accordance with the settlement. It was unclear why the Chinese system had been chosen as an example in paragraph 79, and the current text was not entirely accurate.

47. Mr. HOLTZMANN (United States of America) said that paragraphs 79 and 80 should be deleted, on the grounds that they contained too much detail concerning specific national jurisdictions. While it had been useful for the secretariat to consider such material in preparing the draft Model Law, its inclusion in the Guide would only lead to confusion. Similarly, he failed to understand the usefulness of paragraph 81, which merely emphasized the ambiguities and weaknesses of the Model Law.

48. Mr. ZANKER (Observer for Australia) expressed support for the deletion of paragraphs 79, 80 and 81.

49. Mr. TANG HOUZHI (China) said that paragraph 79 was very important and should not be deleted. The information it contained reflected a general worldwide trend. His earlier intervention had been intended merely to point out the inaccuracies with regard to the situation in China and should not be taken as support for the deletion of the paragraph. Without the details provided, settlements reached through conciliation would be more difficult to enforce. No further amendments should be made to paragraphs 79, 80 and 81.

50. Mr. MARKUS (Observer for Switzerland) said that paragraph 81 was likely to be damaging to the objective of promoting the Model Law. However, the examples provided in paragraphs 79 and 80 were enlightening, given that enforceability was a broad term, with various interpretations. He failed to understand the objections of the United States delegation.

51. Ms. MOOSA (Singapore) said that it was helpful for States to be able to see which jurisdictions to refer to for examples of the various interpretations of enforceability, with a view to developing their own provisions.

52. Mr. HOLTZMANN (United States of America) said that the use of examples could only be justified if they constituted a balanced and nuanced reflection of world practice. Since that was impossible in such a short space, it was more judicious to leave out examples altogether. Broad statements such as those currently at the beginning of paragraphs 79 and 80 could be retained in order to provide a short summary of the situation worldwide.

53. Mr. SEKOLEC (Secretary of the Commission) acknowledged the danger of attempting to summarize national legislation in such a short space. Nevertheless, the ellipsis at the end of draft article 15 invited States to complete the article. It would be beneficial to consider the options objectively in order to guide States in determining how to approach the issue of enforceability.

ELECTION OF OFFICERS (*continued*)

54. Mr. SEKOLEC (Secretary of the Commission) announced that owing to illness, Mr. Akam Akam (Cameroon) was unable to assume the office of Chairman.

55. Mr. KOGDA (Burkina Faso), speaking on behalf of the Group of African States, nominated Mr. Joko Smart (Sierra Leone) to replace him as Chairman.

56. Mr. MORÁN BOVIO (Spain) expressed his regret that Mr. Akam Akam had been unable to attend the session, and he welcomed the nomination of Mr. Joko Smart.

57. *Mr. JOKO SMART (Sierra Leone) was elected Chairman by acclamation.*

The meeting rose at 6 p.m.

**Summary record (partial)* of the 751st meeting,
held at United Nations Headquarters on Tuesday, 25 June 2002, at 10 a.m.**

[A/CN.9/SR.751]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Joko Smart (Sierra Leone), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 10.15 a.m.

**FINALIZATION AND ADOPTION OF THE DRAFT
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL
CONCILIATION** (*continued*)

Draft Guide to Enactment of the UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/514) (continued)

1. The CHAIRMAN said that he had indicated to the United States delegation that, while its request to eliminate paragraphs 79 and 80 from the draft Guide had not garnered support in the Commission, the UNCITRAL secretariat would, to the extent possible, take its concerns into account. A proposal had also been made by the Working Group on Insolvency Law to insert a paragraph on recourse to conciliation in multiparty situations, the most notable example being insolvency proceedings. The suggestion had met with general support but a final decision had been deferred in order to allow delegations time to consult their experts and Governments.

2. Mr. de FONTMICHEL (France) said that his delegation had expressed reservations the previous day largely because conciliation was not used frequently in French insolvency proceedings, although French law provided for a number of mechanisms in insolvency proceedings that ultimately led to conciliation. While conciliation could be of great value prior to suspension of payments, it was, by its very nature, conducted between two parties and might not lend itself to collective proceedings such as reorganization and liquidation.

3. Mr. SIGAL (Observer for the American Bar Association) said that conciliation had been very successfully used in connection with insolvency in the United States of America. It had been of tremendous benefit in complex situations, had brought rapid solutions that might not otherwise have been achieved and had spared the parties considerable expense. Expressing support for the remarks made by the representative of France, he noted that France was a leader in the successful use of conciliation before insolvency and its statutes in that regard were a potential model for other countries. He agreed that insolvency proceedings already under way could not be overridden by conciliation, which would have to remain subject to the overall scheme of the insolvency proceedings. The draft Guide could be expanded to incorporate the points raised by the French delegation.

4. Mr. KOVAR (United States of America) said that he had had an opportunity to consult with his authorities and could now confirm that his delegation shared the views expressed at the previous meeting and could support the paragraph.

5. Mr. TANG HOUZHI (China) expressed support for the secretariat's proposal for a paragraph on conciliation in insolvency proceedings, provided that the parties agreed to engage in them. In China, insolvency proceedings and liquidations were decided

by the court, not by arbitration or conciliation. However, conciliation could be used to settle a dispute within the context of insolvency proceedings.

6. Mr. MARSH (United Kingdom) said that the reservations expressed by his delegation the previous day might have been misunderstood. In no way had his delegation been suggesting that conciliation was inappropriate in insolvency proceedings—indeed it was often used in the United Kingdom—but rather that dwelling at length on one example might create an imbalance in what was supposed to be a very broad and generic guide.

7. He wondered whether it would be appropriate to include insolvency in footnote 2 of article 1, paragraph 1, on the interpretation of the term “commercial”.

8. The CHAIRMAN said that the debate could not be reopened in order to amend the footnote. He noted the general support for adding a paragraph in the draft Guide to enactment on conciliation in multiparty situations. As agreed, the UNCITRAL secretariat would be requested to take into account the use of conciliation in the stages prior to the actual insolvency and to indicate that it could not be introduced once insolvency proceedings had been initiated. The secretariat should bear in mind the generic nature of the draft Guide in order to allay the concerns of the United Kingdom delegation. It should indicate the value of conciliation in multiparty situations, giving insolvency as an example or perhaps the construction of large industrial complexes and any other examples Commission members might wish to suggest. As the Commission had decided, the secretariat would be entrusted with completing the draft Guide and would be open to, but not necessarily bound to follow, delegations' suggestions to that end.

9. Mr. de FONTMICHEL (France) asked where the paragraph on conciliation and insolvency proceedings would be inserted in the draft Guide.

10. Mr. SEKOLEC (Secretary of the Commission) said that it would probably go under article 1 and that elements of the draft Model Law would be reshuffled, as necessary, to incorporate the various points raised.

11. Mr. MORÁN BOVIO (Spain) said that conciliation would also lend itself to co-insurance by a number of insurance companies, syndicated loans made by several lenders to a common client, regional franchises and national and, in particular, international distribution agreements, which all established contracts providing for conciliation with the aim of avoiding litigation.

12. Mr. TANG HOUZHI (China) said that he hoped the secretariat, in drafting the final version, would take into account the flexibility of insolvency proceedings in China, in which the judge could assume responsibility for conciliation proceedings conducted in the court.

*No summary record was prepared for the rest of the meeting.

13. Mr. HEGER (Germany) wondered whether problems would arise if the list of examples of multiparty situations was compared to the list contained in footnote 2 on the interpretation of the term “commercial”.

14. The CHAIRMAN said that the secretariat would take note of the concerns expressed by the representative of Germany in drafting the final version of the draft Guide.

Report of the Drafting Group

15. The Chairman invited Commission members to consider the draft Model Law as contained in the report of the drafting group (A/CN.9/XXXV/CRP.2).

16. Mr. BARSY (Sudan) drew attention to a problem in the Arabic version, which consistently rendered the English “parties”, meaning two or more parties, by the narrower “two parties”.

17. Mr. SEKOLEC (Secretary of the Commission) said that, while the dual form that existed in Arabic and some other languages had once been favoured, the plural form was now the preferred usage. The appropriate corrections would be made by the secretariat.

18. Mr. HEGER (Germany), referring to article 14, said that it was his understanding that “exécutoire” in the French version was supposed to have been changed to “susceptible d’exécution”.

19. The CHAIRMAN said that the secretariat would take note of the change, and that “ejecutable” in the Spanish text could be similarly changed to read “susceptible de ejecución”.

20. *The report of the drafting group contained in conference room paper A/CN.9/XXXV/CRP.2, as orally amended, was approved.*

The discussion covered in the summary record ended at 11 a.m.

Summary record of the 752nd meeting, held at United Nations Headquarters on Tuesday, 26 June 2002, at 3 p.m.

[A/CN.9/SR.752]

Chairman: Mr. Abascal ZAMORA (Mexico), Chairman of the Committee of the Whole

*In the absence of Mr. Joko Smart (Sierra Leone), Mr. Abascal Zamora (Mexico),
Chairman of the Committee of the Whole, took the chair.*

The meeting was called to order at 3.20 p.m.

FINALIZATION AND ADOPTION OF THE DRAFT UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL CONCILIATION (*continued*)

Finalization of the draft report (A/CN.9/XXXV/CRP.1/Add.1-6 and Add.9)

Section II.B. Consideration of draft articles

1. Mr. MORÁN BOVIO (Rapporteur) presented conference room papers A/CN.9/XXXV/CRP.1/Add.1-6 and Add.9, the sections of the draft report concerning the discussion on the draft Model Law.

Consideration of draft articles 1-5 (A/CN.9/XXXV/CRP.1/Add.1)

2. Mr. KOVAR (United States of America) said that paragraph 14, concerning the consideration of draft article 1, paragraph 8, should reflect the remarks that in some countries arbitrators were entitled to act as conciliators whereas in others they were not. He proposed inserting the following words after the opening sentence: “It was noted that it would be useful for the Guide to include a reference to the fact that in some systems an arbitrator could, pursuant to agreement of the parties, become a conciliator and conduct a conciliation proceeding, but that this was not accepted practice in some other systems”.

3. Although the issue of party autonomy had been stressed during the debate, it had not been mentioned in paragraph 19. It would be useful to amend the second sentence to read as follows: “A contrary view was that article 3 should be left as it was in order to preserve maximum party autonomy.” The following sentence should subsequently begin: “A separate but related observation was that while parties could not agree to a higher standard of enforceability . . .”.

4. Mr. TANG HOZHAI (China) said that, during the discussions in the Working Group and the Commission, he had failed to understand why there was such resistance to agreements reached by the parties.

5. Mr. KOVAR (United States of America) proposed to refer in paragraph 21 to the suggestion that countries considering the adoption of article X should be informed that parties should be entitled to protect their rights by court proceedings. The following sentence could be inserted immediately prior to the last sentence of paragraph 21: “It was also stated that States considering adoption of article X should be informed of the possibilities for parties to preserve their rights when article X had not been adopted, namely that a party could commence a national court proceeding or arbitration to protect its interests.” He also suggested that the following words should be added to paragraph 25: “It was agreed that further clarification would be included in the Guide to Enactment and Use.”

Consideration of draft articles 6-9 (A/CN.9/XXXV/CRP.1/Add.2)

6. Mr. KOVAR (United States of America) said that the current text failed to mention the decision to combine draft articles 5 and 6. He proposed to insert the following paragraph 13 (bis): "Following the discussion of articles 5 and 6, the Commission adopted a suggestion of the Secretariat to combine those articles in an article to be numbered article 5. The Commission referred to the drafting group the task of preparing that combined article and in so doing to reflect the discussion set forth above under the headings article 5 and article 6." Concerning paragraph 16, it was to be hoped that the misinterpretation referred to in the opening sentence would not arise, and therefore the word "easily" should be deleted. He proposed a series of amendments to paragraph 17, for it to read: "The widely prevailing view, however, was that paragraph 3 should be regarded as a basic obligation and a non-negotiable minimal standard to be observed mandatorily by any conciliator." That would be a stronger statement than the current version. Paragraph 29 was incomplete and potentially misleading, and the following words should be added to the end of the first sentence in order to reflect the debate more fully: ". . . , unless the party giving the information did so subject to a specific condition that it not be disclosed".

7. Mr. ZANKER (Observer for Australia) said that it was inaccurate to state, in paragraph 28, that a radical concern had been expressed, since the concern had applied to a standard practice common to Australia, Singapore and the United Kingdom. He proposed to redraft the opening sentence as follows: "Certain countries expressed concern with respect to the policy on which draft article 9 was based."

8. Ms. MOOSA (Singapore) said that paragraph 29 should be amended in accordance with the amendments made in the Guide to Enactment and Use.

9. Mr. SEKOLEC (Secretary of the Commission) said that paragraph 29 would not be amended to reflect the Guide unless a specific proposal was made to that effect. The current text was an accurate reflection of a discussion that had taken place in the Working Group.

10. Mr. CHAN (Singapore) said that the draft report should reflect the deliberations of the Commission during the session, and not only those of the Working Group. It was clear that many delegations did not support the current wording.

11. He proposed the following amendment to paragraph 29: in the first line of page 7, immediately after the word "conciliator", the existing text up to the word progress should be deleted and replaced by the following: "is not the practice in some countries, and this is reflected in article 10 of the UNCITRAL Conciliation Rules, but is the practice in some others." The document references in parentheses would remain.

12. The CHAIRMAN said that the change proposed by Singapore would be adopted.

Consideration of draft article 10. Duty of confidentiality (A/CN.9/XXXV/CRP.1/Add.3)

13. Mr. KOVAR (United States of America) suggested that in paragraph 2, the words "assumed to be" should be inserted between the words "professional conciliators who were" and the words "well aware of issues". Thus, the phrase would read: "professional conciliators who were assumed to be well aware of issues".

14. In paragraph 7, the words "since they are superfluous, given the presence of article 3" should be inserted between the words "unless otherwise agreed" and "but after discussion". The following phrase should be added at the end of the same sentence: "in order to reinforce in this context the principle of party autonomy". The amended paragraph would read as follows: "Some support was expressed in favour of deleting the words 'Unless otherwise agreed', since they are superfluous, given the presence of article 3, but after discussion the prevailing view was that they should remain in order to reinforce in this context the principle of party autonomy."

15. Mr. TANG HOUZHI (China) said that the United States proposal did not reflect the discussion. The present wording of paragraph 7 should be retained.

16. The CHAIRMAN said that both he and the Secretary believed that the United States amendment did reflect the decision that had been taken.

17. Mr. ZANKER (Observer for Australia) said that he supported the text proposed by the United States.

Consideration of draft article 11. Admissibility of evidence in other proceedings (A/CN.9/XXXV/CRP.1/Add.4, paras. 1-10)

18. The CHAIRMAN noted that there were no comments on article 11.

Consideration of draft article 12. Termination of conciliation (A/CN.9/XXXV/CRP.1/Add.4, paras. 11-16)

19. Mr. KOVAR (United States of America) said that the following sentence should be inserted before the last sentence of paragraph 14: "It was also pointed out that conciliation depends on both parties being willing participants and that it makes no sense to force an unwilling party to conciliate."

20. Mr. JACQUET (France) said that his delegation could not support the United States amendment. The Commission had consistently left aside everything relating to the question of the contract whereby the parties agreed to conciliate. The United States proposal might in some cases be interpreted as condoning violation of the conciliation contract.

21. The CHAIRMAN pointed out that the United States proposal did not reflect an agreement reached by the Commission but merely stated a position that had been brought up during the discussion.

22. Mr. JACQUET (France) stressed the importance of providing the full context of any point raised in the report. In the case at hand, the matter referred to by the United States delegation had come up in the context of a French proposal to take into account the obligation of the parties to conciliate when they had previously agreed on a conciliation clause. What the United States delegation was proposing would indirectly encroach upon the contractual obligation of the parties to conciliate. Every time his delegation had sought, in the debate, to introduce the matter of the conciliation contract, the objection had been raised that the contract was beyond the scope of the Model Law. The same rule should be applied in every case.

23. Mr. ZANKER (Observer for Australia) said that he supported the United States proposal, which reflected a very important part of the discussion. The amendment could not be construed as the Commission somehow sanctioning anyone intending in the future to breach a conciliation contract; it simply recognized the reality that contracts of any kind were regularly breached.

24. Mr. SEKOLEC (Secretary of the Commission) suggested that the sentence proposed by the United States might be slightly amended by inserting the words “the success of”, so that the sentence would read as follows: “It was also pointed out that the success of conciliation proceedings depends on both parties being willing participants and that it makes no sense to force an unwilling party to conciliate.” The last part of the sentence referred to practice, but was not a matter of law. One of the most important issues that had been raised with respect to the Model Law was the fact that it did not declare conciliation agreements to be binding. It had consistently been stressed that conciliation agreements might well be binding but that that issue was outside the scope of the Model Law.

25. Mr. JACQUET (France) said that he was willing to agree to the United States proposal provided that the Model Law did not give the impression that parties were encouraged to conciliate however they wished, whenever they wished or if they wished, when they had already decided, by means of a conciliation clause, that they should conciliate. He therefore suggested that the following sentence should be added after the sentence proposed by the United States: “It was pointed out that this comment had no implication whatsoever with regard to the possible failure of one of the parties to honour a contractual obligation to participate in conciliation.”

26. Mr. KOVAR (United States of America) pointed out that the wording proposed by the representative of France merely repeated what was said in the last sentence of paragraph 14.

27. Mr. SEKOLEC (Secretary of the Commission) said that the secretariat would find an appropriate wording to incorporate both ideas in the paragraph.

28. Mr. KOVAR (United States of America) proposed a new paragraph 14 bis, which would read as follows:

“It was suggested that while ‘written’ should be deleted as a general matter, a State adopting article X may wish to require that termination be in writing since precision is required in determining when the conciliation ends so that courts can properly determine the prescription period. In this context, it was noted that if writing is required for termination, it might also be required for commencement of the conciliation. It was requested that this be reflected in the Guide to Enactment and Use.”

29. In addition, he pointed out that paragraph 16 did not reflect the fact that changes had been agreed to by the Committee of the Whole. He suggested that the sentence should be reworded to read as follows: “The Commission referred the substance of article 12, as adopted, to the drafting group.”

Consideration of draft article 13. Conciliator acting as arbitrator (A/CN.9/XXXV/CRP.1/Add.5)

30. Mr. MARKUS (Observer for Switzerland) proposed that, after the third sentence of paragraph 2 of conference room paper A/CN.9/XXXV/CRP.1/Add.5, in which the proviso “unless otherwise agreed” was said to be superfluous, the following sentence should be inserted: “In support of this view it was stated that the proviso could even be counterproductive, because it could give the wrong impression, namely, that there were two different degrees of party autonomy, a greater and a lesser one.”

31. Mr. REYES (Colombia) said that his delegation had earlier proposed changing the title to reflect the main thrust of the article, which was that a conciliator should not act as an arbitrator in respect of the same dispute. Although the change had been rejected, he would like to see the point reflected in the report and therefore proposed inserting the following sentence after

paragraph 6 or paragraph 11: “The possibility was raised of changing the title of the article to reflect greater correlation and consistency with the article’s content, which expressly refers to the ineligibility of the conciliator to act as an arbitrator. It was therefore proposed that the article should be entitled, ‘Ineligibility of the conciliator to act as an arbitrator’.”

32. The CHAIRMAN said that the report would have to add that the proposal had not been adopted.

33. Mr. CHAN (Singapore) said that paragraph 9, on the debate concerning the appropriateness of a judge or arbitrator facilitating conciliation, was unbalanced because it reflected the arguments against but not for the proposition. He recalled that the delegation of China had taken some pains to point out that the laws of a number of countries, including Singapore, expressly allowed an arbitrator to act as a conciliator in the same proceedings. In response, it was objected that the International Bar Association considered it unethical for an arbitrator to act as a conciliator. His delegation did not want the record to show that the balance of opinion considered such legal systems to be promoting illegal and unethical conduct. Given time, his and other interested delegations would come up with proposed new language with a better balance of the arguments pro and con.

The meeting was suspended at 4.55 p.m. and resumed at 5.20 p.m.

34. Mr. CHAN (Singapore) said that in order to achieve a balance in the record, his delegation proposed that in paragraph 8 of conference room paper A/CN.9/XXXV/CRP.1/Add.5, the first sentence should be amended and split in two, as follows: “In support of that suggestion, it was stated that the laws of a number of countries expressly provide for this. The draft Model Law should not ignore a practice that is accepted as a good practice in many countries.” In paragraph 9, the last sentence should be deleted and replaced with the following: “It was also mentioned that in some countries such a situation is viewed as unethical.”

35. He proposed deleting the whole of paragraph 11 and replacing it by the following text: “After discussion, as it was not possible to obtain a consensus, the Commission decided that the text proposed by the Working Group should not be interfered with. However, the matter should be discussed in the Guide to Enactment (see document A/CN.9/506, para. 132).” That wording would, he believed, capture all the points made in the discussion while maintaining a balanced representation of the various views expressed on the issue.

36. Mr. KOVAR (United States of America) welcomed that suggestion. However, for the sake of conformity with the language used elsewhere in the report, he would prefer the wording “the text proposed by the Working Group should be adopted”.

Consideration of draft article 14. Resort to arbitral or judicial proceedings (A/CN.9/XXXV/CRP.1/Add.6)

37. Ms. BRELIER (France) said that in the third sentence of paragraph 4 of conference room paper A/CN.9/XXXV/CRP.1/Add.6, after the words “it was observed”, the words “in response” should be added, because the sentence reflected a response to a previous suggestion and a shift in perspective.

38. Mr. KOVAR (United States of America) said that paragraph 5, which reflected the discussion of objective and subjective grounds for a party to preserve its rights by going to court or arbitration despite a contractual obligation to conciliate, would reflect the tenor of the debate better with the following changes: the word “purely” should be deleted from the phrase “purely subjective criterion” in the first sentence; in the fourth sentence the words “subjective criterion” should be replaced by the word

“ground”; and in the eighth sentence, the word “subjective” should be deleted from the phrase “subjective assessment”. During the discussion no speaker, it seemed to his delegation, had said that grounds for a decision to preserve rights were purely subjective, even though they were in the sole discretion of a party.

39. In the debate, reflected in paragraph 6 of conference room paper A/CN.9/XXXV/CRP.1/Add.6, that had culminated in the decision to combine the two paragraphs of the draft article on resort to arbitral or judicial proceedings, the point had been raised several times that the purpose of the change was to provide clarity. Therefore, in the second sentence of paragraph 6 his delegation proposed changing the phrase “to address that concern” to the phrase “to provide greater clarity”.

40. The penultimate sentence of the paragraph presented in a very truncated manner the debate linking the subjective-objective question with the combination-of-paragraphs issue. His delegation felt that it did not adequately reflect the complexity of the debate and should be deleted. In the last sentence, where the words “in its opinion” were quoted, it would be well to indicate their source by adding the words “which are taken from article 16 of the UNCITRAL Conciliation Rules”, in order to emphasize that the decision to change the phrase “in its sole discretion”, originally used in paragraph 2 of the draft article, was influenced by a desire to align the Model Law with the Conciliation Rules. In the same sentence, the word “nevertheless” could be inserted after the word “Commission” to make the point that the Commission had adopted the suggestion to combine the paragraphs despite its doubts.

41. Since it had been decided to reflect some of the debate in the Guide, a new sentence should be added at the end of paragraph 6, as follows: “The Commission also noted that some additional clarification of the operation of this article should be provided in the Guide to Enactment and Use.”

42. He also suggested inserting, at the end of the first sentence of paragraph 7 of conference room paper A/CN.9/XXXV/CRP.1/Add.6, the words “, including action taken by a party to preserve its rights before expiration of a prescription period”.

Adoption of the UNCITRAL Model Law on International Commercial Conciliation (A/CN.9/XXXV/CRP.1/Add.9)

43. The Chairman invited comments on the draft decision contained in conference room paper A/CN.9/XXXV/CRP.1/Add.9.

44. Mr. KOVAR (United States of America) proposed deleting the term “mediation”, which appeared three times in the text of the draft decision (A/CN.9/XXXV/CRP.1/Add.9). It was undoubtedly useful to draw the reader’s attention to the fact that conciliation embraced a wide range of mediation techniques and practices in different legal systems, but that would be more usefully achieved by inserting, after the first preambular paragraph, a new preambular paragraph as follows: “And noting in this connection that the expression ‘conciliation’ includes mediation and other processes of similar import”.

45. Ms. BRELIER (France) said the proposed addition would overload the text. She thought the text was sufficiently clear already on the various kinds of conciliation, and it would be enough just to delete the term “mediation” wherever it appeared in the draft decision.

46. Mr. SEKOLEC (Secretary of the Commission) suggested a separate preambular paragraph beginning: “Noting in this connection that conciliation means other . . .”. A separate paragraph would serve to detach the terminology from considerations of a political or commercial nature.

47. Mr. TANG HOZH (China) said there seemed to be something missing in the third operative paragraph after the words “due consideration to”. What were States being recommended to consider—adopting the Model Law, making reference to it when adopting national legislation or something else?

48. Mr. SEKOLEC (Secretary of the Commission) suggested inserting, after the words “due consideration to”, the words “enactment of the Model Law”.

49. Mr. ZANKER (Observer for Australia) endorsed that suggestion.

50. Mr. REYES (Colombia) suggested a correction in the fifth line of paragraph 2 of the Spanish version of conference room paper A/CN.9/XXXV/CRP.1/Add.9. Instead of “para que la Secretaría lo complete”, the wording should be “para ser completado por la Secretaría”, the comma after “internacional” being deleted.

51. Mr. MIRZAEI-YENGEJEH (Islamic Republic of Iran) queried whether the draft decision should not be treated instead as a draft resolution for transmission to the General Assembly. If so, the term “decision” should be replaced by the word “resolution” and paragraph 2 should be amended by deleting the words “to be finalized by the Secretariat based on the deliberations of the Commission at that thirty-fifth session”.

52. Mr. SEKOLEC (Secretary of the Commission) explained that the decisions of the Commission were adopted in a variety of different ways. Model laws had often been adopted in the present format. However, the Commission’s texts were not submitted directly to the General Assembly. That was the prerogative of the Sixth Committee of the Assembly, except in the case of treaties, which were proposed in draft form to the Assembly.

53. Mr. MIRZAEI-YENGEJEH (Islamic Republic of Iran) asked whether the Commission, as a subsidiary body of the General Assembly, could address the Secretary-General or Member States directly.

54. Mr. SEKOLEC (Secretary of the Commission) said the Commission did address requests to the Secretary-General, occasionally by asking the Secretary-General to prepare a report for the General Assembly. The wording used in the present draft decision was closely modelled on previous decisions on model laws, in particular the Model Law on Electronic Commerce and the Model Law on Electronic Signatures.

55. *The draft text contained in conference room papers A/CN.9/XXXV/CRP.1/Add.1-6 and Add.9, as amended, was adopted.*

56. Mr. KOVAR (United States of America), on behalf of the members of the Commission, congratulated the acting Chairman on his successful endeavours to bring the draft Model Law to completion, within an exceptionally short time.

The meeting rose at 6 p.m.

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XIV. Security interests

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The work of UNCITRAL in the areas of cross-border insolvency and security interests is discussed in chapter 6.

Annex

UNCITRAL legal texts

<i>Short title</i>	<i>Full title</i>
Hamburg Rules (1978)	United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) ^a
Limitation Convention (1974/1980)	Convention on the Limitation Period in the International Sale of Goods, 1974 (New York) ^b and Protocol amending the Convention on the Limitation Period in the International Sale of Goods, 1980 (Vienna) ^c
UNCITRAL Arbitral Proceedings Notes (1996)	UNCITRAL Notes on Organizing Arbitral Proceedings (1996) ^d
UNCITRAL Arbitration Rules (1976)	UNCITRAL Arbitration Rules (1976) ^e
UNCITRAL Conciliation Rules (1980)	UNCITRAL Conciliation Rules (1980) ^f
UNCITRAL Credit Transfer Law (1992)	UNCITRAL Model Law on International Credit Transfers (1992) ^g
UNCITRAL Electronic Commerce Law (1996)	Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (1996) ^h
UNCITRAL International Countertrade Guide (1992)	UNCITRAL Legal Guide on International Countertrade Transactions (1992) ⁱ
UNCITRAL Electronic Funds Guide (1986)	UNCITRAL Legal Guide on Electronic Funds Transfers (1986) ^j
UNCITRAL Construction Contracts Guide (1987)	UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works (1987) ^k
UNCITRAL Infrastructure Projects Guide (2001)	UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (2001) ^l
UNCITRAL Model Arbitration Law (1985)	UNCITRAL Model Law on International Commercial Arbitration (1985) ^m
UNCITRAL Model Insolvency Law (1997)	UNCITRAL Model Law on Cross-Border Insolvency (1997) ⁿ
UNCITRAL Model Procurement Law (1994)	UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994) ^o
UNCITRAL Bills and Notes Convention (1988)	United Nations Convention on International Bills of Exchange and International Promissory Notes (1988) ^p
United Nations Guarantee and Stand-by Convention (1995)	United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1995) ^q
United Nations Sales Convention (1980)	United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) ^r
United Nations Terminal Operators Convention (1991)	United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (1991) ^s
United Nations Assignment Convention (2001)	United Nations Convention on the Assignment of Receivables in International Trade (2001) ^t
UNCITRAL Model Law on Electronic Signatures (2001)	UNCITRAL Model Law on Electronic Signatures (2001) ^u
UNCITRAL Model Conciliation Law (2002)	UNCITRAL Model Law on International Commercial Conciliation (2002) ^v

Notes

^a*Official Records of the United Nations Conference on the Carriage of Goods by Sea, Hamburg, 6-31 March 1978* (United Nations publication, Sales No. E.80.VIII.1), document A/CONF.89/13, annex I.

^b*Official Records of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods, New York, 20 May-14 June 1974* (United Nations publication, Sales No. E.74.V.8), part I.

^c*Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March-11 April 1980* (United Nations publication, Sales No. E.81.IV.3), part I.

^d*Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17)*, part II.

^e*Ibid.*, *Thirty-first Session, Supplement No. 17 (A/31/17)*, para. 57.

^f*Ibid.*, *Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 106.

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^h*Ibid.*, *Fifty-first Session, Supplement No. 17 (A/51/17)*, annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

ⁱUnited Nations publication, Sales No. E.93.V.7.

^j*Ibid.*, Sales No. E.87.V.9.

^k*Ibid.*, Sales No. E.87.V.10.

^l*Ibid.*, Sales No. E.01.V.4.

^m*Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17)*, annex I.

ⁿ*Ibid.*, *Fifty-second Session, Supplement No. 17 (A/52/17)*, annex I.

^o*Ibid.*, *Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), annex I.

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^tGeneral Assembly resolution 56/81, annex, of 12 December 2001.

^u*Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), annex II; see also General Assembly resolution 56/80, annex, of 12 December 2001.

^v*Ibid.*, *Fifty-seventh Session, Supplement No. 17 (A/57/17)*, annex I; see also General Assembly resolution 57/18, annex, of 19 November 2002.

V. CHECK-LIST OF DOCUMENTS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

<i>Document symbol</i>	<i>Title or description</i>	<i>Location in present volume</i>
A. List of documents before the Commission at its thirty-fifth session		
1. General series		
A/CN.9/503	Provisional agenda, annotations thereto and scheduling of meetings of the thirty-fifth session	
A/CN.9/504	Report of the Working Group on Insolvency Law on the work of its twenty-fourth session	Part two, chap. III, A
A/CN.9/505	Report of the Working Group on Privately Financed Infrastructure Projects on the work of its fourth session	Part two, chap. II
A/CN.9/506	Report of the Working Group on Arbitration on the work of its thirty-fifth session	Part two, chap. I, A
A/CN.9/507	Report of the Working Group on Insolvency Law on the work of its twenty-fifth session	Part two, chap. III, D
A/CN.9/508	Report of the Working Group on Arbitration on the work of its thirty-sixth session	Part two, chap. I, D
A/CN.9/509	Report of the Working Group on Electronic Commerce on its thirty-ninth session	Part two, chap. IV, A
A/CN.9/510	Report of the Working Group on Transport Law on the work of its ninth session	Part two, chap. VI, A
A/CN.9/511 and Corr.1	Report of the Working Group on Insolvency Law on the work of its twenty-sixth session	Part two, chap. III, H
A/CN.9/512	Report of the Working Group on Security Interests on the work of its first session	Part two, chap. V, A
A/CN.9/513 and Add.1 and 2	Draft Model Law on International Commercial Conciliation: compilation of comments by Governments and international organizations	Part two, chap. I, G
A/CN.9/514	Draft Guide to Enactment and Use of the UNCITRAL Model Law on International Commercial Conciliation	Part two, chap. I, H
A/CN.9/515	Note by the Secretariat on training and technical assistance	Part two, chap. IX
A/CN.9/516	Note by the Secretariat on the status of conventions and model laws	Part two, chap. VIII
A/CN.9/517	Note by the Secretariat on a bibliography of recent writings related to the work of UNCITRAL	Part three, chap. III

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A/CN.9/518	Report on the fourth UNCITRAL-INSOL Judicial Colloquium on Cross-Border Insolvency, 2001	Part two, chap. III, J
2. Restricted series		
A/CN.9/XXXV/CRP.1 and Add.1-22	Draft report of the United Nations Commission on International Trade Law on the work of its thirty-fifth session	Not reproduced
A/CN.9/XXXV/CRP.2	Draft UNCITRAL Model Law on International Commercial Conciliation	Not reproduced
A/CN.9/XXXV/CRP.3	Footnote to draft article 1 of the draft UNCITRAL Model Law on International Commercial Conciliation	Not reproduced
A/CN.9/XXXV/CRP.4	Note from the International Development Law Institute	Not reproduced
3. Information series		
A/CN.9/XXXV/INF.1	List of participants	Not reproduced

B. List of documents before the Working Group on International Commercial Arbitration at its thirty-fifth session

1. Working papers		
A/CN.9/WG.II/WP.114	Provisional agenda	Not reproduced
A/CN.9/WG.II/WP.115	Note by the Secretariat on the settlement of commercial disputes: model legislative provisions on international commercial conciliation, working paper submitted to the Working Group on Arbitration at its thirty-fifth session	Part two, chap. I, B
A/CN.9/WG.II/WP.116	Note by the Secretariat on the settlement of commercial disputes: Draft Guide to Enactment of the UNCITRAL [Model Law on International Commercial Conciliation], working paper submitted to the Working Group on Arbitration at its thirty-fifth session	Part two, chap. I, C
2. Restricted series		
A/CN.9/WG.II/XXXV/CRP.1 and Add.1-10	Draft report of the Working Group on Arbitration on the work of its thirty-fifth session	Not reproduced
A/CN.9/WG.II/XXXV/CRP.2 and Add.1-3	Report of the Drafting Group: Draft UNCITRAL Model Law on International Commercial Conciliation	Not reproduced
A/CN.9/WG.II/XXXV/CRP.3	Draft model law on international commercial conciliation	Not reproduced
3. Information series		
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C. List of documents before the Working Group on International Commercial Arbitration at its thirty-sixth session

1. Working papers		
A/CN.9/WG.II/WP.117	Provisional agenda	Not reproduced

<i>Document symbol</i>	<i>Title or description</i>	<i>Location in present volume</i>
A/CN.9/WG.II/WP.118	Note by the Secretariat on the settlement of commercial disputes: preparation of uniform provisions on written form for arbitration agreements, working paper submitted to the Working Group on Arbitration at its thirty-sixth session	Part two, chap. I, E
A/CN.9/WG.II/WP.119	Note by the Secretariat on the settlement of commercial disputes: preparation of uniform provisions on interim measures of protection, working paper submitted to the Working Group on Arbitration at its thirty-sixth session	Part two, chap. I, F
2. Restricted series		
A/CN.9/WG.II/XXXVI/CRP.1 and Add.1-8	Draft report of the Working Group on Arbitration on the work of its thirty-sixth session	Not reproduced
3. Information series		
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D. List of documents before the Working Group on Insolvency Law at its twenty-fourth session

1. Working papers		
A/CN.9/WG.V/WP.53	Provisional agenda	Not reproduced
A/CN.9/WG.V/WP.54 and Add.1 and 2	Report of the Secretary-General on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-fourth session	Part two, chap. III, B
A/CN.9/WG.V/WP.55	Report of the Secretary-General on alternative approaches to out-of-court insolvency processes, working paper submitted to the Working Group on Insolvency Law at its twenty-fourth session	Part two, chap. III, C
2. Restricted series		
A/CN.9/WG.V/XXIV/CRP.1 and Add.1-13	Draft report of the Working Group on Insolvency Law on the work of its twenty-fourth session	Not reproduced
A/CN.9/WG.V/XXIV/CRP.2-5	Draft legislative guide on insolvency law	Not reproduced
3. Information series		
A/CN.9/WG.V/XXIV/INF.1	List of participants	Not reproduced

E. List of documents before the Working Group on Insolvency Law at its twenty-fifth session

1. Working papers		
A/CN.9/WG.V/WP.56	Provisional agenda	Not reproduced
A/CN.9/WG.V/WP.57	Report of the Secretary-General on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-fifth session	Part two, chap. III, E

<i>Document symbol</i>	<i>Title or description</i>	<i>Location in present volume</i>
A/CN.9/WG.V/WP.58	Report of the Secretary-General on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-fifth session	Part two, chap. III, F
A/CN.9/WG.V/WP.59	Working paper on alternative informal insolvency processes: comments by the Commercial Finance Association, submitted to the Working Group on Insolvency Law at its twenty-fifth session	Part two, chap. III, G
2. Restricted series		
A/CN.9/WG.V/XXV/CRP.1 and Add.1-14	Draft report of the Working Group on Insolvency Law at its twenty-fifth session	Not reproduced
A/CN.9/WG.V/XXV/CRP.2-6	Draft legislative guide on insolvency law	Not reproduced
3. Information series		
A/CN.9/WG.V/XXV/INF.1/Rev.1	List of participants	Not reproduced

F. List of documents before the Working Group on Insolvency Law at its twenty-sixth session

1. Working papers		
A/CN.9/WG.V/WP.60	Provisional agenda	Not reproduced
A/CN.9/WG.V/WP.61 and Add.1 and 2	Note by the Secretariat on the draft legislative guide on insolvency law, working paper submitted to the Working Group on Insolvency Law at its twenty-sixth session	Part two, chap. III, I
2. Restricted series		
A/CN.9/WG.V/XXVI/CRP.1 and Add.1-4	Draft report of the Working Group on Insolvency Law on the work of its twenty-sixth session	Not reproduced
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3. Information series		
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G. List of documents before the Working Group on Electronic Commerce at its thirty-ninth session

1. Working papers		
A/CN.9/WG.IV/WP.92	Provisional agenda	
A/CN.9/WG.IV/WP.94	Note by the Secretariat on legal aspects of electronic commerce; legal barriers to the development of electronic commerce in international instruments relating to international trade, working paper submitted to the Working Group on Electronic Commerce at its thirty-ninth session	Part two, chap. IV, B
A/CN.9/WG.IV/WP.95	Note by the Secretariat on legal aspects of electronic commerce; electronic contracting; provisions for a draft convention, working paper submitted to the Working Group on Electronic Commerce at its thirty-ninth session	Part two, chap. IV, C

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A/CN.9/WG.IV/WP.96	Note by the Secretariat on legal aspects of electronic commerce; electronic contracting: provisions for a draft convention; comments by the International Chamber of Commerce, working paper submitted to the Working Group on Electronic Commerce at its thirty-ninth session	Part two, chap. IV, D

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A/CN.9/WG.IV/XXXIX/CRP.1 and Add.1-7	Draft report of the Working Group on Electronic Commerce on the work of its thirty-ninth session	Not reproduced
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H. List of documents before the Working Group on Security Interests at its first session

1. Working papers

A/CN.9/WG.VI/WP.2 and Add.1-12	Report of the Secretary-General on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session	Part two chap. V, B
A/CN.9/WG.VI/WP.3	Report of the Secretary-General on the UNCITRAL-Commercial Finance Association international colloquium on secured transactions, working paper submitted to the Working Group on Security Interests at its first session	Part two chap. V, C
A/CN.9/WG.VI/WP.4	Note by the Secretariat on the draft legislative guide on secured transactions, working paper submitted to the Working Group on Security Interests at its first session	Part two chap. V, D

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A/CN.9/WG.VI/I/CRP.1 and Add.1-6	Draft report of the Working Group on Security Interests at its first session	Not reproduced
A/CN.9/WG.VI/I/CRP.2	Draft legislative guide on secured transactions	Not reproduced

3. Information series

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I. List of documents before the Working Group on Transport Law at its ninth session

1. Working papers

A/CN.9/WG.III/WP.21 and Add.1	Note by the Secretariat on the preliminary draft instrument on the carriage of goods by sea, working paper submitted to the Working Group on Transport Law at its ninth session	Part two, chap. VI, B
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VI. LIST OF DOCUMENTS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW REPRODUCED IN PREVIOUS VOLUMES OF THE *YEARBOOK*

The present list indicates the particular volume, year, part, chapter and page where documents relating to the work of the United Nations Commission on International Trade Law were reproduced in previous volumes of the *Yearbook*; documents that do not appear in the list were not reproduced in the *Yearbook*. The documents are divided into the following categories:

1. Reports on the annual sessions of the Commission
2. Resolutions of the General Assembly
3. Reports of the Sixth Committee
4. Extracts from the reports of the Trade and Development Board, United Nations Conference on Trade and Development
5. Documents submitted to the Commission (including reports of the meetings of Working Groups)
6. Documents submitted to the Working Groups:
 - (a) Working Group I:
Time-Limits and Limitation (Prescription) (1969-1971); Privately Financed Infrastructure Projects (since 2001)
 - (b) Working Group II:
International Sale of Goods (1968-1978); International Contract Practices (1981-2000); International Commercial Arbitration (since 2000)
 - (c) Working Group III:
International Legislation on Shipping (1973-1974); Transport Law (since 2002)^a
 - (d) Working Group IV:
International Negotiable Instruments (1973-1987); International Payments (1988-1992); Electronic Data Interchange (1992-1996); Electronic Commerce (since 1997)
 - (e) Working Group V:
New International Economic Order (1981-1994); Cross-Border Insolvency (1996-1999); Insolvency Law (since 1999)^b
 - (f) Working Group VI:
Security Interests (since 2002)^a
7. Summary records of discussions in the Commission
8. Texts adopted by Conferences of Plenipotentiaries
9. Bibliographies of writings relating to the work of the Commission.

^aAt its thirty-fifth session, the Commission adopted one-week sessions, creating six of the three active working groups.

^bFor its twenty-third session (Vienna, 11-22 December 2000), this Working Group was named Working Group on International Contract Practices (see the report of the Commission on its thirty-third session A/55/17, para. 186).

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A/37/17 and Corr.1 (fifteenth session)	Volume XIII: 1982	Part one, A	3
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