

**United Nations
Commission on
International
Trade Law**

YEARBOOK

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NOTE

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

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 twenty-ninth 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-first session, which was held in New York from 1 to 12 June 1998, 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 thirtieth 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 a bibliography of recent writings related to the Commission's work, a list of documents before the thirty-first 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, A-1400 Vienna, Austria
Telephone: 43-1-26060-4060 Telex: 135612 Telefax: 43-1-26060-5813
E-Mail: uncitral@unov.un.or.at 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

Part One

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

THE THIRTY-FIRST SESSION (1998)

A. Report of the United Nations Commission on International Trade Law on the work of its thirty-first session (New York, 1-12 June 1998) (A/53/17) [Original: English]^a

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^aOfficial Records of the General Assembly, Fifty-third Session, Supplement No. 17 (A/53/17) (hereinafter referred to as "Report").

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I. INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law covers the Commission's thirty-first session, held in New York from 1 to 12 June 1998.

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

II. ORGANIZATION OF THE SESSION

A. Opening of the session

3. The United Nations Commission on International Trade Law (UNCITRAL) commenced its thirty-first session on 1 June 1998. The session was opened by the Under-Secretary-General for Legal Affairs, the Legal Counsel.

B. Membership and attendance

4. The General Assembly, by 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 present members of the Commission, elected on 28 November 1994 and on 24 November 1997, 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

Algeria (2001), Argentina (2004—alternating annually with Uruguay, starting 1998), Australia (2001), Austria (2004), Botswana (2001), Brazil (2001), Bulgaria

(2001), Burkina Faso (2004), Cameroon (2001), China (2001), Colombia (2004), Egypt (2001), Fiji (2004), Finland (2001), France (2001), Germany (2001), Honduras (2004), Hungary (2004), India (2004), Iran (Islamic Republic of) (2004), Italy (2004), Japan (2001), Kenya (2004), Lithuania (2004), Mexico (2001), Nigeria (2001), Paraguay (2004), Romania (2004), Russian Federation (2001), Singapore (2001), Spain (2004), Sudan (2004), Thailand (2004), Uganda (2004), United Kingdom of Great Britain and Northern Ireland (2001), United States of America (2004) and Uruguay (2004—alternating annually with Argentina, starting 1999).

5. With the exception of Brazil, Burkina Faso, Fiji, the Sudan and Uganda, all members of the Commission were represented at the session.

6. The session was attended by observers from the following States: Belarus, Benin, Bolivia, Canada, Côte d'Ivoire, Croatia, Czech Republic, Democratic Republic of the Congo, El Salvador, Gabon, Guinea, Indonesia, Iraq, Kuwait, Mongolia, Morocco, Myanmar, Poland, Republic of Korea, Republic of Moldova, Saudi Arabia, Slovakia, Sweden, Switzerland, Syrian Arab Republic, Tunisia, Turkey and Venezuela.

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

(a) *United Nations system*: United Nations Conference on Trade and Development; World Bank; International Monetary Fund;

(b) *Intergovernmental organizations*: Hague Conference on Private International Law;

(c) *International non-governmental organizations invited by the Commission*: Cairo Regional Centre for International Commercial Arbitration; Caribbean Law Institute Centre; Ibero-American Institute of International Economic Law; International Association of Lawyers; International Association of Ports and Harbours; International Bar Association; International Maritime Committee; Latin American Group of Lawyers for International Trade Law; University of the West Indies; World Association of Former United Nations Interns and Fellows.

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

¹Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 17 were elected by the General Assembly at its forty-ninth session, on 28 November 1994 (decision 49/315), and 19 were elected at its fifty-second session, on 24 November 1997 (decision 52/314). Pursuant to resolution 31/99 of 15 December 1976, the term of those members elected by the Assembly at its forty-ninth session will expire on the last day prior to the opening of the thirty-fourth session of the Commission, in 2001, while the term of those members elected at the fifty-second session will expire on the last day prior to the opening of the thirty-seventh session of the Commission, in 2004.

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 officers²

9. The Commission elected the following officers:

<i>Chairman:</i>	Mr. Dumitru Mazilu (Romania)
<i>Vice-Chairmen:</i>	Mr. Louis-Paul Enouga (Cameroon) Mr. Reinhard G. Renger (Germany) Ms. Shahnaz Nikanjam (Islamic Republic of Iran)
<i>Rapporteur:</i>	Mr. Esteban Restrepo-Uribe (Colombia)

D. Agenda

10. The agenda of the session, as adopted by the Commission at its 632nd meeting, on 1 June 1998, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Privately financed infrastructure projects.
5. Electronic commerce.
6. Receivables financing: assignment of receivables.
7. Monitoring implementation of the 1958 New York Convention.
8. Case law on UNCITRAL texts (CLOUT).
9. Training and technical assistance.
10. Status and promotion of UNCITRAL legal texts.
11. General Assembly resolutions on the work of the Commission.
12. New York Convention Day and Uniform Commercial Law Information Colloquium.
13. Coordination and cooperation.
14. Other business.
15. Date and place of future meetings.
16. Adoption of the report of the United Nations Commission on International Trade Law.

²The election of the Chairman took place at the 632nd meeting, on 1 June 1998, the election of the Vice-Chairmen at the 639th meeting, on 4 June 1998, and the election of the Rapporteur at the 636th meeting, on 3 June 1998. In accordance with a decision taken by the Commission at its first session, the Commission has three Vice-Chairmen, so that, together with the Chairman and the Rapporteur, each of the five groups of States listed in General Assembly resolution 2205 (XXI), sect. II, para. 1, will be represented on the bureau of the Commission (see the report of the United Nations Commission on International Trade Law on the work of its first session, *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16 (A/7216)*, para. 14 (*Yearbook of the United Nations Commission on International Trade Law*, vol. I: 1968-1970 (United Nations publication, Sales No. E.71.V.1), part two, chap. I, sect. A)).

E. Adoption of the report

11. At its 650th meeting, on 12 June 1998, the Commission adopted the present report by consensus.

III. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

A. Background

12. At its twenty-ninth session, in 1996, the Commission decided to prepare a legislative guide on build-operate-transfer and related types of project.³ The Commission reached that decision after recommendations by many States and consideration of a report prepared by the Secretary-General (A/CN.9/424), which contained information on work then being undertaken by other organizations in that field, as well as an outline of issues covered by relevant national laws. The Commission considered that it would be useful to provide legislative guidance to States preparing or modernizing legislation relevant to those projects. The Commission requested the Secretariat to review issues suitable for treatment in a legislative guide and to prepare draft materials for its consideration.

13. At its thirtieth session, in 1997, the Commission had before it a table of contents setting out the topics proposed to be covered by the legislative guide, which were followed by annotations concerning the issues suggested for discussion therein (A/CN.9/438). The Commission also had before it initial drafts of chapter I, "Scope, purpose and terminology of the guide" (A/CN.9/438/Add.1), chapter II, "Parties and phases of privately financed infrastructure projects" (A/CN.9/438/Add.2), and chapter V, "Preparatory measures" (A/CN.9/438/Add.3).

14. The Commission exchanged views on the nature of the issues to be discussed in the draft legislative guide and possible methods for addressing them and considered a number of specific suggestions.⁴ The Commission generally approved the line of work proposed by the Secretariat, as contained in documents A/CN.9/438 and Add.1-3. The Commission requested the Secretariat to seek the assistance of outside experts, as required, in the preparation of future chapters. The Commission invited Governments to identify experts who could be of assistance to the Secretariat in that task.

15. At the current session, the Commission had before it drafts of the introductory chapter, entitled "Introduction and background information on privately financed infrastructure projects", and of chapters I, "General legislative considerations", II, "Sector structure and regulation", III, "Selection of the concessionaire", and IV, "Conclusion and general terms of the project agreement" (A/CN.9/444/Add.1-5, respectively), which had been prepared by the

³*Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17)*, paras. 225-230.

⁴*Ibid.*, *Fifty-second Session, Supplement No. 17 and corrigendum (A/52/17 and Corr.1)*, paras. 231-246.

Secretariat with the assistance of outside experts and in consultation with other international organizations. The Commission was informed that initial drafts of chapters V to XI were being prepared by the Secretariat for consideration by the Commission at its thirty-second session, in 1999.

B. General remarks

16. It was pointed out that the annotated table of contents (A/CN.9/444) had been prepared by the Secretariat for the purpose of enabling the Commission to make an informed decision on the proposed structure of the draft legislative guide and its contents. For the purpose of distinguishing the advice provided by the legislative guide from the background discussion contained therein, each substantive chapter was preceded by the legislative recommendations pertaining to the matters dealt with in the chapter.

17. The Commission expressed its satisfaction at the commencement of the work of preparation of a legislative guide on privately financed infrastructure projects. It was observed that many Governments, and also international organizations and private entities, had expressed keen interest in the work of the Commission concerning such projects. The Commission was reminded of the importance of bearing in mind the need to keep the appropriate balance between the objective of attracting private investment for infrastructure projects and the protection of the interests of the host Government and the users of the infrastructure facility.

C. Structure of the draft legislative guide and issues to be covered

18. The Commission noted and generally approved the proposed structure of the draft legislative guide and the selection of issues suggested for discussion therein, as set out in document A/CN.9/444. It was observed that topics it was currently proposed to deal with separately in future chapters of the legislative guide might at a later stage be combined so as to simplify the structure of the guide (e.g. construction phase, operational phase) (see below, para. 201).

19. The Commission engaged in a general discussion concerning the presentation of the guide and the desirability of formulating legislative recommendations in the form of sample provisions for the purpose of illustrating possible legislative solutions for the issues dealt with in the legislative guide, as had been suggested at its thirtieth session.⁵ It was noted that the legislative guide would, upon completion, constitute a useful tool for Governments in reviewing and modernizing their legislation pertaining to privately financed infrastructure projects, in particular in countries lacking experience in the execution of such projects. Support was expressed for the suggestion that the usefulness of the legislative guide might be enhanced by providing the reader, where appropriate, with model legislative provisions on issues discussed within the guide.

20. However, various speakers pointed out the potential difficulty and undesirability of formulating model legislative provisions on privately financed infrastructure projects in view of the complexity of the legal issues typically raised by those projects, some of which concerned matters of public policy, as well as the diversity of national legal traditions and administrative practices. It was also pointed out that, as currently formulated, the draft chapters of the legislative guide offered the necessary flexibility for national legislators, regulators and other authorities to take into account the local reality when implementing, as appropriate, the legislative recommendations contained therein. The suggestion was made that, from a practical perspective, the provision of model contractual clauses for project agreements might be a more useful alternative than the formulation of model legislative provisions.

21. Having noted the various views expressed, members felt that the Commission should keep under consideration the desirability of formulating model legislative provisions when discussing the legislative recommendations contained in the draft chapters and in that connection identify any issues for which the formulation of model legislative provisions would increase the value of the guide (for further discussion concerning the question of model legislative provisions and the presentation of the recommendations in general, see below, paras. 202-204).

22. The Commission exchanged views on the nature of the issues to be discussed in the draft legislative guide and possible methods of addressing them. It was noted that, in dealing with individual topics, the draft legislative guide should distinguish between the following categories of issues: general legal issues under the laws of the host country; issues relating to legislation specific to privately financed infrastructure projects; issues that might be dealt with at the regulatory level; and issues of a contractual nature. Although a clear distinction might not always be feasible, it was considered that the draft legislative guide should focus primarily on issues relating to legislation specific to, or of particular importance for, privately financed infrastructure projects.

D. Consideration of draft chapters

Introduction and background information on privately financed infrastructure projects (A/CN.9/444/Add.1)

23. At its thirtieth session, the Commission had considered an initial draft of chapter I, "Scope, purpose and terminology of the guide" (A/CN.9/438/Add.1), which had contained information on the projects covered by, and on the purpose of, the legislative guide, as well as an explanation of terms frequently used therein. The Commission had also considered an initial draft of chapter II, "Parties and phases of privately financed infrastructure projects" (A/CN.9/438/Add.2), which had contained general background information on the concept of project finance, the parties to a privately financed infrastructure project and the phases of their implementation.

⁵Ibid., para. 235.

24. At its thirty-first session, the Commission was informed that, in the consultations that had been conducted by the Secretariat with outside experts and international organizations since the Commission's thirtieth session, it had been suggested that the usefulness of the legislative guide might be enhanced by distinguishing more clearly between the introductory portions and those remaining chapters of the legislative guide, which were intended to contain substantive discussion and legislative advice. For that purpose, the former draft chapters I and II had been combined into a single introduction, which took into account, as appropriate, the suggestions that had been made at the thirtieth session of the Commission as regards documents A/CN.9/438/Add.1 and 2.⁶

Section A. Introduction

1. Purpose and scope of the guide

25. A question was asked concerning the statement made in paragraph 5 that the legislative guide did not cover "privatization" transactions that did not relate to infrastructure development and operation, and the reason for such an exclusion. It was stated that the distinction made in the guide between privately financed infrastructure projects and other transactions for the "privatization" of state functions or property might not be justified in certain cases and that it was preferable not to exclude privatization transactions from the scope of the guide. In response to that suggestion, it was pointed out that, at its thirtieth session, the Commission had decided that the guide should not deal with transactions for the "privatization" of state property by means of the sale of state property or shares of state-owned entities to the private sector, because privatization gave rise to legislative issues that were different from legislative issues pertaining to privately financed infrastructure projects.

26. The Commission was reminded of the reasons why the guide did not cover projects for the exploitation of natural resources under "concessions", "permissions" or "licences" issued by the State. In that connection, it was suggested that the focus of the guide on infrastructure projects was sufficiently clear and that there was no need to elaborate on that point to the extent that the draft paper currently did.

2. Terminology used in the guide

27. As regards the presentation of the subsection, it was suggested that, for ease of reading, the terminology should be presented in a chart, rather than as part of the text. However, it was observed that the subsection on terminology contained not only definitions, but also explanations of the use of certain expressions that appeared frequently in the guide.

28. It was suggested that the use of expressions such as "private entity" or "private operator" in subsection 2 and

throughout the guide might generate the erroneous impression that the legislative guide did not cover infrastructure projects that were carried out by public entities. It was proposed that the guide should instead use more neutral expressions and that the expressions currently used to refer to national authorities of the host country (e.g. "Government", "State" and "regulatory agency") should be reviewed in all language versions so as to ensure consistency and avoid ambiguities.

29. It was suggested that the notion of "project management contract" should be added to the portion of the text dealing with the definition of "turnkey" contract, and that the definition should mention the elements of fixed price and fixed time for the performance of the contract.

30. It was also suggested that the appropriateness, in some language versions, of the use of the expression "project consortium" should be reviewed, since that expression might be understood in a narrow sense in some legal systems (e.g. as a particular contractual arrangement). Furthermore, it was suggested that the use of the expressions "project company" and "shareholders of the project company" should also be reviewed, since in some language versions they might convey the erroneous impression that the guide only referred to a particular type of legal entity.

Section B. Background information on infrastructure projects

General comments

31. It was pointed out that the section discussed basic issues of privately financed infrastructure projects, such as private sector participation in public infrastructure and the concept of project finance. It also identified the main parties involved in those projects and their respective interests and briefly described the evolution of a privately financed infrastructure project.

32. As a general comment, it was stated that some portions of section B were lengthy and could be usefully reduced. It was noted that the section was conceived as general background information on matters that were examined from a legislative perspective in the subsequent chapters of the guide. Once all chapters of the guide were available, some of the information contained in the section might be restructured or presented in a more concise way.

33. It was suggested that the sections should elaborate on the financial arrangements used in connection with privately financed infrastructure projects and should emphasize the use and essential characteristics of "non-recourse" and "limited-recourse" finance. It was also suggested that the draft legislative guide should stress the role that capital market financing, including financing obtained in the local market, might play in the development of infrastructure projects. Once such changes had been made, the section might need to be restructured.

⁶Ibid., paras. 238-243.

1. *Private sector and public infrastructure*

34. The view was expressed that the portions of the sections dealing with historical aspects of private participation in infrastructure were not needed and should be deleted or moved to earlier parts of the text. In reply, it was said that paragraphs 31 to 34 of the draft chapter had a useful informative function, in particular in the light of the experience of those countries which had a tradition of awarding concessions for the construction and operation of infrastructure.

2. *Forms of private sector participation*

35. The paragraphs dealing with the forms of private sector participation did not elicit comment.

3. *Financing infrastructure projects*

36. The view was expressed that the guide should emphasize the importance of pledging shares of the project company for the purpose of obtaining finance to the project. However, it was suggested that the penultimate sentence of paragraph 48, which mentioned the shares of the project company among the collaterals provided by the borrowers, should be redrafted, since it seemed to imply that the project company would offer its own shares to guarantee the repayment of loans. Furthermore, it was noted that the laws of certain countries posed obstacles to the pledge, as a collateral to commercial loans, of certain categories of assets held by the project company but owned by the public entity that awarded the concession. Therefore, for purposes of clarity, it was suggested that the words "to the extent permitted by the laws of the host country" should be added at the end of the penultimate sentence of paragraph 48.

37. In connection with the distinction between "unsubordinated" and "subordinated" loans, in paragraphs 48 to 50, it was suggested that the guide should discuss possible implications of the laws of the host country for contractual arrangements establishing precedence of payment of certain categories of loan over the payment of any other of the borrower's liabilities.

38. With respect to paragraph 50, it was observed that companies wishing to have access to loans provided by investment funds and other so-called "institutional investors", such as insurance companies, collective investment schemes (e.g. mutual funds) or pension funds, typically had to fulfil certain requirements, such as having a positive credit rating. For purposes of clarity, it was suggested that those "institutional investors" should be dealt with separately from other sources of subordinated loans.

39. It was suggested that the guide should also mention the sale of shares in capital markets among the financing sources mentioned in paragraph 51.

40. It was suggested that the last sentence of paragraph 53 might not be needed, since all financial institutions, and not only Islamic financial institutions, would ordinarily review economic and financial assumptions of

projects for which financing was sought and would follow closely all phases of its implementation.

41. It was suggested that export credit agencies and bilateral aid and financing agencies should be mentioned among the financing institutions referred to in paragraphs 54 to 56. In connection with paragraph 56, it was also suggested that mention should be made of the limited scope of the guarantees provided by international financial institutions and of the requirement typically imposed by them that counter-guarantees should be provided by the host Government.

4. *Parties involved in infrastructure projects*

42. In connection with paragraph 66, it was suggested that the guide should clarify that some countries might be precluded from favouring the employment of local personnel pursuant to international obligations on trade facilitation or regional economic integration.

43. It was suggested that a reference should be included in paragraph 77 to completion guarantees, which the project company might be required to provide so as to protect the lenders against pre-completion risks.

44. With regard to the methods of remuneration of the operating company, it was pointed out that, in the practice of some countries, other methods might be used, in addition to those referred to in paragraph 87. Those methods might include availability charges, whereby the operating company was paid for the services made available, regardless of actual usage; service charges relating to satisfactory maintenance and operation; and volume-related payments, whereby payments related to the intensity of usage, which might be calculated with the aid of sophisticated methods for measuring performance, and functioned as a bonus paid to the operator for intensive usage of the infrastructure.

45. With regard to the insurance arrangements for privately financed infrastructure projects, it was suggested that mention should be made in paragraph 89 that, in some countries, insurance underwriters structured comprehensive insurance packages aimed at avoiding certain risks being left uncovered owing to gaps between individual insurance policies. It was also suggested that a reference to re-insurance arrangements should be included in the same paragraph.

46. It was suggested that reference should be made, in paragraph 90, to the role of independent advisers in advising the lenders to the project.

5. *Phases of execution*

47. As a general comment, it was stated that, while containing useful information, paragraphs 93 to 110 anticipated to some extent issues that would be discussed in more detail in the substantive chapters of the legislative guide. It was therefore suggested that those paragraphs might need to be revised and restructured once the remaining draft chapters of the legislative guide had been prepared.

48. The suggestion was made that paragraph 98 should be clarified to the effect that competitive selection procedures were not only used for projects involving the construction of new infrastructure. At the same time, it was suggested that mention should be made in that paragraph that there might be instances where the host Government did not resort to competitive proposals for the award of infrastructure projects. In that regard, the Commission was informed of the particular connotation given in some legal systems to expressions such as “procurement” and “project award”, which were not used in those legal systems in connection with the selection of public service providers. The Commission took note of that information and decided to revert to the issue when considering the draft chapter on the selection of the concessionaire (A/CN.9/444/Add.4).

49. In view of the fact that the financial arrangements in some privately financed infrastructure projects might contemplate direct payments by the Government to the project company (see A/CN.9/444/Add.1, para. 60), it was suggested that the words “is the sole source of funds” in the first sentence of paragraph 107 should be replaced with words such as “is the main source of funds” before “for repaying its debts”.

Chapter I. General legislative considerations (A/CN.9/444/Add.2)

50. It was noted that the opening section of draft chapter I (previously numbered chap. III) discussed two issues concerning the general legal framework for privately financed infrastructure projects, namely, the legislative authorization for the host Government to undertake such projects and the legal regime to which they were subject. The second section of draft chapter I considered the possible impact of other areas of legislation on the successful implementation of those projects. The concluding section of draft chapter I discussed the possible relevance of international agreements entered into by the host country for domestic legislation governing privately financed infrastructure projects.

51. The Commission was reminded that, at its thirtieth session, it had been suggested that the chapter dealing with general legislative considerations should elaborate on the different legal regimes governing the infrastructure in question, as well as on the services provided by the project company, issues concerning which there were significant differences among legal systems. It had also been suggested that attention should be given to constitutional issues relating to privately financed infrastructure projects.⁷ It was noted that draft chapter I reflected those suggestions and included some of the contents of former draft chapter V, “Preparatory measures” (A/CN.9/438/Add.3).

52. By way of a general comment, it was suggested that stronger language should be used in formulating legislative recommendations. The emphasis should be on the major objectives of legislation governing privately fi-

nanced infrastructure projects; those objectives were to establish sufficient authority for the host Government to enter into transactions for the construction of infrastructure projects with private financing, to reduce the need for governmental approvals to a reasonable minimum and to foster coordination between different levels of government and among different governmental departments. It was agreed that the legislative guide should be drafted in such a way that it would not appear to promote the use of private financing for infrastructure projects, but would draw the attention of those Governments which opted for such transactions to the underlying legislative issues.

Constitutional issues (legislative recommendation 1 and paras. 1-4)

53. It was generally agreed that it was necessary not only to review constitutional restrictions to private sector participation in infrastructure development and operation, but also to address restrictions established by legislation and regulations subordinate to the constitution.

54. It was suggested that, since recommendation 1 was restricted to advice for a review of legislation, the advice could be expressed in stronger terms. However, a more reserved approach was advisable in discussing possible changes in constitutions and other legislation.

Legislative approaches (legislative recommendation 2 and paras. 5-8)

55. It was pointed out that, if the recommendations in the chapter were to be reformulated to emphasize the need for the host Government to have the authority to enter into transactions relating to privately financed infrastructure projects (see above, para. 52), recommendation 2 could be merged with recommendation 1. It was also observed that, in addition to sector-specific laws, some States had adopted laws governing individual privately financed infrastructure projects; it was suggested that that legislative approach might also need to be reflected in the guide. However, the view was expressed that such a legislative approach might not constitute a wise practice.

Legislative authority to grant concessions (legislative recommendations 3 and 4 and paras. 10 and 11)

56. It was suggested that legislative recommendations 1, 2, 3, 4 and possibly 5 and 6 should be combined. It was also suggested that attention should be drawn, in the context of the legislative recommendations referred to, or at another appropriate place, to the following: the ability of the host Government to conclude and carry out commitments relating to privately financed infrastructure projects; the ability of the Government to provide the site for such projects; the authority to initiate or carry out any necessary expropriations; the ability of the Government to convey property interests to private investors; the ability of the Government to agree to the encumbrance of state-owned property in order to create security interests; freedom of the Government to agree to arbitration and other methods of non-judicial settlement of disputes; the ability of the

⁷Ibid., para. 237 (a).

Government to give guarantees for the protection of investors' rights; and to allow linking of prices of services or goods generated by the privately operated infrastructure to price indices.

57. It was observed that paragraph 11 discussed methods of calculating and adjusting prices and that that discussion should not appear under the current title "Legislative authority to grant concessions".

Legal regime of privately financed infrastructure projects
(legislative recommendation 5 and paras. 12-15)

58. It was suggested that the second sentence of legislative recommendation 5 should be reformulated so that it would, in a positive fashion, advise the establishment of rules and mechanisms that would facilitate the execution of privately financed infrastructure projects.

Ownership and use of infrastructure
(legislative recommendation 6 and paras. 16-19)

59. No comments were made on legislative recommendation 6.

Legal status of public service providers
(legislative recommendation 7 and paras. 20 and 21)

60. Apart from terminological suggestions relating to some language versions of the document, no substantive comments were made on recommendation 7.

Administrative coordination
(legislative recommendations 8-11 and paras. 22-27)

61. It was suggested that the desirability of centralizing the issuance of licences should not be overemphasized, since the reasons for the distribution of administrative authority among various levels of government (e.g. local, regional and central) were typically not overridden by the existence of a privately financed infrastructure project; any possibility of delay that might result from such distribution of administrative authority should be countered, in particular, by making the process of obtaining licences more transparent and efficient.

62. It was suggested that, in the annotations accompanying the legislative recommendations, it should be indicated that, in addition to coordination among various levels of government and various governmental departments, there was a need for consistency in the application of criteria for the issuance of licences and for the transparency of the administrative process.

Other relevant areas of legislation
(legislative recommendation 12 and paras. 28-62)

63. It was suggested that legislative recommendation 12 should be reformulated in order to avoid an unintended implication that some of the areas of law mentioned

therein (e.g. security law, company law and investment protection) were not immediately relevant to privately financed infrastructure projects.

64. It was also suggested that reference should be made wherever appropriate to laws on consumer protection or that issues relating to consumer protection should be discussed as a separate issue. Furthermore, it was requested that reference be made to the need to protect, wherever relevant, groups of indigenous people who might be adversely affected by privately financed infrastructure projects.

Investment protection (paras. 29-32)

65. It was suggested that the title of the subsection should be changed to "Investment promotion and protection".

66. As to paragraph 31, it was suggested that reference should be made to the need expressly to allow the transfer of foreign exchange in order to repay loans.

Property law (paras. 33-35)

67. It was observed that the title of the subsection did not refer to security interests.

68. It was suggested that the expression "reasonable proof" in paragraph 34 should be replaced by a stronger expression, such as "clear proof".

Rules and procedures on expropriation
(paras. 36 and 37)

69. It was suggested that paragraph 36 should not imply that providing the land should always be the responsibility of the host Government. As a matter of terminology, it was suggested that the term "expropriation" might not be appropriate in some legal systems (see below, para. 183).

70. It was considered, with respect to the third sentence of paragraph 37, that it was inappropriate to refer to court proceedings as a source of delay without at the same time clarifying the benefits of, and public policy objectives sought to be achieved by, entrusting expropriation proceedings to courts. It was also suggested that the statement made in the last sentence of paragraph 37 should be qualified with words such as "to the extent permitted by law".

Intellectual property law (paras. 38 and 39)

71. It was proposed to refer in the subsection to the desirability of strengthening the protection of intellectual property rights in line with international instruments governing that area of law. With respect to the italicized text in paragraph 39, support was expressed for listing in the guide international instruments regarding intellectual property rights in discussing the benefits of establishing a legal framework for the protection of intellectual property rights.

72. It was suggested that paragraph 38 should reflect the fact that protection of patents was limited to the jurisdiction in which the patent was registered and that that protection did not automatically extend beyond that jurisdiction.

Security law (paras. 40-45)

73. It was stressed that reliable security offered to lenders was crucial for the success of privately financed infrastructure projects and that therefore the discussion of the law of security interests should be further developed either in the subsection on security law or elsewhere in the guide. For example, it was pointed out that it would be desirable to discuss the different types of security interest and the different types of asset that might be encumbered for the purpose of providing security and that in some legal systems the inalienability of public assets might constitute an obstacle to creating security interests in the context of privately financed infrastructure projects. It was, however, observed in a general way that, because of the significant differences between legal systems regarding the law of security interests, it would be difficult and probably inadvisable to discuss in more detail the technicalities of legislation in that area.

74. It was suggested that the second sentence of paragraph 40 should be reviewed so as to rearrange the different types of security interest according to their practical importance, and that reference should be made to the assignment of intangible assets other than receivables. It was also suggested that the penultimate sentence of paragraph 40 and its link with the last sentence of the paragraph should be reviewed.

75. It was proposed to address “step-in” rights in favour of creditors, which would allow them to take over the concession or the operation of the infrastructure project if the project company was in default of its obligations towards the creditors.

76. Another suggestion was to mention the work of the International Institute for the Unification of Private Law regarding security interests in mobile equipment, which might be relevant also in the context of privately financed infrastructure projects.

77. It was considered that the discussion in paragraph 41 should appropriately reflect the fact that in many countries no central registers of title existed.

Company law (paras. 46-49)

78. It was proposed that mention be made in the legislative recommendation and the annotations on company law of the fact that some national laws established an obligation for the project company to be incorporated as a particular type of commercial entity that was best suited to the various interests involved in the project and that some laws also contained mandatory rules regarding the definition of the registered activity of the project company.

79. It was proposed that paragraph 49 also mention directors of the project company as possible parties to agree-

ments concerning the management of the project company.

80. It was observed that the legislative guide in many instances referred to project consortia and that those references were too narrow, in that a single entity might seek to obtain a concession, establish a project company and assume the responsibilities that in other cases were assumed by a consortium. It was observed that the legislative guide, in referring to the project company, often used terms that indicated a particular form of company; it was suggested that such terminology should be avoided, because various corporate forms were used for incorporating project operators, the common characteristic of which was that the liability of the company owners for the obligations of the company was limited to their stake in the company.

81. It was suggested that, in the section regarding company law, references should be made to the settlement of disagreements among owners of the project company, responsibility of directors and administrators, including criminal responsibility, and the protection of interested third persons.

Accounting practices (para. 50)

82. It was observed that the emphasis of paragraph 50 was on accounting practices and that, in line with the purpose of the guide, the discussion should be recast so as to focus on legislation.

Contract law (paras. 51 and 52)

83. It was considered that section 8 should indicate more clearly the types of contract envisaged in the section and, in particular, should distinguish between contracts between the project company and its suppliers or customers and the agreement between the host Government and the concessionaire, which was in some legal systems subject to administrative law, rather than contract law. It was suggested that reference should also be made to private international law, in the context of the discussion on law on commercial contracts.

Insolvency law (paras. 53 and 54)

84. It was suggested that the following should be addressed: the question of the ranking of creditors, the priority between the insolvency administrator and creditors, legal mechanisms for reorganization of the insolvent debtor, special rules designed to ensure the continuity of the public service in case of insolvency of the project company and provisions on avoidance of transactions entered into by the debtor shortly before the opening of the insolvency proceedings.

Tax law (paras. 55-57)

85. It was stated that the stability of the tax regime was crucial for the success of privately financed infrastructure projects. The suggestion was made to mention the possibility of agreements between the host Government and the

investors or the project company establishing the stability of the tax regime applicable to the concession. It was noted that the authority to establish or increase taxes or enforce tax legislation might be decentralized, a circumstance that should be reflected in the section. The guide might also mention various forms of tax incentives granted to private investors (e.g. permanent incentives or incentives that were limited in time).

Environmental protection (paras. 58-60)

86. It was observed that environmental matters played an important role in privately financed infrastructure projects and that such matters were among the most frequent causes of dispute. It was suggested that the list of examples in the second sentence of paragraph 58 should be expanded by adding, for example, the coal-fired power sector, power transmission, roads and railways. It was also suggested that the section should refer to the desirability of adhering to treaties relating to the protection of the environment.

87. It was considered that the guide should avoid the impression of suggesting that laws designed to protect the environment were an obstacle to be removed in order to facilitate privately financed infrastructure projects. The same applied to the possibility for any individual person to initiate proceedings to review the compliance of the project with environmental laws, a possibility that had been provided for by a number of national laws and was being discussed in international forums.

Settlement of disputes (paras. 61 and 62)

88. It was suggested that the section should address the different types of dispute that might arise in the context of a privately financed infrastructure, namely, disputes arising in relation to the selection of the concessionaire, disputes between the private companies involved in the construction and operation of the project and disputes between the host Government or the regulatory agency and the project company during the operational phase of the project. It was also suggested that reference should be made in the section to choice-of-law issues.

89. In response to a question, it was pointed out that the International Centre for Settlement of Investment Disputes had already been involved in the settlement of disputes arising from privately financed infrastructure projects and that cases considered by the Centre might provide valuable information that might usefully be reflected in the guide. It was suggested that other institutions administering arbitration proceedings, such as the International Chamber of Commerce, might also be referred to in the guide.

90. The view was expressed that, to the extent relevant to legislation, alternative methods of dispute settlement such as conciliation or mediation should be mentioned in the guide.

91. The view was also expressed that the guide should call upon States to make judicial proceedings more efficient and thereby make referral of disputes to state courts

a more attractive option. A contrary view was that, in the context of privately financed infrastructure projects, the prospect of judicial settlement of disputes was frequently seen by international investors as an obstacle in negotiating such projects and that, therefore, that method of dispute settlement should not be promoted. It was added, however, that, even if arbitration was chosen as a method of settling disputes, efficient judicial protection of rights of interested parties remained crucial for the success of privately financed infrastructure projects. It was suggested that, in addition to the recognition and enforcement of foreign arbitral awards, the regime for the recognition and enforcement of foreign judgements should be mentioned in paragraph 61.

92. The view was expressed that the guide should refer to the UNCITRAL Model Law on International Commercial Arbitration as one of the examples of texts the adoption of which might provide a hospitable legal climate for the settlement of disputes.

*National legislation and international agreements
(legislative recommendation 13 and paras. 63-67)*

93. It was suggested that the title of the recommendation (in particular the phrase "national legislation") should be reviewed in view of the fact that the recommendation and the annotation were directed primarily towards international treaties.

94. It was suggested that reference should be made in the guide to international instruments designed to eliminate corruption. The guide should also refer to environmental protection and it should be made clear that regional economic integration treaties were the source of certain national legislative provisions.

95. The view was expressed that it would be useful to refer to the World Trade Organization's Agreement on Government Procurement. That Agreement currently had some 25 contracting parties and efforts were under way to make it universally accepted.

**Chapter II. Sector structure and regulation
(A/CN.9/444/Add.3)**

General remarks

96. The Commission was reminded of its deliberations during its thirtieth session, when it had been noted that issues pertaining to privately financed infrastructure projects also involved issues of market structure and market regulation and that consideration of those issues was important for the treatment of a number of individual topics proposed to be covered by the legislative guide.⁸

97. The Commission noted that, for the purpose of dealing with issues of competition, sector structure and regulation at the level of detail that had been envisaged by the Commission, a separate chapter had been prepared by the

⁸Ibid., para. 236.

Secretariat. The Commission expressed its appreciation to the Private Sector Development Department of the World Bank for having contributed the substance of the draft chapter.

98. The Commission engaged in a general exchange of views regarding the scope and purpose of the chapter.

99. According to one view, the issues raised by privately financed infrastructure projects were not exclusively legal in nature, as they were closely related to considerations of economic and industrial policy as well. The inclusion of a discussion on competition in the legislative guide was welcome in view of the difficulties some countries had encountered in the aftermath of privatization processes in which private monopolies had succeeded state monopolies. In that connection, it was stated that the draft chapter contained useful background information that might assist national legislators to consider the various options available.

100. In another view, the discussion of policy issues contained in the draft chapter was excessively detailed and might convey the impression that the guide advocated certain specific policies. It was stated that the issue of sector structure, as well as the options available for achieving the desired structure, were essentially matters of national economic policy, which should not figure prominently in the guide. It was also pointed out that in various legal systems a distinction was made between regulated sectors, such as electricity and telecommunications, in which the operators were authorized to provide services under a licence issued by the competent authorities, and other sectors in which the operators were awarded concessions through contractual arrangements entered into with the competent public entity. The Commission was urged to revise the draft chapter with a view to ensuring that it adequately reflected those distinctions. Concern was also expressed that the wording and character of the discussion contained in the draft chapter appeared to be excessively prescriptive and not in harmony with the nature and style of the remaining chapters.

101. The Commission considered possible ways to address the concerns that had been expressed. One proposal was to move the substance of the discussion on competition and sector structure, currently contained in sections A, "Market structure and competition", and B, "Legislative measures to implement sector reform", to the introductory part of the guide or simply to refer to a treatment of those issues elsewhere in the guide. It was also proposed to move the substance of the discussion on regulatory issues, currently contained in section C, "Regulation of infrastructure services", to a future chapter dealing with the operational phase. It was pointed out, in that connection, that further redrafting might subsequently be required so as to harmonize those portions with the remaining text of the guide. An alternative proposal was to combine sections A and B of the draft chapter in a separate part of the guide, possibly in the form of an annex, while moving most of section C to the future chapter dealing with the operational phase.

102. After deliberation, the Commission requested the Secretariat to rearrange the substance of the draft chapter as suggested in the first proposal referred to above in para-

graph 101, taking into account the views expressed during the discussion. Without prejudice to that decision, the Commission proceeded to exchange views on the substance of the draft chapter.

Market structure and competition
(legislative recommendation 1 and paras. 1-13)

103. It was suggested that the corresponding notes to legislative recommendation 1 should make clear that the review of the assumptions under which state monopolies had been established involved a review of the historical circumstances and political conditions that had led to the creation of such monopolies.

104. The view was expressed that it was important to refer in the corresponding notes to competition laws and other similar rules that protected the market from abusive or restrictive practices.

Abolition of legal barriers and obstacles
(legislative recommendation 2 and paras. 15 and 16)

105. It was suggested that the draft chapter should take into account the fact that certain countries, in particular developing countries, might have a legitimate interest in promoting the development of certain sectors of national industry and might thus choose not to open certain infrastructure sectors to competition.

106. The view was expressed that the phrase "other legal impediments to competition" in recommendation 2 could be understood in an excessively broad sense, encompassing public policy rules, such as environmental or consumer protection rules. It was therefore suggested that the phrase should be qualified by adding words such as "that cannot be justified by reasons of public interest".

Restructuring infrastructure sectors
(legislative recommendation 3 and paras. 18-21)

107. It was pointed out that the manner in which a country decided to organize a particular infrastructure sector constituted a matter of national economic policy. Accordingly, the inclusion in the legislative guide of a description of measures that had been taken in some countries to restructure various infrastructure sectors should be done in such a fashion as to avoid the impression that the guide advocated any particular model. It was also suggested that the guide should take into account the varying levels of economic and technological development of countries.

Transitional measures
(legislative recommendations 4 and 5 and paras. 33-35)

108. It was pointed out that the restructuring of infrastructure sectors was a particularly complex exercise that not only involved transitional measures of a technical or legal nature, but required the consideration of a variety of political, economic and social interests. The draft chapter should also mention those other factors, as appropriate.

*Controlling residual monopolies
(legislative recommendations 6 and 7 and paras. 37-40)*

109. In connection with the reference, in paragraphs 37 to 39 of the notes, to the use of competitive procedures for the choice of the operator, it was observed that, in some countries, concessions of public services had traditionally been regarded as involving a delegation of state functions and, as such, the delegating authority was not bound to follow the same procedures that governed the award of public contracts. In those countries, concessions might be awarded after direct negotiations between the delegating authority and a concessionaire of its choice, subject to certain requirements, such as the previous publication of a notice to interested parties who wished to be invited to those negotiations. That reality, it was stated, was not adequately reflected in the above-mentioned paragraphs, which should be redrafted so as to avoid the impression that they prescribed the use of tendering or other competitive selection procedures as the only acceptable ones for the award of infrastructure projects. In reply it was stated that the guide should stress the need for competitive selection procedures.

110. As regards paragraph 40 of the notes, it was stated that in some cases the retention of geographical monopolies might be warranted for a transitional period only, a circumstance that should be mentioned in the guide.

*Conditions for the award of licences and concessions
(legislative recommendation 8 and para. 50)*

111. The view was expressed that paragraph 50 of the notes might need to be revised so as to ensure its consistency with the advice provided in chapter III, "Selection of the concessionaire".

*Interconnection and access regulation
(legislative recommendation 9 and paras. 51-54)*

112. It was observed that the text of the legislative recommendation and the corresponding notes did not distinguish adequately between obligations imposed on an operator pursuant to the applicable regulatory regime and contractual rights or obligations that might be provided in a bilateral concession agreement. Since the distinctions had various important implications in some legal systems, the legislative recommendation and the notes should be revised.

*Price and profit regulation
(legislative recommendations 10 and 11 and paras. 55-57);
Subsidies and universal service
(legislative recommendation 12 and para. 62);
Performance standards
(legislative recommendation 13 and para. 63)*

113. Comments were made to the effect that the regulatory issues dealt with in recommendations 10 to 13 typically arose during the operational phase of the infrastructure and that it would therefore be more appropriate to

address those issues in a future chapter concerning the operational phase, rather than in the second chapter of the legislative guide (see also above, paras. 100 and 101).

114. It was suggested that issues relating to consumer protection were not limited to the need to ensure universal access to the services provided by infrastructure operators and that the guide should include a discussion, as appropriate, of consumer protection.

*Independence and autonomy of regulatory bodies
(legislative recommendations 14 and 15 and
paras. 67-71)*

115. In response to questions as to the need for a discussion of the functions of regulatory bodies in the legislative guide, it was stated that it was of crucial importance for potential investors to be able to ascertain whether the regulatory regime would be fair and stable and would take appropriate account of the public interest and the interests of the project company. The notions of independence and autonomy of regulatory bodies encompassed two important elements that merited further elaboration in the notes corresponding to recommendations 14 and 15, namely, the functional autonomy of the regulatory body within the administrative structure of the host Government and its independence from the regulated industry.

116. It was pointed out that the reference in recommendation 15 to decisions made by the regulatory body on "technical" grounds might be interpreted in some legal systems as implying the strict application of a rule without consideration of the particular context in which the rule was being applied. It was suggested that it would be preferable to refer to "substantive" or "objective" grounds.

*Sectoral attributions of regulatory bodies
(legislative recommendation 16 and paras. 72 and 73)*

117. It was observed that the attributions of regulatory bodies were not always limited to individual sectors, since in some countries they might also extend to several sectors within a given region.

*Mandate of regulatory bodies
(legislative recommendation 17 and para. 74)*

118. The view was expressed that recommendation 17 might conflict with recommendation 15. It was noted that recommendation 15 (see above, para. 116) required that the regulatory bodies be given autonomy to take decisions on technical rather than political grounds. However, the general objectives that should guide the actions of regulatory bodies pursuant to recommendation 17 (e.g. the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector, the financial viability of the public service providers, the safeguarding of the public interest or of public service obligations and the protection of investors' rights) were not of a strictly "technical" nature. It was suggested that the notes should clarify the interplay between the two recommendations.

*Powers of regulatory bodies
(legislative recommendation 18 and paras. 75-78)*

119. Except for editorial or linguistic comments, or the reiteration of general comments made earlier during the debate, such as a suggestion to include a reference to consumer protection, no specific comments were made in connection with recommendation 18 and the accompanying notes.

*Composition of the regulatory body
(legislative recommendations 19 and 20
and paras. 80 and 81)*

120. The view was expressed that the guide should establish a clearer distinction between legislative advice and practical advice on the regulatory function. It was suggested that the substance of recommendation 19, which related to the ideal number of members in regulatory bodies that took the form of a commission, was not a matter for legislation. Similar examples could be found in other recommendations made in the draft chapter. In reply it was stated that in order to implement some of the practical advice given in the guide (e.g. as to the membership of the regulatory body) legislative provisions might be needed and that therefore it would be useful to discuss practical advice in the guide.

*Disclosure requirements
(legislative recommendation 21 and paras. 84-86)*

121. The view was expressed that the disclosure requirements imposed on the operator under recommendation 21 (e.g. the obligation to provide the regulatory body with information on the operation of the company) might cause practical difficulties in connection with recommendations 22 and 23, which contemplated, *inter alia*, the accessibility by interested parties to regulatory decisions. The guide should address the legitimate concern of the regulated industry as to the confidentiality of proprietary information.

*Sanctions (legislative recommendation 24 and para. 94);
Appeals (legislative recommendation 25 and para. 95)*

122. Except for editorial or linguistic comments, or the reiteration of general comments made earlier during the debate, no specific comments were made in connection with recommendations 24 and 25 and the accompanying notes.

**Chapter III. Selection of the concessionaire
(A/CN.9/444/Add.4)**

General remarks

123. It was noted that draft chapter III (previously chapter IV), which dealt with methods and procedures recommended for use in the award of privately financed infrastructure projects, also discussed issues raised by unsolicited proposals, as had been suggested at the thirtieth session of the Commission.⁹

124. It was felt that the overall purpose of the legislative guide was to assist host countries to stimulate the flow of investment in infrastructure projects by providing advice on essential elements of a favourable legal framework. One of those elements was the existence of appropriate selection procedures. One significant practical obstacle to the execution of privately financed infrastructure projects was the considerable length of time invested in negotiations between the public authorities of the host country and potential investors. By devising appropriate procedures for the award of privately financed infrastructure projects that were aimed at achieving efficiency and economy, while ensuring transparency and fairness in the selection procedures, the guide might become a helpful tool for the public authorities of host countries.

125. It was noted that no international legislative model had been devised specifically for competitive selection procedures in privately financed infrastructure projects. In that connection, it was suggested that the usefulness of the chapter might be enhanced by focusing the recommendations on issues of a legislative nature and formulating them as much as possible in language that lent itself to being incorporated into national legislation.

126. With regard to the preference expressed in the chapter for the use of competitive methods to select the concessionaire, comments were made to the effect that the guide should recognize more clearly that other methods might also be used, according to the legal tradition of the country concerned. It was observed that, in the legal tradition of certain countries, privately financed infrastructure projects involved the delegation, by the appropriate public entity, of the right and authority to provide a public service. As such, they were subject to a special legal regime that differed in many respects from the regime that applied generally to the award of public contracts for the purchase of goods, construction or services.

127. In those countries, for the award of public contracts for the purchase of goods or services, the Government had the choice of a number of procedures, which, as a general rule, involved publicity requirements, competition and the strict application of pre-established award criteria. The most common procedure was the tendering method (*adjudication*), in which the contract was awarded to the tenderer offering the lowest price. While there also existed less rigid procedures, such as the request for proposals (*appel d'offres*), which allowed for consideration of other elements in addition to price (e.g. operating cost, technical merit and proposed completion time), negotiations were only resorted to under exceptional circumstances. However, those countries applied different procedures for the award of privately financed infrastructure projects. Given the very particular nature of the services required (e.g. complexity, amount of investment and completion time), the procedures used placed the accent on the delegating body's freedom to choose the operator who best suited its need, in terms of professional qualification, financial strength, ability to ensure the continuity of the service, equal treatment of the users and quality of the proposal. However, freedom of negotiation did not mean arbitrary choice and the laws of those countries provided procedures to ensure transparency and fairness in the conduct of the selection process.

⁹Ibid., para. 237 (b).

128. In addition to the special procedures used in those countries for selecting the infrastructure operator, another notable difference had to do with the method of payment of the infrastructure operator, as distinct from the payment of a supplier or a work contractor. In practically every case, the payment for the performance of a public contract in those countries was made in the form of a price paid by the governmental agency to the supplier or contractor. In the case of privately financed infrastructure projects, however, the remuneration was spread out over a number of years and usually derived from the operation of the infrastructure, generally in the form of fees charged to the user. The duration of the project was calculated in such a way as to enable the operator to recoup the investment and ensure a return in the amount freely set in the project agreement.

129. In view of those considerations, it was suggested that the chapter should elaborate further on the fact that competitive procedures typically used for the procurement of goods, construction or services were not entirely suitable for privately financed infrastructure projects. It was noted that, while the selection procedures described in the chapter differed from the procurement methods provided in the UNCITRAL Model Law on Procurement of Goods, Construction and Services, further adjustments might still be required. Particular attention should be given to the need to avoid the use of terminology that in some legal systems was normally used in connection with procurement methods for the acquisition of goods, construction and services.

130. Support was expressed for the thrust of the chapter, which offered a structured and transparent framework for the exercise of administrative discretion in the selection of the concessionaire. However, when expressing a preference for competitive selection procedures, particular care should be taken to avoid the impression that the guide excluded the use of any other procedures.

Selection procedures covered by the guide (paras. 3-5)

131. In connection with paragraph 3 (a) of the notes, it was suggested that the text should make mention of the fact that, in many countries, the sale of shares of public utility enterprises required prior legislative authorization. It was also suggested that the offering of shares on stock markets should be mentioned among the disposition methods.

General objectives of selection procedures (paras. 6-14)

132. Support was expressed for including in the chapter a discussion of the objectives of economy, efficiency, integrity and transparency. It was observed that those objectives fostered the interests not only of the host Government, but also of the parties wishing to invest in infrastructure projects in the country. An important corollary of those objectives was the availability of administrative and judicial procedures for the review of decisions made by the authorities involved in the selection procedure, and it was suggested that the chapter should, at an appropriate place, include a discussion on that subject.

133. It was observed that the main purpose of privately financed infrastructure projects was for the host Government to obtain a higher quality of public services. It was therefore suggested that paragraph 8 should give more emphasis to the potential benefits of participation by foreign companies in selection proceedings.

134. It was pointed out that transparency required not only clarity of the rules and procedures for the selection of the concessionaire, but also that decisions were not improperly made. The chapter should therefore also include a discussion on appropriate measures to fight corrupt or abusive practices in the selection process. One of the measures it might be worthwhile mentioning in the guide was the so-called "integrity agreement" ("*acuerdo de integridad*"), whereby all companies invited to participate in the selection process undertook neither to seek to influence unduly the decisions of the public officials involved in the selection process nor otherwise to distort the competition by means of collusive or other illicit practices.

135. Various comments were made to the effect that adequate provisions to protect the confidentiality of proprietary information constituted one of the essential elements for fostering the confidence of investors in the selection procedures. It was therefore suggested that the issue should be mentioned in paragraph 10 and concrete recommendations included at appropriate places in the guide for the purpose of ensuring the confidentiality of proprietary information.

136. It was suggested that the text should mention the objectives of ensuring the continuous provision of public services and the universal access to public services among the objectives that governed the award of privately financed infrastructure projects.

*Appropriate selection method
(legislative recommendations 1 and 2 and paras. 15-25)*

137. In connection with the discussion on the range of proponents to be invited, it was pointed out that the procurement guidelines of some multilateral financial institutions prohibited the use of pre-qualification proceedings for the purpose of limiting the number of bidders to a predetermined number.

138. It was suggested that paragraph 22 should mention that awarding authorities typically required that the bidders submit sufficient evidence that the technical solutions proposed had been previously tested and satisfactorily met internationally acceptable safety and other standards.

139. It was suggested that paragraph 24 should elaborate on the distinction between qualification and evaluation criteria.

140. It was suggested that paragraph 25 should caution against unrestricted negotiations between the awarding authority and the selected project consortium.

Preparations for selection proceedings (paras. 26-32)

141. It was suggested that paragraph 27 should include a reference to the role of independent advisers and the need to appoint them at the early stages of the project.

142. It was suggested that the expression “pre-feasibility studies”, rather than “feasibility studies”, should be used in the context of paragraphs 28 and 29. It was also suggested that it might be useful to refer in those paragraphs to the fact that, in some countries, it was found useful to provide for some public participation in the preliminary assessment of the environmental impact of a project and the various options available to minimize that impact. The suggestion was made that the text should reflect that an environmental impact assessment should ordinarily be carried out by the host Government as part of its feasibility studies.

143. The availability of standard documentation prepared in sufficiently precise terms was said to be an important element to facilitate the negotiations between project consortia and prospective lenders and investors. It was suggested that appropriate references to those circumstances should be included in paragraph 31.

*Pre-qualification of project consortia
(legislative recommendations 3-7 and paras. 33-46)*

144. As a general comment, it was noted that preferred selection procedures described in the chapter consisted of relatively elaborate pre-qualification and final selection phases and a relatively short phase for the final negotiation of the project agreement. In the practice of some countries, however, there was more scope for negotiating the final agreement after the project consortium had been selected, in view of the complexity and scale of infrastructure projects. In that connection, the view was expressed that the preferred selection procedures described in the chapter, which were in many aspects inspired by the procurement methods provided for in the UNCITRAL Model Law on Procurement of Goods, Construction and Services, might require further adjustments so as to address the particular needs of privately financed infrastructure projects in an adequate manner.

145. It was noted that, beginning with paragraph 34, the reader was referred, in various instances, to provisions of the Model Law. It was suggested that, for ease of reading, it might be preferable to incorporate in the text, as appropriate, the substance of the relevant provisions of the Model Law. Eliminating the cross-references between the two texts might also serve to underscore the particular nature of the selection procedure described in the chapter.

146. It was observed that the nature of the proceedings described in paragraphs 33 to 36 differed in many respects from traditional pre-qualification proceedings, as applied in connection with the procurement of goods and services. In order to avoid the connotation of automatic qualification (or disqualification) that was inherent in those traditional pre-qualification proceedings, it was suggested that it would be more appropriate to use the phrase “pre-selection proceedings” in the draft chapter.

147. It was proposed to include among the criteria mentioned in paragraph 36 additional criteria that might be particularly relevant for privately financed infrastructure projects, such as the ability to manage the financial aspects of the project and previous experience in operating public infrastructure or in providing services under regulatory oversight.

148. In connection with the last sentence of paragraph 37, the view was expressed that the requirements of a minimum percentage of equity investment might not be in line with multilateral agreements governing trade in services.

149. It was suggested that paragraphs 39 and 40 should distinguish between subsidies or incentives available under national laws to certain industries and regions and preferences given to domestic companies over foreign competitors bidding for the same project. The text should make clear that the issue of domestic preferences only arose in cases where the awarding authority invited proposals from both national and foreign companies. However, it was also suggested that paragraphs 39 and 40 should mention the fact that the use of domestic preferences was not permitted under the guidelines of some international financial institutions and might be inconsistent with international obligations entered into by many States pursuant to agreements on regional economic integration or trade facilitation.

150. Comments were made in support of the reference in paragraph 42 to the practice of some countries of authorizing the awarding authority to consider arrangements for compensating pre-qualified proponents, if the project could not proceed for reasons outside their control, or for contributing to the costs incurred by them after the pre-qualification phase.

151. The view was expressed that paragraph 45 should be redrafted so as to avoid the undesirable impression that it advocated the use of an automatic rating system that might unnecessarily limit the awarding authority’s discretion in assessing the qualifications of project consortia.

*Procedures for requesting proposals
(legislative recommendations 8-19 and paras. 47-80)*

152. The question was asked whether the two-stage procedure described in paragraphs 47 to 52 implied that, after discussions with the project consortia, the awarding authority had to issue a set of specifications that indicated the expected input. It was suggested, in that connection, that even at the final stage of the procedure the awarding authority might wish to formulate its specifications only in terms of the expected output.

153. For purposes of clarity, it was suggested that the word “negotiations” in paragraphs 51 and 52 should be replaced with the word “discussions”.

154. The proposal was made to emphasize in paragraph 60 the fact that evaluation criteria should give special importance to aspects related to the operation of the infrastructure and should not be focused on the construction phase.

155. In connection with the possibility of rejecting proposals on grounds such as the governmental policy for the sector concerned referred to in paragraph 62, it was suggested that any such grounds should be invoked only if they had been included by the awarding authority among the pre-qualification criteria.

156. It was proposed to include among the elements of the financial proposals mentioned in paragraph 67 the requirement that the project consortia submit letters of intent issued by the prospective lenders or other satisfactory evidence of their commitment to provide the financing to the project.

157. Questions were asked as to the purpose of requiring that the financial viability studies referred to in paragraph 68 (a) indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. It was suggested that, from the perspective of the host Government, the key factors in evaluating proposals should be the quality of the services and the overall viability of the financial arrangements, rather than the net profit expected by the operator.

158. It was suggested that paragraph 70 should clearly recommend the submission of tender securities by project consortia.

159. In connection with the last sentence of paragraph 72, it was observed that, while the criteria used for pre-qualifying consortia should not be weighted again at the evaluation phase, it was appropriate for the awarding authority to require, at any stage of the selection process, that the participants again demonstrate their qualifications in accordance with the same criteria used to pre-qualify them.

160. In response to a question concerning the need for providing in paragraph 75 that the proposals be opened at a time previously specified in the request for proposals, it was observed that such a requirement helped to minimize the risk that the proposals might be altered or otherwise tampered with and represented an important guarantee of the integrity of the proceedings.

161. It was suggested that, where a two-stage procedure had been used to request proposals, the awarding authority should also have the right to reject proposals that were found to deviate grossly from the first request for proposals. With regard to the assessment of the responsiveness of proposals, which was referred to in paragraph 76, it was suggested that paragraph 76 should make clear that "unresponsive" proposals were not only incomplete or partial proposals, but all proposals that deviated from the request for proposals.

162. Differing views were expressed regarding the relative importance of the proposed unit price for the expected output as an evaluation criterion. In one view, in order to foster objectiveness and transparency, the unit price should be regarded, wherever possible, as a decisive factor for choosing between equally responsive proposals. According to another view, the notion of "price" could not

have the same value for the award of privately financed infrastructure projects as it had in the procurement of goods and services. The remuneration of the concessionaire was often the combined result of charges paid by the users, ancillary revenue sources and direct subsidies or payments made by the public entity awarding the contract. Furthermore, non-price criteria, such as the quality of services, including the guarantees offered for ensuring its continuity and universality, needed to be taken fully into account. In that context, while the unit price for the expected output retained its role as an important element of comparison of proposals, it could not be regarded as the most important factor. It was felt that the guide should elaborate on those issues, as suggested in the note following paragraph 77.

163. It was suggested that the text of the legislative recommendations did not cover the entirety of the subject matter discussed in the corresponding notes. It was therefore suggested that additional recommendations should be formulated to reflect, in particular, the issues covered in paragraph 77.

164. With regard to the final negotiations referred to in paragraphs 78 and 79, the view was expressed that the legislative guide should distinguish more clearly between the negotiation of the final contract, after the project has been awarded, and the procedure to request proposals. It was suggested that the reference in paragraph 53 to the invitation of proposals with respect to the revised specifications and contractual terms might imply that the terms of the contract were open to negotiation even prior to the final award. Such a situation was considered inadvisable, since the proposals should address technical and financial aspects of the project, but not the terms of the contract. In response, it was stated that knowledge of certain contractual terms, such as the risk allocation envisaged by the awarding authority, were important in order for the participating consortia to formulate their proposals and discuss the "bankability" of the project with potential lenders. It was therefore advisable to provide the participating consortia with a draft of the contract as early as possible.

165. It was proposed to add the words "or the consumers" after the words "to the detriment of the host Government" in paragraph 78.

Direct negotiations

(legislative recommendations 20-24 and paras. 81-93)

166. Support was expressed for the inclusion, in paragraphs 81 to 84, of a discussion on possible advantages and disadvantages of direct negotiations for the award of privately financed infrastructure projects.

167. It was suggested that paragraphs 81 to 84 should elaborate on possible methods for ensuring transparency and introducing elements of competition in direct negotiations.

168. It was noted that the list of exceptional circumstances authorizing the use of direct negotiations contained

in paragraph 85 was not exhaustive and that other circumstances might exist that justified the use of direct negotiations. They included, for instance, the following: reasons of national defence; cases where there was only one source capable of providing the required service (e.g. because it involved the use of patented technology or special know-how); lack of experienced personnel or of an adequate administrative structure to conduct competitive selection procedures; or cases where a higher administrative authority of the host country had authorized such an exception for reasons of public interest. It was suggested that paragraph 85 should make clear that the list provided therein was for illustrative purposes only.

169. The question was asked as to how likely would there be an urgent need for ensuring immediate provision of the service that justified the recourse to direct negotiations rather than to competitive selection procedures. In response, it was noted that such an exceptional authorization was needed, for instance, in cases of interruption in the provision of a given service or where an incumbent concessionaire failed to provide the service at acceptable standards, when engaging in a competitive selection procedure would be impractical in view of the urgent need to ensure the continuity of the service. Questions were raised, however, as to the appropriateness of using the technique of private financing in case of urgency.

170. In response to a question concerning the reasons for limiting the application of paragraph 85 (a) to cases where the circumstances giving rise to the urgency were neither foreseeable by the awarding authority nor the result of dilatory conduct on its part, it was observed that such a limitation was intended to ensure the accountability of the awarding authority.

171. Support was also expressed for the consideration given in paragraphs 87 to 93 to the issues raised by unsolicited proposals. It was observed that unsolicited proposals had been used in a number of countries and that it was desirable to formulate concrete recommendations as to how to deal with such proposals. In that connection, it was suggested that the entity submitting an unsolicited proposal should generally be required to meet essentially the same qualification criteria as would be required of the proponents participating in the competitive selection procedure described in the chapter. It was also suggested that unsolicited proposals should meet acceptable technical and quality standards in order to be considered by the awarding authority.

172. It was suggested that the word "Government" in paragraph 88 might be interpreted in a narrow meaning and exclude local or municipal authorities. It was proposed to replace it with words such as "public entities" or "public enterprises" so as to take into account that other entities of the host country might have the power to negotiate unsolicited proposals.

173. The view was expressed that the legislative recommendations concerning unsolicited proposals were in fact not of a legislative nature and should therefore be kept only in the notes.

Review procedures (para. 94)

174. It was noted that the availability of administrative or judicial remedies was an essential element in ensuring the transparency and fairness of a selection procedure. It was therefore suggested that the guide should elaborate on the issue of review procedures, mentioning procedures and remedies typically available under national laws, and that it might be useful to formulate appropriate legislative recommendations.

Record of selection proceedings (legislative recommendation 25 and paras. 95-99)

175. The need to protect the confidentiality of privileged and proprietary information, as referred to in paragraphs 95 and 96, was noted. It was suggested that a discussion should be included of what kind of information should be available to the public and what information should be reserved for the host Government and the proponents.

Chapter IV. Conclusion and general terms of the project agreement (A/CN.9/444/Add.5)

176. The Commission noted that the opening section of draft chapter IV (previously chapter VI) dealt with general considerations concerning the project agreement, discussing, in particular, the different approaches taken by national legislations to the project agreement (from those which scarcely referred to the project agreement to those which contained extensive mandatory provisions concerning clauses to be included in the agreement). The remaining sections dealt with rights and obligations of the project company that, in addition to being dealt with in the project agreement, might be usefully addressed in the legislation, as they might affect the interests of third parties.

Section A. General considerations (legislative recommendations 1 and 2 and paras. 1-6)

177. The suggestion was made to indicate in paragraph 2 advantages and disadvantages of the legislative approaches discussed.

178. It was considered that the guide should stress the need for clarity as to the persons or governmental agencies that had the authority to enter into commitments on behalf of the Government at different stages of negotiation and to sign the project agreement. In that discussion, due regard should be given to the fact that different levels of government (e.g. federal, provincial or municipal) might be involved in a given privately financed infrastructure project.

179. The view was expressed that the guide should point out the disadvantages of subjecting the entry into force of the project agreement to prior approval through an ad hoc act of parliament. It was noted in reply that, in some cases or in some States, good reasons existed for providing for legislative approval of individual privately financed infra-

structure projects. There was general agreement that legislative approval did not mean that parliament would be called upon to modify individual provisions in the project agreement.

180. It was observed that what the guide defined as the “project agreement” in practice often consisted of more than one separate agreement between the host Government and the project company.

Section B. General terms of the project agreement

1. The project site

(legislative recommendation 3 and paras. 8-12)

181. It was suggested that the second sentence of paragraph 10, which appeared to discourage the Government unduly from providing the project company with the land needed for privately financed infrastructure projects, should be reviewed.

182. It was proposed to replace the reference in paragraph 11 to “the more expeditious” expropriation procedure by “the more efficient” procedure in order to avoid creating an unintended impression that the protection of interests of the affected owners could be overridden by the desirability of rapid expropriation proceedings.

183. The view was expressed that the term “expropriation” in the English version should be replaced, because in some legal systems it carried a negative connotation and might suggest confiscation without prompt and adequate compensation. Alternative expressions suggested included “eminent domain”, “compulsory acquisition” and “expropriation against just compensation”. It was agreed that the language to be used should avoid the negative connotation referred to and that it should be readily understood in different legal systems.

2. Easements

(legislative recommendation 4 and paras. 13-16)

184. It was suggested that paragraph 14 should refer to the public interest and other conditions for obtaining an easement through expropriation.

3. Exclusivity

(legislative recommendation 5 and paras. 17-21)

185. As regards the second sentence of paragraph 21, the view was expressed that the advice therein might be understood as suggesting that the parties should leave the question of subsequent changes in the host Government’s policies to general clauses in the project agreement dealing with changes of circumstance. It was suggested that such an understanding should be avoided and that the guide should instead promote certainty and predictability with respect to the consequences of changes in the host Government’s policies.

186. It was suggested that the question of exclusivity dealt with in recommendation 5 gave rise to important

policy issues and involved interests of consumers and other public interests and that, therefore, the question should not be left entirely to the negotiation between the parties in the context of a given project. Legislation on the question of exclusivity might, for example, deal with the length of periods for which the host Government might commit itself to respecting the project company’s exclusive rights in providing the public service.

187. The suggestion was made that the discussion relating to exclusivity (e.g. para. 17, first sentence, and para. 19, first sentence) should be reviewed to make it explicit who was the beneficiary of exclusivity and who might be the potential competitors.

188. It was proposed that paragraph 18 should not use the phrase “general enabling legislation”, since many States did not have legislation that could be categorized as general enabling legislation.

4. Legal status of the concessionaire

(legislative recommendations 6-8 and paras. 22-34)

189. With respect to the first sentence of paragraph 22, it was considered necessary to clarify the phrase “legal status” of the concessionaire so as to coordinate the treatment of that matter with paragraphs 20 and 21 of draft chapter I, “General legislative considerations” (A/CN.9/444/Add.2), and to make clear to what extent the project agreement might deal with the question of whether the concessionaire was to be established as an independent entity. It was noted that, in practice, project companies were typically incorporated as legal entities separate from the project sponsors, but that, from the viewpoint of legislation, that did not always need to be the case.

190. In connection with the last sentence of paragraph 32, the suggestion was made that some co-owners of the project company might be concerned about the risks arising from the involvement of the company in other projects awarded to it in a separate selection process.

191. As regards the third sentence of paragraph 33, the question was raised whether the legislative guide should endorse the requirement of a positive vote by the host Government and whether some of the objectives underlying the requirement could be achieved by less intrusive means.

192. It was suggested that some original members of the project consortium and shareholders in the project company might have a legitimate interest in being replaced by other entities as shareholders and that there was no need to give the host Government an unqualified prerogative to approve such replacements.

5. Assignment of the concession

(legislative recommendations 9 and 10 and paras. 35-38)

193. It was considered desirable for legislation to allow the parties to agree on “step-in” rights, that is, the right to have the concession transferred to the lenders or to another entity appointed by them if the project company is in de-

fault of its obligations. In that context, it was stated that, where the Government was to be given the right to withhold approval of the assignment of a concession, that right should be subject to the reservation that consent must not be unreasonably withheld. A similar restriction should exist as regards the right of the host Government to approve the granting of a subconcession by the concessionaire (para. 37).

194. It was pointed out, however, that the requirement of prior governmental approval for the assignment of the concession existed in many legal systems and was found to be justified by reasons of public interest. The public entities concerned had a legitimate interest in preventing the transfer of the responsibility to provide public services to entities that had not been selected by them.

195. The suggestion was made that the words "Except for assignment as security to lenders," should be inserted at the beginning of recommendation 9.

6. Security interests

(legislative recommendations 11-13 and paras. 39-45)

196. Statements were made to the effect that, in practice, lenders expected to obtain the widest possible security over the assets of the project company, including the intangible assets. The availability of such security was considered crucial for the availability of financing for privately financed infrastructure projects. In view of that, the legislative guide should advise that legal obstacles to giving such security should be eliminated from legislation.

197. It was observed, however, that in many instances the assets managed by the project company remained in the ownership of the State, that such ownership was inalienable and that it was therefore not possible to use those assets as security.

198. As to the possibility of establishing security interests in the ownership shares of the project company, it was noted that in some legal systems the pledge of shares was either prohibited or restricted; moreover, it was likely that the circumstances under which the creditors would be prompted to invoke the security interest in the shares would also cause the value of the shares to drop sharply, which made that type of security uncertain and potentially illusory. It was observed, however, that the creditors' objective in obtaining shares as security was not to sell them in case of the project company's default, but to take over the control of the project company. The possibility of using shares in the project company as security was crucial for the "bankability" of privately financed infrastructure projects and States would be well advised to adopt special legislation on the matter in order to facilitate such projects. It was noted, however, that the pledge of shares of the project company raised essentially the same concerns as arose where the project company itself or the concession was assigned to another entity or consortium.

199. To the extent it was possible to create a security interest in the shares of the project company and for the creditors to take over the project company in case of default, it was noted that it was desirable to clarify whether,

in the case of a "step-in" by creditors, the obligations of the host Government and of the previous project sponsors were in any way affected.

7. Duration

(legislative recommendation 14 and paras. 46 and 47)

200. It was considered that legislation should not establish a maximum number of years for which concessions might be granted. Such mandatory provisions were in practice found to be an obstacle to agreeing to commercially reasonable solutions. Such maximum limits also could not take into account the possibility of changed circumstances that would require an extension of the concession. It was observed that the right of the host Government to purchase the concession from the concessionaire presented another possibility for dealing in a flexible manner with the duration of the concession.

Section C. Specific terms (para. 48)

201. With respect to paragraph 48, which indicated issues to be dealt with in the latter chapters of the guide, general suggestions were made to the effect that the anticipated chapters might be usefully combined and that care should be taken to distinguish clearly between the issues that were to be dealt with by legislation and those which were to be negotiated by the parties.

E. Considerations on the finalization of the draft chapters

202. It was suggested that the legislative recommendations to be included in the various chapters of the legislative guide should be supplemented, where appropriate, with sample model legislative provisions, possibly with alternative solutions. It was considered that such model provisions would make the legislative guide more practical and more readily usable. The suggestion, it was explained, was not to prepare a model law, but to facilitate as much as possible the task of legislators in countries wishing to set up a favourable legal framework for privately financed infrastructure projects.

203. The countervailing view was that the subject matter dealt with in the guide touched upon a number of public law and policy issues and that it would therefore be difficult to attempt to formulate model provisions that adequately took into account the differences between legal systems and the variety of policy options. The importance of affording sufficient flexibility to legislators in countries wishing to promote private investment in infrastructure was stressed. For that purpose, a clear set of legislative recommendations followed by an explanatory discussion of the pertinent issues and the possible options available might be a more useful tool than a set of model provisions that certain legislators might regard as being difficult to adjust to domestic conditions.

204. After considering the different views expressed, the Commission requested the Secretariat to draft the legis-

lative recommendations in the form of concise legislative principles, thereby reducing the number of recommendations, and, where deemed feasible and appropriate, to formulate sample provisions for illustrative purposes for consideration by the Commission.

205. It was also suggested that the guide should not stray from legislative advice on privately financed infrastructure projects and that it should not attempt to give negotiating and contractual advice. The discussion on negotiating and contractual issues should be presented only to the extent necessary to explain the need for a particular legislative solution. It was suggested that the guide should, where appropriate, refer to other publications containing contractual advice, such as the United Nations Industrial Development Organization Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects and publications of the World Bank.

206. The Commission considered the method that should be followed in the finalization of the legislative guide, including the question whether the preparation of future chapters should be entrusted to a working group. After deliberation, it was agreed that the possible need for a working group should be considered at the thirty-second session of the Commission. It was also agreed that, at the present stage, it was desirable to allow the Secretariat to proceed in the preparation of future chapters for submission to the next session of the Commission. Such preparation, as well as the revision of existing drafts, should be carried out with the assistance of outside experts, as had been done thus far. The Secretariat was requested to make all reasonable efforts to obtain the advice of experts from both the public and the private sectors and to consult with experts from developing and developed countries as well as from countries with economies in transition.

IV. ELECTRONIC COMMERCE

A. Draft uniform rules on electronic signatures

207. It was recalled that the Commission, at its thirtieth session, in May 1997, had entrusted the Working Group on Electronic Commerce with the preparation of uniform rules on the legal issues of digital signatures and certification authorities. With respect to the exact scope and form of such uniform rules, it was generally agreed at that session that no decision could be made at such an early stage of the process. In addition, it was felt that, while the Working Group might appropriately focus its attention on issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the uniform rules to be prepared should be consistent with the media-neutral approach taken in the UNCITRAL Model Law on Electronic Commerce. Thus, the uniform rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, those uniform rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures.

With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, in particular where cross-border certification was sought.¹⁰

208. At the current session, the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). The Commission expressed its appreciation of the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. It was noted that the Working Group, throughout its thirty-first and thirty-second sessions, had experienced manifest difficulties in reaching a common understanding of the new legal issues arising from the increased use of digital and other electronic signatures. It was also noted that a consensus was still to be found as to how those issues might be addressed in an internationally acceptable legal framework. However, it was generally felt by the Commission that the progress achieved so far indicated that the draft uniform rules on electronic signatures were progressively being shaped into a workable structure. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such uniform rules¹¹ and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session (New York, 29 June-10 July 1998) on the basis of the revised draft prepared by the Secretariat (A/CN.9/WG.IV/WP.76). In the context of that discussion, the Commission noted with satisfaction that the Working Group had become generally recognized as a particularly important international forum for the exchange of views regarding the legal issues of electronic commerce and for the preparation of solutions to those issues.

209. The Commission noted that, at the close of the thirty-second session of the Working Group, a proposal had been made that the Working Group might wish to give preliminary consideration to undertaking the preparation of an international convention based on provisions of the Model Law on Electronic Commerce and of the draft uniform rules. The Working Group had agreed that the topic might need to be taken up as an item on the agenda of its thirty-third session on the basis of more detailed proposals possibly to be made by interested delegations. However, the preliminary conclusion of the Working Group had been that the preparation of a convention should in any event be regarded as a project separate from both the preparation of the uniform rules and any other possible addition to the Model Law. Pending a final decision as to the form of the uniform rules, the suggestion to prepare a convention at a later stage should not distract the Working Group from its current task, which was to focus on the preparation of draft uniform rules on digital and other electronic signatures, and from its current working assumption that the uniform rules would be in the form of draft legislative provisions. It had been generally understood in the Working Group that the possible preparation of a draft convention should not be used as a means of

¹⁰Ibid., para. 250.

¹¹Ibid., paras. 249 and 250.

reopening the issues settled in the Model Law, which might have a negative effect on the increased use of that already successful instrument (A/CN.9/446, para. 212).

210. The Commission noted that a specific and detailed proposal for the preparation of a convention had been submitted by a delegation to the Working Group for consideration at a future session (A/CN.9/WG.IV/WP.77). Diverging views were expressed in that connection. One view held that a convention based on the provisions of the Model Law was necessary, since the latter might not suffice to establish a universal legal framework for electronic commerce. Owing to the nature of the instrument, the provisions of the Model Law were subject to variation by any national legislation that enacted them, thus detracting from the desired harmonization of the legal rules applicable to electronic commerce. The opposite view was that, owing to the rapidly changing technical background of electronic commerce, the matter did not easily lend itself to the rigid approach suggested by an international convention. It was pointed out that the Model Law was of particular value as a collection of principles, which could be enacted in domestic legislation through various formulations to accommodate the increased use of electronic commerce.

211. The prevailing view was that it would be premature to undertake the preparation of the suggested convention. Delegations of various countries indicated that law reform projects based on the provisions of the Model Law were currently under way in their countries. Concern was expressed that the preparation of an international convention based on the Model Law might adversely affect the widespread enactment of the Model Law itself, which, only two years after its adoption by the Commission, was already being implemented in a significant number of countries. Moreover, it was generally felt that the Working Group should not be distracted from its current task, namely, the preparation of draft uniform rules on electronic signatures, as agreed by the Commission. Upon concluding that task, the Working Group would be welcome, in the context of its general advisory function with respect to the issues of electronic commerce, to make proposals to the Commission for future work in that area. It was suggested by the proponents of a convention that the matter might need to be further discussed at a future session of the Commission and in the context of the Working Group, possibly through informal consultations. It was recalled that, while possible future work might include the preparation of a convention, other topics had also been proposed, such as the issues of jurisdiction, applicable law and dispute settlement on the Internet.¹²

B. Incorporation by reference

212. At various stages in the preparation of the Model Law, it had been suggested that the text should contain a provision aimed at ensuring that certain terms and conditions that might be incorporated in a data message by means of a mere reference would be recognized as having

the same degree of legal effectiveness as if they had been fully stated in the text of the data message. That effect was generally referred to as “incorporation by reference”.¹³

213. At its thirtieth session, in May 1997, the Commission endorsed the conclusion reached by the Working Group at its thirty-first session that many aspects of battle-of-forms and adhesion contracts would need to be left to applicable national laws for reasons involving, for example, consumer protection and other public policy considerations (see A/CN.9/437, para. 155).¹⁴

214. At its thirty-second session, the Working Group discussed the issue of incorporation by reference on the basis of various texts that were proposed as possible additions to the Model Law. That discussion was recorded in the report of the Working Group on the work of its thirty-second session (A/CN.9/446, paras. 14-23), together with the text of the various proposals that were considered by the Working Group. At the close of that discussion, the Working Group adopted the text of the following draft provision:

“Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is incorporated by reference in a data message.”

The Working Group decided that it should be presented to the Commission for review and possible insertion as a new article 5 *bis* of the Model Law, and requested the Secretariat to prepare an explanatory note to be added to the guide to enactment of the Model Law (A/CN.9/446, para. 24). A draft text prepared pursuant to that decision for possible insertion in the guide to enactment of the Model Law is set forth in annex II to the note prepared by the Secretariat (A/CN.9/450).

215. At the current session, the Commission noted that the text adopted by the Working Group embodied a minimalist approach to the issue of incorporation by reference. Consistent with the earlier deliberations of the Working Group (A/CN.9/437, para. 155, and A/CN.9/446, paras. 14-23), it did not attempt to achieve any substantial unification of the existing rules of domestic law regarding that issue. Instead, it restated in the context of incorporation by reference the general principle of non-discrimination embodied in article 5 of the Model Law. The text adopted by the Working Group was aimed at facilitating incorporation by reference in electronic commerce by removing the uncertainty that might prevail in certain jurisdictions as to whether the rules applicable to traditional

¹³For earlier discussion of the issue of incorporation by reference by the Commission, by the Working Group on Electronic Commerce, and in notes prepared by the Secretariat, see *ibid.*, paras. 248-250; *ibid.*, *Fifty-first Session, Supplement No. 17* (A/51/17), paras. 222 and 223; A/CN.9/450; A/CN.9/446, paras. 14-24; A/CN.9/437, paras. 151-155; A/CN.9/421, paras. 109 and 114; A/CN.9/407, paras. 100-105 and 117; A/CN.9/406, paras. 90, 178 and 179; A/CN.9/360, paras. 90-95; A/CN.9/350, paras. 95 and 96; A/CN.9/333, paras. 66-68; A/CN.9/WG.IV/WP.74; A/CN.9/WG.IV/WP.71, paras. 77-93; A/CN.9/WG.IV/WP.69, paras. 30, 53, 59, 60 and 91; A/CN.9/WG.IV/WP.66; A/CN.9/WG.IV/WP.65; A/CN.9/WG.IV/WP.55, paras. 109-113; and A/CN.9/WG.IV/WP.53, paras. 77 and 78).

¹⁴*Official Records of the General Assembly, Fifty-second Session, Supplement No. 17* and corrigendum (A/52/17 and Corr.1), paras. 249-251.

¹²*Ibid.*, para. 251.

paper-based incorporation by reference also applied in an electronic environment. Another aim of the provision was to make it clear that consumer-protection or other national or international law of a mandatory nature (e.g. rules protecting weaker parties in the context of contracts of adhesion) should not be interfered with.

216. It was widely felt in the Commission that, as currently drafted, the text presupposed a certain degree of familiarity of enacting States with the concept of incorporation by reference. However, although the expression "incorporation by reference" had been used consistently by the Working Group as a concise way of referring to a complex range of legal and factual situations, it might not convey the same meaning in all enacting States. With a view to reducing the difficulties that might arise in the interpretation of the text, it was suggested that a more descriptive language might be used along the following lines, consistent with the formulation adopted by the Working Group:

"Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is not contained in the data message purported to give rise to such legal effect, but is merely referred to in that data message."

217. Various alternative texts were proposed, based on a more positive formulation of effects to be given to incorporation by reference. However, it was generally felt that any attempt to establish a positive rule on issues of incorporation by reference might result in interfering with existing rules by which domestic legislation dealt with the issue of incorporation by reference. The Commission generally agreed that such interference should be avoided and that the minimalist approach adopted by the Working Group should be maintained. In the context of that discussion, the view was expressed, however, that a provision dealing with incorporation by reference based on such an approach was unnecessary altogether.

218. After discussion, the Commission found the substance of the proposed text (see above, para. 216) to be generally acceptable. As a matter of drafting, it was suggested that the provision might need to indicate more clearly that incorporation by reference should be distinguished from a mere reference. The following text was proposed:

"Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is not contained in the data message purporting to give rise to such legal effect, but is referred to within that data message as forming part of that message."

219. After discussion, the Commission decided to retain the original proposal (see above, para. 216), subject to the substitution of the word "purporting" for the word "purported".

220. As to the placement of the additional provision, while it was suggested that the text should be added as a new part III of the Model Law, it was generally agreed that the insertion of the text as a new article 5 *bis*, as suggested by the Working Group, was more appropriate.

221. With respect to the draft additional section prepared by the Secretariat for insertion in the guide to enactment of the Model Law (see A/CN.9/450, annex II), the Secretariat was requested to ensure that the text indicated clearly that the newly adopted article 5 *bis* was not to be interpreted as creating a specific legal regime for incorporation by reference in an electronic environment. Rather, by establishing a principle of non-discrimination, it was to be construed as making the domestic rules applicable to incorporation by reference in a paper-based environment equally applicable to incorporation by reference for the purposes of electronic commerce.

V. ASSIGNMENT IN RECEIVABLES FINANCING

222. It was recalled that the Commission had considered legal problems in the area of assignment at its twenty-sixth to twenty-eighth sessions (1993-1995)¹⁵ and had entrusted, at its twenty-eighth session, in 1995, the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing.¹⁶

223. The Working Group commenced its work at its twenty-fourth session (Vienna, 13-24 November 1995) and continued it at its twenty-fifth and twenty-sixth sessions (New York, 8-19 July, and Vienna, 11-22 November 1996, respectively). It was noted that, at its twenty-fourth session, the Working Group had been urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16). In addition, it was noted that, at its twenty-fifth and twenty-sixth sessions, the Working Group had decided to proceed with its work on the assumption that the text being prepared would take the form of a convention (A/CN.9/432, para. 28) and would include private international law provisions (A/CN.9/434, para. 262).

224. At its thirty-first session, the Commission had before it the reports of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CN.9/445 and A/CN.9/447). At the outset, the Commission noted that its work on receivables financing had attracted the interest of the international trade and finance community, since it had the potential of increasing access to lower-cost credit. In addition, the Commission noted that the Working Group had made substantial progress on a number of other matters, including the validity of assignments of future receivables and of receivables not identified individually (i.e. bulk assignments), as well as of assignments concluded despite an anti-assignment clause contained in the contract under which the assigned receivables arose, and the debtor-protection issues. In particular, the Commission noted that, at its twenty-eighth session, the Working Group had adopted the substance of the provisions dealing with the relationship between the assignor and the assignee, as well as the provisions dealing with the debtor's protection (draft articles 14-16 and 18-22,

¹⁵Ibid., *Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-301; *ibid.*, *Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), paras. 208-214; and *ibid.*, *Fiftieth Session, Supplement No. 17* (A/50/17), paras. 374-381.

¹⁶Ibid., *Fiftieth Session, Supplement No. 17* (A/50/17), paras. 374-381.

respectively) and requested the Secretariat to revise the provision dealing with the right of the assignee to payment and with proceeds-related issues (draft article 17; see A/CN.9/447, paras. 161-164 and 68, respectively).

225. At the same time, it was noted that a number of issues remained to be resolved, including those relating to the scope of the draft convention, public policy issues arising in the context of the protection of the debtor, conflicts of priority among several claimants and private international law issues.

226. As to the scope of application, the view was widely shared that it was too wide and that it should be limited to contractual receivables assigned for the purpose of obtaining financing. It was observed that such an approach would be in line with the overall purpose of the project to facilitate receivables financing and thus to increase the availability of lower-cost credit. In addition, it was stated that, under such an approach, the draft convention would be more acceptable to a number of States, which were prepared to introduce specific legislation to address the needs of modern financing transactions but not to make a general overhaul of their assignment law. Moreover, under such an approach, practices that were already functioning well on the basis of well-established rules would not be interfered with. With respect to the territorial scope of application of the draft convention, it was observed that a solution based on a choice-of-law approach similar to that followed in the United Nations Convention on Contracts for the International Sale of Goods would not be appropriate.

227. With regard to public policy concerns, it was observed that it would be preferable for the draft convention to introduce such a high threshold for the protection of the debtor that it would meet the concerns of all States and would make it unnecessary for them to have to fall back on a general public policy reservation, which could jeopardize the certainty achieved by the convention and thus have an adverse impact on the cost and the availability of credit.

228. As to prior conflicts, wide support was expressed for the approach taken in the draft convention combining substantive and private international law priority rules. It was stated that allowing States to choose, by way of a declaration, between a priority rule based on the time of assignment and a rule based on the time of registration, which would take effect only upon establishment of a suitable registration system, would increase the acceptability of the draft convention.

229. With regard to the private international law provisions contained in the draft convention, the Commission welcomed the holding of a meeting of experts by the Hague Conference on Private International Law in cooperation with the Secretariat of the Commission. The Commission noted that, at that meeting, it had been confirmed that the private international law priority provisions contained in the draft convention would be appropriate, provided that their application was limited to the transactions falling under the scope of the draft convention. In addition, it was noted that the Permanent Bureau of the Conference would prepare and submit to the Working Group a report of that meeting (see also below, paras. 269 and 270).

230. In the discussion, broad support was expressed in favour of the working assumption of the Working Group that the text being prepared should take the form of a convention. It was noted that, in view of the differences existing in the various legal systems in the field of assignment, a convention would provide the appropriate degree of unification, introducing the certainty and predictability needed for credit to be made available on the basis of receivables.

231. The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete it in 1999 and to submit the draft convention for adoption by the Commission at its thirty-third session (2000).

VI. MONITORING THE IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION

232. It was recalled that the Commission, at its twenty-eighth session in 1995, had approved the project, undertaken jointly with Committee D of the International Bar Association, aimed at monitoring the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).¹⁷ It was stressed that the purpose of the project, as approved by the Commission, was limited to that aim and, in particular, its purpose was not to monitor individual court decisions applying the Convention. In order to be able to prepare a report on the subject, the Secretariat had sent to the States parties to the Convention a questionnaire relating to the legal regime in those States governing the recognition and enforcement of foreign awards.

233. Up until the current session of the Commission, the Secretariat had received 54 replies to the questionnaire. The Commission called upon the States parties to the Convention that had not yet replied to the questionnaire to do so 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 requested to prepare, for a future session of the Commission, a note presenting the findings based on the analysis of the information gathered.

234. In connection with that discussion, it was observed that the Convention had become an essential factor in the facilitation of international trade and that, besides the legislative enactment of the Convention, it would be useful for the Commission also to consider its interpretation. Such consideration, together with information to be prepared by the Secretariat for that purpose, would serve to promote the Convention and facilitate its use by practitioners. It was stressed that information on the interpretation of the Convention was not available in all the official languages of the United Nations and that, therefore, the Commission was the appropriate body to prepare it. The Commission did not take any decision regarding that suggestion.

¹⁷Ibid., paras. 401-404, and *ibid.*, *Fifty-first Session, Supplement No. 17 (A/51/17)*, paras. 238-243.

235. It was noted that, later during the session, on 10 June 1998, the Commission would hold a special commemorative New York Convention Day in order to celebrate the fortieth anniversary of the Convention (see below, para. 257); on that occasion, attention would also be paid to legal issues that were not covered by the Convention and with respect to which the Commission might wish to consider whether any work by it would be desirable and feasible and, if so, what form it should take. The Commission considered that it would be useful to engage in such a consideration of possible future work in the area of arbitration at its thirty-second session, in 1999, and requested the Secretariat to prepare, for that session, a note that would serve as a basis for the considerations of the Commission. Considerations at the New York Convention Day and at the Congress of the International Council for Commercial Arbitration (Paris, 3-6 May 1998) might be taken into account in the preparation of the note.

VII. CASE LAW ON UNCITRAL TEXTS

236. The Commission noted with appreciation that, since its thirtieth session in 1997, five additional sets of abstracts with court decisions and arbitral awards relating to the United Nations Convention on Contracts for the International Sale of Goods and to the UNCITRAL Model Law on International Commercial Arbitration had been published (A/CN.9/SER.C/ABSTRACTS/13-17). The Commission also noted with appreciation that a search engine had been placed on the Web site of the UNCITRAL secretariat on the Internet (<http://www.un.or.at/uncitral>) to enable users of case law on UNCITRAL texts (CLOUT) to carry out searches into CLOUT cases and other documents. The Secretariat was encouraged to continue its efforts to increase the availability of UNCITRAL documents through the Internet in all six official United Nations languages.

237. The Commission also noted that the work of the Secretariat in editing abstracts, storing decisions and awards in their original form, translating abstracts into the other five United Nations languages, publishing them in all six United Nations languages, forwarding abstracts and full texts of decisions and awards to interested parties upon request and establishing and operating the CLOUT search engine had substantially increased in tandem with the number of decisions and awards covered by CLOUT. The Commission therefore requested that adequate resources be made available to the Secretariat for the effective operation of CLOUT.

238. The Commission expressed its appreciation to the national correspondents and to the Secretariat for their work and urged States to cooperate with the Secretariat in the operation of CLOUT and to facilitate the carrying out of the tasks of the national correspondents. The Commission emphasized the importance of CLOUT for the purpose of promoting the uniform application of the legal texts that resulted from its work. It was generally agreed that, by being issued in all six United Nations languages, CLOUT constituted an invaluable tool for practitioners, academics and government officials. In order to ensure that CLOUT became a system covering in a comprehensive

way all case law available on UNCITRAL texts, the Commission urged the States that had not yet appointed a national correspondent to do so. In addition, the Commission urged States to ensure that CLOUT information was made available to national judges, arbitrators, practitioners and academics.

VIII. TRAINING AND TECHNICAL ASSISTANCE

239. The Commission had before it a note by the Secretariat (A/CN.9/448) outlining the activities undertaken since the previous session and indicating the direction of future activities being planned. It was noted that UNCITRAL seminars and briefing missions for government officials were designed to explain the salient features and utility of international trade law instruments of UNCITRAL.

240. It was reported that since the previous session the following seminars and briefing missions had been held: Stellenbosch, South Africa (11 March 1997); Cartagena and Bogotá (14 and 15 and 17 and 18 April 1997, respectively); Quito (21 and 22 April 1997); Lima (24-26 April 1997); Thessaloniki, Greece (12 and 13 September 1997); Nicosia (9 and 10 October 1997); Dubai (10 December 1997); and Valletta (24 and 25 February 1998). The Secretariat reported that for the remainder of 1998 and up to the next session of the Commission, in May 1999, seminars and briefing missions were being planned in Africa, Asia, Latin America and eastern Europe.

241. The Commission expressed its appreciation to the Secretariat for the activities undertaken since its past session and emphasized the importance of the training and technical assistance programme for promoting awareness of its work and disseminating information on the legal texts it had produced. It was pointed out that seminars and briefing missions were particularly useful for developing countries lacking expertise in the areas of trade and commercial law covered by the work of UNCITRAL. The Commission noted the relevance of uniform commercial law, in particular legal texts prepared by UNCITRAL, in the economic integration efforts being undertaken by many countries and emphasized the important role that the training and technical assistance activities of the Secretariat might play in that context.

242. The Commission noted the various forms of technical assistance that might be provided by the Secretariat, such as review of preparatory drafts of legislation, assistance in the preparation of drafts, comments on reports of law reform commissions and briefings for legislators, judges, arbitrators and other end-users of UNCITRAL legal texts embodied in national legislation. The Commission encouraged the Secretariat to devise ways to address the continuing and significant increase in the importance being attributed by Governments, by domestic and international business communities and by multilateral and bilateral aid agencies to improving the legal framework for international trade and investment.

243. The Commission emphasized the importance of cooperation and coordination between development assis-

tance agencies providing or financing legal technical assistance with the Secretariat, with a view to avoiding situations in which international assistance might lead to the adoption of national laws that would not represent internationally agreed standards, including UNCITRAL conventions and model laws.

244. The Commission took note with appreciation of the contributions made by Greece and Switzerland towards the seminar programme. The Commission also expressed its appreciation to those other States and organizations which had contributed to the Commission's programme of training and assistance by hosting seminars. Stressing the importance of extrabudgetary funding for carrying out training and technical assistance activities, the Commission appealed once more to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL Trust Fund for Symposia so as to facilitate planning and to enable the Secretariat to meet the increasing demands in developing countries and newly independent States for training and assistance.

245. Concern was expressed that the majority of the participants in the internship programme of the Secretariat were nationals of developed countries. An appeal was made to all States to consider supporting programmes that sponsored the participation of nationals of developing countries in the internship programme.

IX. STATUS AND PROMOTION OF UNCITRAL TEXTS

246. The Commission, on the basis of a note by the Secretariat (A/CN.9/449), 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 actions of States after 30 May 1997 (date of the conclusion of the thirtieth 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*. New action by the Republic of Moldova; number of States parties: 17;

(b) *[Unamended] Convention on the Limitation Period in the International Sale of Goods (New York, 1974)*. New action by the Republic of Moldova; number of States parties: 23;

(c) *United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules)*; number of States parties: 25;

(d) *United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)*. New actions by Croatia, Greece, Latvia and Mongolia; number of States parties: 52;

(e) *United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988)*. The Convention has two States parties. It requires eight more adherences for entry into force;

(f) *United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (Vienna, 1991)*. The Convention has one State party. It requires four more adherences for entry into force;

(g) *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995)*. The Convention has two States parties. It requires three more adherences for entry into force;

(h) *UNCITRAL Model Law on International Commercial Arbitration, 1985*. New jurisdictions that have enacted legislation based on the Model Law: Germany, Iran (Islamic Republic of), Lithuania and Oman;

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

(j) *UNCITRAL Model Law on Procurement of Goods, Construction and Services, 1994*. New jurisdictions that have enacted legislation based on the Model Law: Kyrgyzstan and Slovakia;

(k) *UNCITRAL Model Law on Electronic Commerce, 1996*;

(l) *UNCITRAL Model Law on Cross-Border Insolvency, 1997*;

(m) *Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)*. New actions by Armenia, El Salvador, Lebanon, Nepal and Paraguay; number of States parties: 117.

247. Appreciation was expressed for those 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 thereof. Such information would be useful to other States in their consideration of similar legislative actions. The UNCITRAL Model Law on Cross-Border Insolvency and the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit were mentioned as examples of texts with respect to which such information was particularly desirable.

248. 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.

249. It was noted that, despite the universal relevance and usefulness of those texts, a great number of States had not yet enacted any of them. In view of the broad support for the legislative texts emanating from the work of the Commission among practitioners and academics in countries with different legal, social and economic systems, the pace of adoption of those texts was slower than it needed to be. An appeal was directed to the representatives and observers participating in the meetings of the Commission and its working groups to contribute, to the extent they in their discretion deemed appropriate, to facilitating consideration by legislative organs in their countries of texts of the Commission.

X. GENERAL ASSEMBLY RESOLUTIONS ON THE WORK OF THE COMMISSION

250. The Commission took note with appreciation of General Assembly resolution 52/158 of 15 December 1997, in which the Assembly expressed its appreciation to the Commission for completing and adopting the Model Law on Cross-Border Insolvency. In paragraph 3 of the resolution, the Assembly recommended that all States review their legislation on cross-border aspects of insolvency to determine whether the legislation met the requirements of a modern and efficient insolvency system and, in that review, give favourable consideration to the Model Law, bearing in mind the need for an internationally harmonized legislation governing instances of cross-border insolvency.

251. In addition, the Commission took note with appreciation of General Assembly resolution 52/157, also of 15 December 1997, on the report of the Commission on the work of its thirtieth session, held in 1997. In particular, it was noted that, in paragraph 6, the Assembly reaffirmed 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 that field, and, in that connection, called upon all bodies of the United Nations system and invited other international organizations to bear in mind the mandate of the Commission and the need to avoid duplication of effort and to promote efficiency, consistency and coherence in the unification and harmonization of international trade law, and recommended that the Commission, through its secretariat, continue to maintain close cooperation with the other international organs and organizations, including regional organizations, active in the field of international trade law.

252. The Commission also noted with appreciation the decision of the General Assembly, in paragraph 7 of resolution 52/157, to reaffirm 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, and that, in paragraph 8, the Assembly expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide such training and assistance.

253. The Commission also noted with appreciation the appeal by the General Assembly, in paragraph 8 (b) of resolution 52/157, to Governments, the relevant United Nations organs, organizations, institutions and individuals to make voluntary contributions to the UNCITRAL Trust Fund for Symposia and, where appropriate, to the financing of special projects. Furthermore, it was noted that the Assembly appealed, in paragraph 9 of the resolution, to the United Nations Development Programme and other bodies responsible for development assistance, such as the World Bank 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.

254. It was also appreciated that the Assembly appealed, in paragraph 10 of resolution 52/157, 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. (That trust fund had been established pursuant to General Assembly resolution 48/32 of 9 December 1993.) The Commission noted with appreciation the decision of the Assembly, in paragraph 11, to continue, in the competent Main Committee during the fifty-second session of the Assembly, its consideration of granting travel assistance to the least developed countries that were members of the Commission, at their request and in consultation with the Secretary-General.

255. The Commission welcomed the request by the General Assembly, in paragraph 12 of the resolution, to the Secretary-General to ensure the effective implementation of the programme of the Commission. The Commission, in particular, hoped that the Secretariat would be allocated sufficient resources to meet the increased demands for training and assistance. The Commission noted with regret that, despite the above-mentioned request of the Assembly, the secretariat of the Commission was generally short of funds for the publication of the *UNCITRAL Yearbook* and brochures containing texts resulting from the work of the Commission.

256. The Commission also noted with appreciation that the General Assembly, in paragraph 13 of the resolution, stressed the importance of bringing into effect the conventions emanating from the work of the Commission, and that, to that end, it urged States that had not yet done so to consider signing, ratifying or acceding to those conventions.

XI. NEW YORK CONVENTION DAY AND UNIFORM COMMERCIAL LAW INFORMATION COLLOQUIUM

257. During its thirty-first session, on 10 June 1998, the Commission held a special commemorative New York Convention Day in order to celebrate the fortieth anniversary of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958). In addition to representatives of States members of the Commission and observers, some 300 invited persons participated in the event. The opening speech was made by the Secretary-General of the United Nations. In addition to speeches by former participants in the diplomatic conference that adopted the Convention, leading arbitration experts gave reports on matters relating to the significance of the Convention; its promotion, enactment and application; the interplay between the Convention and other international legal texts on international commercial arbitration (such as the UNCITRAL Model Law on International Commercial Arbitration and the European Convention on International Commercial Arbitration, Geneva, 1961); and legal issues that were not covered by the Convention. In

the reports, various suggestions were made for presenting to the Commission some of the problems identified in practice so as to enable it to consider whether any work by the Commission would be desirable and feasible (see also above, para. 235).

258. On 11 June 1998, the Commission held the Uniform Commercial Law Information Colloquium, in which representatives of States members of the Commission and observers and some 250 invited persons participated. At the Colloquium, leading experts presented their insights and assessment of legal issues relating to electronic commerce, privately financed infrastructure projects, receivables financing and cross-border insolvency. The Colloquium was designed to provide condensed information on current topics in those legal areas and exchange views that might be useful in the consideration of those issues by the Commission.

259. The Commission expressed the wish that the Secretariat publish reports from the New York Convention Day and the Colloquium as expeditiously as possible.

XII. COORDINATION AND COOPERATION

A. Transport law

260. It was recalled that, at the thirtieth session (26 February-8 March 1996) of the Working Group on Electronic Data Interchange (later renamed the Working Group on Electronic Commerce), it had been observed in various contexts that existing national laws and international conventions left significant gaps regarding issues such as the functioning of bills of lading and seaway bills, and the relationship of those transport documents to the rights and obligations between the seller and the buyer of the goods and to 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 created the need for uniform provisions addressing the issues particular to the use of new technologies.¹⁸

261. As a result of those considerations in the Working Group, it had been proposed, at the twenty-ninth session of the Commission, in 1996, that the Commission should 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 in the areas where no such rules existed, and with a view to achieving greater uniformity of laws than had so far been achieved. It had been suggested at that session that the Secretariat should be requested to solicit views and suggestions on those difficulties not only from Governments but in particular also from the inter-

governmental and non-governmental organizations representing the various interests in the international carriage of goods by sea. It was thought 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. Such an information-gathering exercise by the Secretariat should encompass a broad range of issues in the carriage of goods by sea and in related areas such as terminal operations and multi-modal carriage.

262. Several reservations had been expressed at that session with regard to the suggestion. One had been that the issues to be covered were numerous and complex, which would unduly strain the limited resources of the Secretariat. Furthermore, 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 (Hamburg Rules) made it unlikely that adding a new treaty to the existing ones would lead to a greater harmony of laws. In addition, it had been pointed out that any work that included the reconsideration of the liability regime was likely to discourage States from adhering to the Hamburg Rules, which would be an unfortunate result. It had been stressed that, if any investigation were to be carried out, it should not cover the liability regime, since the Hamburg Rules had already provided modern solutions. It had been stated in reply, however, that, although some aspects of liability might be involved, 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 were not dealt with in treaties adequately, or at all.

263. Given the differing views, the Commission had not included the consideration of the suggested issues on its current agenda. Nevertheless, it had 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. 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 Maritime Committee, 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 Harbours.

264. At its thirty-first session, the Commission heard a statement on behalf of the International Maritime Committee 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. That analysis would allow the Commission to take an informed decision as to the desirable course of action.

265. It was said that the exploratory work would not focus on the liability regime but would rather be based on a broad assessment of the current problems and needs arising from modern trade practices relating to the interna-

¹⁸Ibid. para. 210, and A/CN.9/421, paras. 104-108.

tional carriage of goods and from the use of new transport and communication methods. The Commission was informed that the International Maritime Committee had already taken steps, in consultation with the Secretariat, to organize the collection and analysis of such information. The work would from the outset involve a broad spectrum of international organizations interested in the international carriage of goods. Such a thorough and broadly based approach to the issues was time-consuming but was considered indispensable for obtaining complete and accurate information about the current practices and problems and for arriving at a balanced assessment of the desirability and feasibility of work towards internationally harmonized legal solutions.

266. Strong support was expressed by the Commission for the exploratory work being undertaken by the International Maritime Committee and the Secretariat. The Commission expressed its appreciation to the Committee for its willingness to embark on that important and far-reaching project, for which few or no precedents existed at the international level; the Commission was looking forward to being apprised of the progress of the work and to considering the opinions and suggestions resulting from it.

267. Subsequently, a statement was made on behalf of the International Association of Ports and Harbours in support of considering the impact of new transport techniques on the law of carriage of goods and expressing willingness to contribute to the work of searching for harmonized legal solutions.

B. Trade and development

268. A representative of the United Nations Conference on Trade and Development (UNCTAD) recalled several instances of cooperation with the Commission. The Commission was informed that UNCTAD was currently interested in cooperating with the Commission with respect to rules relating to electronic commerce. UNCTAD was particularly interested in the question of how better to integrate developing countries in international electronic commerce. It was hoped that the secretariat of the Commission would be able to participate in those activities of UNCTAD; besides electronic commerce, the collaboration between the two organizations could extend to areas such as the settlement of disputes in the fields of trade and investment. The Commission expressed its appreciation for the work of UNCTAD, reiterated its desire to cooperate with it and endorsed plans of cooperation between the secretariats of the two organizations.

C. Private international law in the area of receivables financing

269. The Commission was informed that the Hague Conference on Private International Law had organized, in cooperation with the Secretariat, a meeting of experts at The Hague in order to consider private international law issues arising in the context of the draft convention on

assignment in receivables financing currently being prepared by the Commission's Working Group on International Contract Practices. At that meeting, experts had considered private international law issues connected with the substantive law provisions of the draft convention; the private international law priority provisions supplementing the substantive law priority provisions of the draft convention; and the private international law provisions that were potentially aimed at also covering transactions that fell outside the scope of the draft convention. In addition, with a view to assisting the UNCITRAL Working Group, the Bureau of the Conference would prepare a report of the meeting and submit it to the Working Group.

270. The Commission welcomed the cooperation with the Hague Conference. It was felt that such cooperation was necessary for the optimal utilization of the resources available to the respective organizations to the benefit of the process of law unification.

D. International Association of Lawyers

271. It was stated on behalf of the International Association of Lawyers that the Association would continue to publicize the work of the Commission through its committees and through conferences and seminars it organized. In addition, the Association was prepared to offer expert assistance to the Commission in a number of areas in which the latter was currently active, including the area of privately financed infrastructure projects. The Commission was appreciative of the statement and looked forward to strengthened cooperation with the Association.

XIII. OTHER BUSINESS

A. Bibliography

272. The Commission noted with appreciation the bibliography of recent writings related to the work of the Commission (A/CN.9/452) and the guide to enactment of the UNCITRAL Model Law on Cross-Border Insolvency (A/CN.9/442).

273. The Commission stressed that it was important for it to have as complete as possible information about publications, including academic theses, commenting on the results of its work. It therefore requested Governments, academic institutions and other relevant organizations to send copies of such publications to the Secretariat.

B. Willem C. Vis International Commercial Arbitration Moot

274. It was reported to the Commission that the Institute of International Commercial Law at Pace University School of Law, New York, had organized the fifth Willem C. Vis International Commercial Arbitration Moot (Vienna,

4-9 April 1998). Legal issues that the teams of students participating in the Moot dealt with were based, *inter alia*, on the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Model Law on International Credit Transfers. Some 58 teams from law schools in some 30 countries participated in the 1998 Moot. The sixth Moot is to be held in Vienna from 26 March to 1 April 1999.

275. The Commission heard the report with interest and appreciation. It regarded the Moot, with its international participation, as an excellent method of teaching international trade law and disseminating information about current uniform texts.

C. Date and place of the thirty-second session of the Commission

276. It was decided that the Commission would hold its thirty-second session in Vienna from 17 May to 4 June 1999.

D. Sessions of working groups

277. The Commission approved the following schedule of meetings for its working groups:

(a) The Working Group on International Contract Practices is to hold its twenty-ninth session in Vienna from 5 to 16 October 1998 and its thirtieth session in New York from 1 to 12 March 1999;

(b) The Working Group on Electronic Commerce is to hold its thirty-third session in New York from 29 June to 10 July 1998 and its thirty-fourth session in Vienna from 8 to 19 February 1999.

ANNEX

List of documents before the Commission at its thirty-first session

[The annex is reproduced in part three of this *Yearbook*]

B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board on its forty-fifth session (TD/B/45/13) (Vol. I)^a

"I.G. (Agenda item 8) Other matters in the field of trade and development: Progressive development of the law of international trade: thirty-first annual report of the United Nations Commission on International Trade Law

9. At its 899th plenary meeting, on 16 October 1998, the Board took note of the thirty-first annual report

^a*Official Records of the General Assembly, Fifty-third Session, Supplement No. 15 (A/53/15).*

of UNCITRAL (A/53/17) and decided to invite a representative of UNCITRAL to present the report of the Commission to the regular session of the Board in 1999."

C. General Assembly: report of the United Nations Commission on International Trade Law on the work of its thirty-first session: report of the Sixth Committee (A/53/632) [Original: English]

I. INTRODUCTION

1. At its 3rd plenary meeting, on 15 September 1998, the General Assembly, on the recommendation of the General Committee, decided to include in the agenda of its fifty-third session the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-first session" and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 3rd, 4th and 26th meetings, on 12 and 13 October and on 11 November 1998. The views of the representatives who spoke during the Committee's consideration of the item

are reflected in the relevant summary records (A/C.6/53/SR.3, 4 and 26).

3. For its consideration of the item, the Committee had before it the report of the United Nations Commission on International Trade Law on the work of its thirty-first session.¹

4. At the 3rd meeting, on 12 October, the Chairman of the United Nations Commission on International Trade Law at its thirty-first session introduced the report of the

¹*Official Records of the General Assembly, Fifty-third Session, Supplement No. 17 (A/53/17).*

Commission on the work of that session (see A/C.6/53/SR.3).

5. At the 4th meeting, on 13 October, the Chairman of the Commission made a statement in the light of the debate (see A/C.6/53/SR.4).

II. CONSIDERATION OF DRAFT RESOLUTION A/C.6/53/L.7

6. At the 26th meeting, on 11 November, the representative of Austria, on behalf of *Algeria, Argentina, Armenia, Australia, Austria, Azerbaijan, Belgium, Bolivia, Botswana, Brazil, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Côte d'Ivoire, Croatia, Cyprus, the Czech Republic, Denmark, Ecuador, Egypt, Fiji, Finland, France, Germany, Greece, Guatemala, Hungary, Iceland, India, the Islamic Republic of Iran, Ireland, Israel, Italy, Japan, Kenya, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Mongolia, Morocco, Myanmar, the Netherlands, Nigeria, Norway, Poland, Portugal, Romania, the Russian*

Federation, Singapore, Slovakia, Slovenia, South Africa, Spain, the Sudan, Sweden, Thailand, Turkey, Uganda, the United Kingdom of Great Britain and Northern Ireland, the United States of America, Uruguay, Venezuela and Zimbabwe, introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-first session" (A/C.6/53/L.7).

7. At the same meeting, the Committee adopted draft resolution A/C.6/53/L.7 without a vote (see para. 8).

III. RECOMMENDATION OF THE SIXTH COMMITTEE

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

[The text is not reproduced in this section. The draft resolution was adopted, with editorial changes, as General Assembly resolution 53/103 (see section D below).]

D. General Assembly resolution 53/103 of 8 December 1998

53/103. Report of the United Nations Commission on International Trade Law on the work of its thirty-first session

The General Assembly,

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

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

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

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

Mindful of the valuable contribution to be rendered by the Commission within the framework of the United Nations Decade of International Law, in particular as regards the dissemination of international trade law,

Concerned that activities undertaken by other bodies of the United Nations system in the field of international trade law without 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,

Stressing the importance of the further development of the Case Law on United Nations Commission on International Trade Law Texts in promoting the uniform application of the legal texts of the Commission and its value for government officials, practitioners and academics,

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

2. Commends the Commission for the progress made in its work on receivables financing, electronic commerce, privately financed infrastructure projects and the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York on 10 June 1958;²

3. Also commends the Commission for holding a special commemorative "New York Convention Day" in order to celebrate the fortieth anniversary of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and a Uniform Commercial Law Information Colloquium, designed to provide information on current topics and generate discussion among experts that might be

¹Official Records of the General Assembly, Fifty-third Session, Supplement No. 17 (A/53/17).

²United Nations, Treaty Series, vol. 330, No. 4739.

useful in the consideration of those topics by the Commission;

4. *Appeals* to Governments that have not yet done so to reply to the questionnaire circulated by the Secretariat in relation to the legal regime governing the recognition and enforcement of foreign arbitral awards;

5. *Invites* States to nominate persons to work with the private foundation established to encourage assistance to the Commission from the private sector;

6. *Reaffirms* 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 and, in this connection:

(a) Calls upon all bodies of the United Nations system and invites other international organizations to bear in mind the mandate of the Commission and the need to avoid duplication of effort and to promote efficiency, consistency and coherence in the unification and harmonization of international trade law;

(b) Recommends that the Commission, through its secretariat, continue to maintain close cooperation with the other international organs and organizations, including regional organizations, active in the field of international trade law;

7. *Also 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, such as assistance in the preparation of national legislation based on legal texts of the Commission;

8. *Expresses the desirability* for increased efforts by the Commission, in sponsoring seminars and symposia, to provide such training and technical assistance, and in this connection:

(a) Expresses its appreciation to the Commission for organizing seminars and briefing missions in Colombia, Cyprus, Ecuador, Greece, Malta, Peru, South Africa and the United Arab Emirates;

(b) Expresses its appreciation to the Governments whose contributions enabled the seminars and briefing missions to take place, and appeals to Governments, the relevant United Nations organs, 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;

9. *Appeals* 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;

10. *Appeals* 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 travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General;

11. *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-third 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;

12. *Requests* the Secretary-General to ensure the effective implementation of the programme of the Commission;

13. *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.

83rd plenary meeting
8 December 1998

Part Two

**STUDIES AND REPORTS
ON SPECIFIC SUBJECTS**

I. ASSIGNMENT IN RECEIVABLES FINANCING

A. Report of the Working Group on International Contract Practices on the work of its twenty-seventh session

(Vienna, 20-31 October 1997) (A/CN.9/445) [Original: English]

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I. INTRODUCTION

1. At its twenty-seventh session, the Working Group on International Contract Practices continued its work, undertaken pursuant to a decision taken by the Commission at its twenty-eighth session (Vienna, 2-26 May 1995), on the preparation of a uniform law on assignment in receivables financing.¹ It was the fourth session devoted to the preparation of that uniform law, tentatively entitled the draft Convention on Assignment in Receivables Financing.

2. The Commission's decision to undertake work on assignment in receivables financing was taken in response to suggestions made to it in particular at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century" (held in New York in conjunction with the twenty-fifth session, 17-21 May 1992). A related suggestion made at the Congress was for the Commission to resume its work on security interests in general, which the Commission at its thirteenth session (New York, 14-25 July 1980) had decided to defer for a later stage.²

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission considered three reports by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Those reports concluded that it

would be both desirable and feasible for the Commission to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.³

4. At its twenty-fourth session, the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report by the Secretary-General entitled "Discussion and preliminary draft of uniform rules" (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16).

5. At its twenty-fifth session, the deliberations of the Working Group were based on a note prepared by the Secretariat, which contained provisions on a variety of issues, including form and content of assignment, rights and obligations of the assignor, the assignee, the debtor and other third parties, subsequent assignments and conflict-of-laws issues (A/CN.9/WG.II/WP.87).

6. At its twenty-sixth session, the Working Group considered a note prepared by the Secretariat, which contained

¹Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

²Ibid., Thirty-fifth Session, Supplement No. 17 (A/35/17), paras. 26-28.

³Ibid., Forty-eighth Session, Supplement No. 17 (A/48/17), paras. 297-301; *ibid.*, Forty-ninth Session, Supplement No. 17 (A/49/17), paras. 208-214; and *ibid.*, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

a revised version of the draft Convention on Assignment in Receivables Financing (A/CN.9/WG.II/WP.89).

7. At its thirtieth session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth sessions of the Working Group (A/CN.9/432 and A/CN.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor.⁴

8. The Commission noted that the draft Convention had aroused the interest of the receivables financing community and Governments, since it had the potential of increasing the availability of credit at more affordable rates, and expressed the hope that the Working Group, after three more sessions scheduled to take place at Vienna in October 1997, in New York in March 1998 (2-13 March 1998) and at Vienna in October 1998, would be able to submit the draft Convention for consideration by the Commission at its thirty-second session in 1999.⁵

9. The Working Group, which was composed of all States members of the Commission, held its twenty-seventh session at Vienna from 20 to 31 October 1997. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Egypt, Finland, France, Germany, Hungary, India, Iran (Islamic Republic of), Japan, Mexico, Nigeria, Poland, Saudi Arabia, Singapore, Slovakia, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

10. The session was attended by observers from the following States: Azerbaijan, Belarus, Canada, Costa Rica, Czech Republic, Democratic People's Republic of Korea, Georgia, Greece, Indonesia, Iraq, Ireland, Kuwait, Lebanon, Malaysia, Namibia, Oman, Pakistan, Philippines, Qatar, Republic of Korea, Romania, Sweden, Switzerland, Turkey and Venezuela.

11. The session was attended by observers from the following organizations: Association of the Bar of the City of New York (ABCNY), Bank for International Settlements (BIS), Banking Federation of the European Union, Commercial Finance Association (CFA), Hague Conference on Private International Law, International Association of Lawyers, Factors Chain International (FCI), Interamerican Bar Association (IABA) and International Bar Association (IBA).

12. The Working Group elected the following officers:

Chairman: Mr. David Morán Bovio (Spain)

Rapporteur: Mr. Moses O. Adediran (Nigeria).

13. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.94) and a note by the Secretariat containing revised articles of the draft Convention on Assignment in Receivables Financing (A/CN.9/WG.II/WP.93).

14. The Working Group adopted the following provisional agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Assignment in receivables financing.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

15. Recalling its decision to consider private international law issues at the beginning of the current session (A/CN.9/434, para. 262) and in view of the fact that those issues first arose in the context of draft article 23, one of the most important provisions of the draft Convention on which agreement had not been reached yet, the Working Group decided to begin its deliberations by discussing draft article 23.

16. The Working Group discussed draft articles 23-32, as well as the annex to the draft Convention, and draft articles 1-14(1) as set forth in document A/CN.9/WG.II/WP.93.

17. The deliberations and conclusions of the Working Group, including its consideration of various draft provisions, are set forth below in chapters III and IV. The Secretariat was requested to prepare, on the basis of those conclusions, a revised draft of articles 23-32, the provisions contained in the annex to the draft Convention and draft articles 1-14(1), as well as of the other provisions of the draft Convention.

III. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

Article 23. *Competing rights of several assignees*

18. The text of draft article 23 as considered by the Working Group was as follows:

“(1) Until the establishment of a registration system as provided in article 1 of the annex to this Convention, priority among several assignees of the same receivables from the same assignor [is determined on the basis of the time of the assignment] [will be governed by the law determined in accordance with paragraph (1) of article 28].

“(2) After the establishment of a registration system as provided in article 1 of the annex to this Convention, priority among several assignees of the same receivables from the same assignor will be governed by paragraphs (3) and (4) of this article. However, if a State makes a declaration under paragraph (1) of article 30, priority will be [determined on the basis of the time of the assignment] [governed by the law determined in accordance with paragraph (1) of article 28].

⁴Ibid., *Fifty-second Session, Supplement No. 17 (A/52/17)*, para. 254.

⁵Ibid., para. 256.

“(3) An assignee who has registered certain information about the assignment under this Convention has priority over another assignee of the same receivables from the same assignor who has registered later or not registered at all. If neither assignee registers, priority is determined on the basis of the time of the assignment.

“(4) An assignee asserting priority under the provisions of this Convention has priority over an assignee asserting priority based on grounds other than the provisions of this Convention. However, if the State the law of which is applicable under paragraph (1) of article 28 has made a declaration under paragraph (2) of article 30, priority will be determined on the basis of the time of the assignment.

“(5) Notwithstanding the preceding paragraphs of this article, conflicts of priority may be settled by agreement between competing assignees.”

Paragraph (1)

19. The Working Group first considered the question whether a substantive or a conflict-of-laws approach would be preferable in addressing the problem of competing rights of several assignees.

20. It was generally agreed that a substantive law approach would be preferable, since it would provide more certainty. Support was expressed for both a substantive law priority rule based on the time of assignment and for a rule based on the time of registration.

21. Arguments in favour of a priority rule based on the time of assignment included that such a rule was simple, practical and conforming with legal tradition in a number of countries. In favour of a registration-based approach, a number of arguments were raised, including that registration provided certainty and predictability, thus having a positive impact on the availability and the cost of credit. In addition, it was stated that, particularly in the case of successive assignments, the time of assignment might be difficult to ascertain. Adopting such a rule, it was observed, would make it necessary for the successive assignees to undertake costly verification as to the time of the first assignment, which might be incompatible with modern practice, particularly with respect to bulk assignments.

22. After discussion, the Working Group came to the conclusion that it would not be feasible to reach agreement on a substantive law provision and that an approach based on a conflict-of-laws provision should be examined. It was stated that, while such an approach could not lead to full uniformity, it could facilitate the extension of credit at more affordable rates. It was explained that, with the uncertainty prevailing as to the law applicable to questions of priority, assignees had to meet the requirements of a number of jurisdictions in order to ensure that they would obtain priority, a process which increased the cost of credit. It was observed that a clear conflict-of-laws provision could have a positive impact on the cost and the availability of credit, to the extent that it would allow assignees to know which law applied to questions of priority and to ensure their rights by meeting the requirements of the applicable law. In addition, it was pointed out that a conflict-

of-laws rule would have the advantage of overcoming the problem of having to resolve conflicts between Convention and non-Convention assignees, since the matter would be left to the applicable law. Moreover, it was said that a conflict-of-laws rule might make the draft Convention more acceptable to States, at least, to the extent that national laws governing priority would be preserved.

23. However, the view was expressed that such an approach might result in conflicts between the draft Convention and the Convention on the Law Applicable to Contractual Obligations (Rome, 1980);^a hereinafter referred to as the “Rome Convention”, article 12 of which dealt with the issue of assignment. In response, it was stated that the reference to a regional instrument applicable to contractual obligations such as the Rome Convention should not prevent the preparation of a specialized legal regime for universal application to receivables financing. In addition, it was stated that legal opinions varied greatly as to whether article 12 of the Rome Convention was applicable to questions of priority or to any other question relating to property rights. Furthermore, it was stated that article 21 of the Rome Convention expressly provided that the Convention did not “prejudice the application of international conventions” to which Contracting States might become parties.

24. The discussion next focused on whether priority among several assignees of the same receivables from the same assignor should be “governed by the law determined in accordance with paragraph (1) of article 28”, i.e. “by the law governing the receivable to which the assignment relates” or “by the law of the country in which the assignor has its place of business”.

25. Under one view, questions of priority should be governed by the law “governing the receivable to which the assignment relates”. It was stated that such a rule would be in line with article 12 of the Rome Convention referring to the law which applied to the contract between the assignor and the debtor. The prevailing view, however, was in favour of adopting a rule under which priority would be governed by the law of the country in which the assignor had its place of business. It was stated that such a rule could provide the level of certainty sought by financiers, thus allowing for low-cost financing on the basis of receivables assigned in bulk, if accompanied by a clear rule for the determination of the place of business of the assignor. In addition, it was observed that subjecting questions of priority to the law governing the receivable could have an adverse impact on the cost and the availability of credit, since assignees would have to examine each contract from which the receivable arose to determine the applicable law.

26. At the close of the discussion, the Working Group was reminded of the fact that paragraph (1) was intended to operate, “until the establishment of a registration system”, as an “interim” priority rule, and, after the establishment of a registration system, as an alternative priority rule for those States that would not wish to be bound by the registration provisions of the draft Convention. In view of the objections to registration systems in a number of coun-

^aUnited Nations, *Treaty Series*, vol. 1605, No. 28023.

tries, it was suggested that a conflict-of-laws rule based on the assignor's place of business should be made the only binding priority rule in the draft Convention. Accordingly, the registration provisions, instead of being binding on all Contracting States, subject to possible reservations ("opting-out" mechanism), could be turned into a set of optional provisions, which Contracting States might freely choose to adopt ("opting-in" mechanism). Such a restructuring of the draft Convention was said to present the advantages of: leaving it to market practice to demonstrate the benefits of registration systems; enhancing the acceptability of the draft Convention; and simplifying a number of provisions of the draft Convention, such as draft article 23, whose paragraphs (2), (3) and (4) would no longer be needed in their current location.

27. While the Working Group generally felt that no final decision could be made at the current session, the proposal was met with considerable interest and support. Pending further discussion regarding the issues of priority, it was decided that paragraph (1) would be phrased along the following lines: "Priority among several assignees of the same receivables from the same assignor is governed by the law of the country in which the assignor has its place of business". It was agreed that appropriate explanation might be needed to clarify that the reference to "the law of the country in which the assignor has its place of business" should be interpreted as covering only the substantive law of that country to avoid possible *renvoi* situations.

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

28. In view of the above decision, it was agreed that paragraphs (2), (3) and (4) would be placed at an appropriate place in the draft Convention for use by States that chose to "opt into" the registration system. It was agreed that the substance of those provisions might need to be reconsidered at a later stage.

Paragraph (5)

29. The substance of paragraph (5) was found to be generally acceptable.

Article 24. Competing rights of assignee and insolvency administrator or creditors of the assignor

30. The text of draft article 24 as considered by the Working Group was as follows:

"(1) Until the establishment of a registration system as provided in article 1 of the annex to this Convention, priority between an assignee and the insolvency administrator or the assignor's creditors will be governed by [paragraph (3) of this article] [the law determined in accordance with paragraphs (2) and (3) of article 28].

"(2) After the establishment of a registration system as provided in article 1 of the annex to this Convention, conflicts of priority referred to in paragraph (1) of this article will be governed by paragraph (4) of this article. However, if a State makes a declaration under para-

graph (1) of article 30, priority will be governed by [paragraph (3) of this article] [the law determined in accordance with paragraphs (2) and (3) of article 28].

"[(3) An assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:

"(a) the receivables [were assigned] [arose] [were earned by performance] before the opening of the insolvency proceeding or attachment; or

"(b) the assignee has priority on grounds other than the provisions of this Convention].

"(4) An assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:

"(a) the receivables [were assigned] [arose] [were earned by performance], and information about the assignment was registered under this Convention, before the opening of the insolvency proceeding or attachment; or

"(b) the assignee has priority on grounds other than the provisions of this Convention.

"(5) Except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor's creditors.

"[(6) This Convention does not affect:

"(a) any right of creditors of the assignor to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer;

"(b) any right of the administrator in the insolvency of the assignor,

"(i) to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer,

"(ii) to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment of receivables that have not arisen at the time of the opening of the insolvency proceeding,

"(iii) to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract, or

"(iv) to encumber the assigned receivables with the expenses of the insolvency administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee;

"(c) [in case the assigned receivables constitute security for indebtedness or other obligations,] any insolvency rules or procedures generally governing the insolvency of the assignor:

"(i) permitting the insolvency administrator to encumber the assigned receivables with privileged claims for taxes, wages and similar privileges, provided that the assignee is treated fairly and equitably with other creditors whose receivables may be so encumbered,

"(ii) providing for a stay of the right of individual assignees or creditors of the assignor

to collect the receivables during the insolvency proceeding;

- “(iii) permitting substitution of the assigned receivables for new receivables of at least equal value,
- “(iv) providing for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured, or
- “(v) other rules and procedures of similar effect and of general application in the insolvency of the assignor [specifically described by a Contracting State in a declaration made at the time of signature, ratification, acceptance, approval of or accession to this Convention.]

“[(7) An assignee asserting rights under this article has no fewer rights than an assignee asserting rights under other law.]

“[(8) For the purposes of this article:

“(a) ‘insolvency proceeding’ means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the assignor are subject to control or supervision by a court for the purpose of reorganization or liquidation;

“(b) ‘opening of an insolvency proceeding’ is deemed to have taken place when the order opening the proceeding becomes effective, whether or not [final] [subject to appeal]; and

“(c) ‘attachment’ is deemed to have taken place when the order attaching the assigned receivables becomes effective, whether or not [final] [subject to appeal].”

General comments

31. As a result of the decision of the Working Group on draft article 23 (see paras. 26-27 above), the Working Group decided that paragraph (1) of draft article 24 should include a private international law rule, paragraphs (2) and (4) should be moved to a part or annex to the draft Convention, the application of which would be optional, and paragraph (3) should be deleted.

Paragraph (1)

32. As to the contents of the private international law rule to be included in draft article 24, the Working Group agreed that competing rights of the assignee and the assignor’s creditors should be distinguished from competing rights of the assignee and the administrator in the insolvency of the assignor.

33. With regard to conflicts of priority between the assignee and the assignor’s creditors, the suggestion was made that they should be governed by the law of the country in which the assignor had its place of business. In support of that suggestion, it was stated that such an approach would provide the desirable degree of certainty, since the same law would apply irrespective of

the country in which the assignor’s creditors might obtain a court judgement ordering the attachment of the assigned receivables or of the country in which enforcement of the claims of the assignor’s creditors might be sought.

34. While that suggestion was met with approval, a number of observations were made. One observation was that such an approach would deviate from what appeared to be the normal rule in a number of countries, i.e. a rule subjecting such conflicts of priority to the law of the country in which the debtor was located. In response, it was pointed out that an approach based on the law of the country of the debtor’s place of business would not be appropriate, since draft article 24 dealt with competing rights of creditors of the assignor and not with the rights and obligations of the debtor. Another observation was that, while the suggestion was acceptable, the application of such a rule might result in the assignee not being able to obtain payment, unless the debtor was located in a Contracting State, simply because the assignee met the notification requirements of the applicable law but not those prevailing under the law of the debtor’s country. Yet another observation was that the rule suggested could provide certainty only if parties could easily determine the relevant place of business of the assignor (e.g. if “place of business” meant the registered place of business).

35. As to conflicts between the assignee and the administrator in the insolvency of the assignor, the suggestion was made that they should also be governed by the law of the country in which the assignor had its place of business. In favour of that suggestion, it was pointed out that the place of business of the assignor as a connecting factor presented the advantage of simplicity and predictability for a number of reasons, including that: it provided a single point of reference; it could be ascertained at the time of even a bulk assignment; it would be suitable even to legal systems where registration was practised; and it would result in the application of the law that would govern the insolvency proceedings of the assignor, if those proceedings were opened in the country of the assignor’s place of business or in a country that would have adopted the draft Convention.

36. While there was support for the suggestion, the concern was expressed that the rule suggested might interfere with national insolvency rules or international conventions dealing with matters of insolvency (e.g. the European Union Convention on Insolvency Proceedings) that involved public policy considerations. In order to address that concern, the suggestion was made that the draft Convention should not deal with competing rights of the assignee and the administrator in the insolvency of the assignor.

37. That suggestion was objected to on the grounds that, unless the draft Convention provided some certainty and predictability as to the rights of the assignee in case of the insolvency of the assignor, it would have failed in addressing one of the most important problems in receivables financing and thus in reaching the goal of increasing the availability of lower-cost credit. In addition, it was stated that, while it was not clear whether the draft Convention

was in conflict with any international convention dealing with matters of insolvency, such a conflict could be dealt with in the context of draft articles 9 and 29 dealing with the relationship between the draft Convention and other international conventions.

38. It was suggested that, before deciding on how to deal with the effects of the draft Convention on the law applicable to the insolvency of the assignor, the matter needed to be considered further in consultation with insolvency experts with a view to determining whether it would be preferable to: either leave the matter to the applicable law of the country of the assignor's place of business; or to deal with it in the draft Convention in great detail; or to deal with it only in general terms, thus deferring matters to the law applicable to the insolvency of the assignor.

39. After discussion, the Working Group decided that paragraph (1) should be revised to provide that competing rights of the assignee and the assignor's creditors should be governed by the law of the country in which the assignor had its place of business.

40. As to competing rights between the assignee and the administrator in the insolvency of the assignor, the Working Group tentatively decided that it should also be governed by the law of the country in which the assignor had its place of business. At the same time, the Working Group decided that the relationship between the draft Convention and the law applicable to the insolvency of the assignor should be further considered at a later stage (see paras. 41-43, below).

Paragraphs (5) and (6)

41. The Working Group considered the question whether paragraphs (5) and (6) should be retained or deleted. It was stated that, as mentioned above, three approaches were possible and should be considered at a later stage, after further consultation with insolvency experts (see paras. 38 and 40, above). One approach was to delete both paragraphs (5) and (6) and to leave the rights of the assignee as against the insolvency administrator to the law of the country in which the assignor had its place of business. Another approach was to retain paragraph (5) and to delete paragraph (6), dealing with the matter in general terms and thus effectively leaving it to the law applicable in case of insolvency of the assignor. Yet another approach was to delete paragraph (5) and to retain paragraph (6), thus dealing with the matter in a detailed manner.

42. One reason for retaining paragraph (5) or (6) was said to be that, if the insolvency proceeding were to be opened in a country other than the assignor's country, there would be uncertainty as to the rights of the assignee as against the insolvency administrator. Another reason in favour of retaining paragraph (5) or (6) was that insolvency rules of the forum might be applied, even if the applicable law was the law of the country in which the assignor had its place of business, vesting the insolvency administrator with rights that might not be available under the applicable law (e.g. to reorganize the assets and affairs of the insolvent assignor).

43. After consideration, the Working Group decided to retain both paragraphs (5) and (6) within square brackets.

Paragraphs (7) and (8)

44. Support was expressed in favour of the principle embodied in paragraph (7) that assignees asserting their rights on the basis of the draft Convention should not have any less rights than assignees asserting their rights on the basis of otherwise applicable law. Support was also expressed in favour of retaining paragraph (8), although the Working Group for lack of sufficient time did not go into a discussion of the definitions contained in paragraph (8). After discussion, the Working Group decided to retain both paragraphs (7) and (8).

Chapter V. Subsequent assignments

Article 25. Subsequent assignments

45. The text of draft article 25 as considered by the Working Group was as follows:

“(1) This Convention applies to international assignments of receivables and to assignments of international receivables by the initial or any other assignee to subsequent assignees, even if the initial assignment is not governed by this Convention.

“[(2) A subsequent assignee has the rights afforded by this Convention to an assignee and is subject to the debtor's defences and rights of set-off recognized by this Convention.]

“[(3) A receivable assigned by the assignee to a subsequent assignee is transferred notwithstanding any agreement limiting in any way the assignor's right to assign its receivables. Nothing in this article affects any obligation or liability for breach of *such* an agreement, but the subsequent assignee is not liable for breach of that agreement.]

“(4) Notwithstanding that the invalidity of an assignment renders all subsequent assignments invalid, the debtor is entitled to discharge its obligation by paying in accordance with the payment instructions set forth in the first notification.”

General comments

46. It was stated that draft article 25 was one of the most important articles of the draft Convention, in particular from the point of view of financiers involved in international factoring. It was explained that in international factoring the assignor assigned the receivables to an assignee in its own country (export factor) and the export factor assigned the receivables to an assignee in the debtor's country (import factor). In view of the fact that the debtor was normally notified only of the second assignment, it was necessary to provide that such notification constituted notification of the first assignment, in order to ensure the import factor's right to enforce the claim against the debtor. After discussion, the Working Group requested the Secretariat to add in draft article 25 a provi-

sion along the lines of article 11(2) of the UNIDROIT Convention on International Factoring (Ottawa, 1988; hereinafter referred to as “the Ottawa Convention”), which provided that “... notice of the subsequent assignment also constitutes notice of the assignment to the factor”.

Paragraph (1)

47. Strong support was expressed in favour of the principle embodied in paragraph (1) that the draft Convention should apply to subsequent assignments falling under its scope of application, even if the initial assignment was not covered by the draft Convention (e.g. assignments in securitization transactions).

Paragraphs (2) and (3)

48. While support was expressed in favour of the principle embodied in paragraph (2) that a subsequent assignee was an assignee, the concern was expressed that singling out two types of situations in which that principle found application might inadvertently result in excluding other cases in which that principle should apply as well. In order to address that concern, the suggestion was made that paragraph (2) should be deleted.

49. With regard to paragraph (3), the concern was expressed that excluding the assignee’s liability for a breach of an anti-assignment clause might be considered as an invitation to the assignor to violate its contractual obligations to the debtor, which would run against good faith principles. It was suggested that that concern could be discussed in the context of draft article 13 which involved issues similar to those arising in paragraph (3).

50. After discussion, the Working Group decided to retain paragraphs (2) and (3) within square brackets and deferred its discussion of paragraph (3) until it had completed its review of draft article 13.

Paragraph (4)

51. Support was expressed in favour of the principle that the invalidity of an assignment should not jeopardize the discharge of the debtor who paid in accordance with the instructions contained in the notification. It was agreed, however, that the matter involved the protection of the debtor in case any assignment, and not only a subsequent assignment, was invalid. After discussion, the Working Group requested the Secretariat to consider placing paragraph (4) elsewhere in the text, possibly in draft article 18.

Chapter VI. Conflict of laws

A. General comments

52. The Working Group was reminded that the question of the scope of the conflict-of-laws rules would need to be considered. If these rules were aimed at filling the gaps

left in the draft Convention, their scope of application should be limited to the scope of the draft Convention (and, in order to avoid a renvoi situation, they should apply only in case the forum was in a Contracting State and not by way of other conflict-of-laws provisions of the forum). If, however, the Working Group preferred to establish a uniform conflict-of-laws regime with regard to assignment, as suggested by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.II/WP.90, paras. 4-7), the scope of the conflict-of-laws provisions of the draft Convention should be broader than the scope of the draft Convention. Articles 1(3), 21 and 22 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995)^b; hereinafter referred to as “the United Nations Guarantee and Standby Convention” constituted a precedent for such an approach.

53. Diverging views were expressed as to whether conflict-of-laws provisions should be included in the draft Convention or avoided altogether. In support of including conflict-of-laws rules in the draft Convention, it was stated that they could usefully operate as provisions leading to the application of the draft Convention (under draft article 3(1)(b)) or as specific rules dealing with issues that could not be addressed by way of a substantive law provision (e.g. priority). In addition, it was stated that including such provisions in the draft Convention presented the potential of achieving global unification and clarifying the applicable-law issue on assignments.

54. In favour of avoiding such rules, it was observed that they might inadvertently result in disunification, since they did not form a comprehensive legal regime unifying conflict of laws in assignments. In addition, it was stated that the inclusion of conflict-of-laws provisions might inadvertently result in inconsistencies between the draft Convention and the Rome Convention, which might make the draft Convention less acceptable to States Parties to the Rome Convention. In response, it was suggested that the draft Convention, as a set of specialized rules, could be expected to deviate from the general rules contained in the Rome Convention. The example was given of the Convention on the Law Applicable to International Sales of Goods (The Hague, 1955)^c, whose provisions differed from those of the Rome Convention and were not regarded as creating difficulties in that regard, since they merely reflected the well-established principle that a specialized instrument might derogate from a more general one. Furthermore, the view was expressed that the draft Convention might also be viewed as a unique opportunity to expand the benefit of useful conflict-of-laws provisions to countries that were not parties to the Rome Convention.

55. After discussion, the Working Group postponed its final decision as to whether chapter VI should remain part of the draft Convention until it had further discussed the general scope of the draft Convention under draft article 1 (see paras. 140-145 below). Pending its final decision, the Working Group engaged in a discussion of the substance of the draft articles contained in chapter VI.

^bGeneral Assembly resolution 50/48, annex, of 11 December 1995.

^cUnited Nations, *Treaty Series*, vol. 510, No. 7411.

B. Discussion of draft articles

Article 26. *Law applicable to the rights and obligations of the assignor and the assignee*

56. The text of draft article 26 as considered by the Working Group was as follows:

“(1) [With the exception of matters which are settled in this Convention,] the [effectiveness] [validity] of an assignment as between the assignor and the assignee and the mutual rights and obligations of the assignor and the assignee are governed by the law [expressly] chosen by the assignor and the assignee.

“(2) In the absence of a [valid] choice, the [effectiveness] [validity] of an assignment as between the assignor and the assignee and the mutual rights of the assignor and the assignee are governed by the law of [the country in which the assignor has its place of business] [the country with which the [contract of] assignment is most closely connected].

“[(3) Unless the [contract of] assignment is clearly more closely connected with another country, it is deemed to be most closely connected with the country where the party who is to effect the performance which is characteristic of the [contract of] assignment has, at the time of conclusion of the [contract of] assignment, its place of business].”

Paragraph (1)

57. It was generally agreed that the fundamental principle embodied in paragraph (1), i.e. unrestricted party autonomy for determining the law applicable to the contractual relationship between the assignor and the assignee, was appropriate. In that connection, the view was expressed that the draft Convention should include a provision to the effect that choice-of-law clauses could not be used by the parties to deviate from public policy or other mandatory law in their respective countries. It was suggested that such a provision might be derived from article 7 of the Rome Convention.

58. As to the specific wording of paragraph (1), it was generally agreed that the opening words (“[With the exception of matters which are settled in this Convention,]”) should be retained in square brackets, pending a decision by the Working Group on the scope of the draft Convention.

59. As to the reference to either the “effectiveness” or the “validity” of the assignment, it was widely felt that the notion of “validity” might be unclear and entail various possible meanings. Furthermore, in practice, it was not uncommon for different laws to govern the validity of the assignment (or the “assignability” of a receivable), on the one hand, and the contractual relationship between the assignor and the assignee on the other hand. Preference was thus expressed for a reference to the “effectiveness” of the assignment. The prevailing view, however, was that a reference to either “effectiveness” or “validity” of the assignment might be unduly restrictive and that the

principle of party autonomy should be more broadly recognized.

60. With respect to the reference to “the mutual rights and obligations of the assignor and the assignee”, the view was expressed that such wording might unduly restrict the scope of the provision. While the expression was drawn from the Rome Convention with the intention to cover both the contractual and the proprietary effects of the assignment as between the parties thereto, it was generally agreed that clearer wording might be needed to indicate that the law chosen by the parties should govern not only their rights and obligations but also the entire assignment contract, and that it should also reach beyond the contractual sphere to govern the proprietary rights involved in the assignment. In that connection, it was stated that the Rome Convention might not constitute an appropriate model for drafting such a provision since the scope of the Rome Convention was limited to the contractual sphere. Doubts were expressed as to how it might be feasible for paragraph (1) to apply beyond the contractual sphere to the proprietary effects of the assignment. While it might be desirable for the law chosen by the parties to govern also, for example, transfer of property in the receivable as between the assignor and the assignee, it was a matter of debate whether issues such as assignability of a receivable and time of transfer might appropriately be governed by the law chosen by the parties. After discussion, the Working Group decided that the law chosen by the parties under paragraph (1) should apply to both the assignment contract and the proprietary effects of the assignment. The Secretariat was requested to prepare a revised draft to reflect the above discussion.

61. As to whether paragraph (1) should prescribe that the choice of law should be made “expressly” by the parties, various views were expressed. Under one view, it would be inappropriate for the draft Convention to deal with the modalities of the agreement where it should only focus on whether an agreement had been entered into by the parties. In support of that view, it was stated that any indication that the agreement should be “express” might raise difficult evidentiary issues, which could only be overcome by way of a detailed provision as to how evidence of the agreement might be given. Another view was that, for reasons of consistency with the legal tradition in certain countries and with certain international instruments, a reference to the “express” choice of the parties should be retained. As to how such a reference might be worded, it was recalled that, for example, under article 7 of the Inter-American Convention on the Law Applicable to International Contracts (Mexico City, 1994)^d; hereinafter referred to as “the Inter-American Convention”, the parties’ agreement on the choice of applicable law “must be express or, in the event that there is no express agreement, must be evident from the parties’ behaviour and from the clauses of the contract, considered as a whole”. After discussion, it was agreed that wording inspired from the Inter-American Convention should be included between square brackets for consideration by the Working Group at a future session.

^d*International Legal Materials*, vol. XXXIII, No. 3 (Washington, D.C., 1994).

Paragraphs (2) and (3)

62. Various views were expressed as to the options offered in paragraph (2) with respect to the designation of the law applicable in the absence of agreement by the parties. In favour of adopting as a default rule “the law of the country in which the assignor had its place of business”, it was stated that such a law was easy to determine, thus enhancing certainty and predictability. In favour of retaining “the law of the country with which the assignment was most closely connected, it was stated that such a flexible rule would be more consistent with the legal tradition in a number of countries and with the Rome Convention. It was stated, however, that the characteristic performance might be either that of the assignor or that of the assignee depending upon the type of assignment envisaged, thus resulting in unacceptable uncertainty as to the law applicable.

63. It was generally agreed that, in most cases, adopting the law of the country in which the assignor had its place of business would be an acceptable solution. However, in view of the fact that a dispute was more likely to arise in a situation where parties had been unable to agree on the applicable law, it was generally felt that a degree of flexibility might be needed by the judge or the arbitrator who would subsequently deal with that dispute. In addition, providing for a degree of flexibility might constitute a useful incentive for the parties to agree on the applicable law under paragraph (1).

64. With a view to accommodating certainty as the main criterion and flexibility for dealing with exceptional situations, the Working Group decided that paragraphs (2) and (3) should be combined and embody: a reference to the law of the country with which the assignment was most closely connected; a presumption that the assignment was most closely connected with the law of the country in which the assignor had its place of business at the time of the conclusion of the contract of assignment; and a possibility to rebut that presumption in exceptional circumstances. As a matter of drafting, it was generally agreed that notions such as “effectiveness” and “validity” of the assignment should be avoided for the same reason they had been avoided in paragraph (1). The Secretariat was requested to prepare a revised draft of paragraphs (2) and (3) so as to reflect that decision.

Article 27. *Law applicable to the rights and obligations of the assignee and the debtor*

65. The text of draft article 27 as considered by the Working Group was as follows:

“[With the exception of matters which are settled in this Convention,] the assignability of a receivable, the right of the assignee to request payment, the debtor’s obligation to pay as instructed in the notification of the assignment, the discharge of the debtor and the debtor’s defences are governed by the law [governing the receivable to which the assignment relates] [of the country in which the debtor is located].”

66. The Working Group decided to defer its discussion of the scope of draft article 27 until it had completed its discussion of the scope of the draft Convention.

67. It was generally agreed that the law governing the receivable to which the assignment related was preferable. The main advantage of such a rule was said to be that it followed the generally accepted principle that the assignment should not alter the position of the debtor, except to the extent permitted by the law under which the debtor undertook an obligation towards the assignor. In addition, it was pointed out that such a rule did not create difficulties in practice, since it was not unusual for the assignor and the assignee to specify in the assignment the law governing the receivable so as to avoid that the assignee would need to examine the transaction under which the assigned receivable might arise. Moreover, it was observed that application of the law of the country in which the debtor had its place of business would create difficulties in case of assignments in bulk involving debtors located in several countries.

68. It was noted that the law governing the receivable would normally be the law of the transaction under which the receivable arose (e.g. in case the receivable arose under a sales contract, the law applicable to the sales contract). However, the concern was expressed that, unless the draft Convention were to include provisions for the determination of the law applicable to the transaction under which the receivable arose, full uniformity could not be achieved, since each State would have to apply its own rules on the law applicable to contractual obligations in order to determine the law governing the receivable. It was observed that, in order to achieve full uniformity, the draft Convention would have to include additional provisions on the law applicable to non-contractual obligations, since the draft Convention covered non-contractual receivables as well.

69. After discussion, the Working Group decided that the law applicable to the rights and obligations of the assignee and the debtor should be the law governing the assigned receivable.

Article 28. *Law applicable to conflicts of priority*

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

“(1) The priority among several assignees obtaining the same receivables from the same assignor is governed by the law [governing the receivable to which the assignment relates] [of the country in which the assignor has its place of business].

“(2) The [priority between an assignee and] [the effectiveness of an assignment as against] the insolvency administrator is governed by the law [governing insolvency] [of the country in which the assignor has its place of business].

“(3) The [priority between an assignee and] [the effectiveness of an assignment as against] the assignor’s creditors is governed by the law of the country in which the assignor has its place of business.”

71. Differing views were expressed as to whether, after the decision of the Working Group to turn draft articles 23 and 24 into conflict-of-laws provisions dealing with questions of priority (see paras. 27 and 31, above), draft article 28 should be retained or deleted.

72. One view was that questions of priority were already addressed in draft articles 23 and 24 and that, as a result, draft article 28 was no longer necessary and could be deleted. A related view was that, while paragraphs (1) and (3) could be deleted, since the issues addressed therein had already been resolved in draft articles 23 and 24, paragraph (2) should be retained, since the issues addressed therein remained unresolved.

73. Yet another view was that a decision on the matter should be deferred until the Working Group had completed its discussion of the scope and the purpose of the conflict-of-laws provisions of the draft Convention. It was explained that, if the purpose of the conflict-of-laws provisions was to fill gaps in the draft Convention, draft article 28 would not be necessary, since draft articles 23 and 24 were conflict-of-laws rules and not substantive law provisions. However, if the conflict-of-laws provisions were to serve as uniform provisions relating to the application of the draft Convention under draft article 1(1)(b), draft article 28 would need to be retained as a whole.

74. After discussion, the Working Group decided, subject to further consideration of the matter in the context of its discussion on the scope of the draft Convention, to delete paragraphs (1) and (3) and to retain paragraph (2) within square brackets.

Chapter VII. Final provisions

Article 29. *Conflicts with international agreements*

75. The text of draft article 29 as considered by the Working Group was as follows:

“A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that the Convention will not prevail over international conventions [or other multilateral or bilateral agreements] listed in the declaration, to which it has or will enter and which contain provisions concerning the matters governed by this Convention.”

76. The Working Group decided to defer its discussion on draft article 29 until it had completed its discussion on draft article 9 dealing with the international obligations of Contracting States (see paras. 201-203, below).

Article 30. *Registration*

77. The text of draft article 30 as considered by the Working Group was as follows:

“(1) A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that it will not be bound by the registration provisions of this Convention.

“(2) A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that it will not be bound by paragraph (4) of article 23.”

78. The Working Group noted that, as a result of its decision to make the application of the registration provisions subject to an opt-in clause (see para. 27, above), draft article 30 was no longer necessary and decided to delete it.

Article 31. *Effect of declaration*

79. The text of draft article 31 as considered by the Working Group was as follows:

“(1) Declarations made under article 29 at the time of signature are subject to confirmation upon ratification, acceptance or approval.

“(2) Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

“(3) A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the expiration of six months after the date of its receipt by the depositary.

“(4) Any State which makes a declaration under articles 29 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.”

80. The Working Group took note of draft article 31 and decided to defer its discussion to a future session.

Article 32. *Reservations*

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

“No reservations are permitted except those expressly authorized in this Convention.”

82. The Working Group took note of draft article 32 and decided to defer its discussion to a future session.

ANNEX TO THE DRAFT CONVENTION

A. *General comments*

83. The Working Group recalled its decision to turn the priority rules of the draft Convention (draft articles 23 and 24) into conflict-of-laws provisions and to make the registration provisions optional (“opt-in approach”; see paras. 26-27 and 31, above). The Working Group exchanged views as to the desirability of adopting only one priority system in the optional part of the draft Convention.

84. One view was that the optional part of the draft Convention should offer more alternatives to States. It was stated that including only a registration-based approach might give the impression that that was the preferred approach that States should adopt. It was pointed out that that result would run contrary to the fact that there were a number of concerns with regard to registration. Those concerns, it was said, included that registration might be costly, cumbersome, fall outside the supervision of the Government, increase the liability of banks, harm domestic practices (e.g. non-notification practices and practices involving a prolonged reservation of title) and disadvantage domestic creditors. It was, therefore, suggested that the optional part of the draft Convention should present another alternative priority rule, based on the time of assignment, which could read along the following lines:

“1. If a receivable is assigned several times, the right thereto is acquired by the assignee whose assignment is of the earliest date.

“2. The earliest assignee may not assert priority if it acted in bad faith at the time of the conclusion of the contract of assignment.

“3. If a receivable is transferred by operation of law, the beneficiary of that transfer has priority over an assignee asserting a contract of assignment of an earlier date.

“4. In the event of a dispute, it is for the assignee asserting a contract of assignment of an earlier date to furnish proof of such an earlier date.”

85. Another view was that the optional part of the draft Convention should offer only one alternative based on registration, since registration was the only system that provided certainty and promoted competition among financing institutions, thus resulting in an increase in the availability of credit at a lower cost. All concerns, it was pointed out, relating to registration could be addressed, except a desire to limit competition. With regard to the concern that registration might affect domestic practices, such as those involving a prolonged retention of title (i.e. a retention of title which extended to the proceeds from the sale of the asset the title to which had been retained), it was stated that those practices could be carefully identified and be left to other priority rules.

86. In addition, it was observed that, if the optional part of the draft Convention offered a time-of-assignment rule as an alternative to a registration-based rule, it might inadvertently result in the time-of-assignment rule being considered as the best alternative to registration. It was stated that a time-of-assignment rule should be the last choice, since it provided the least certainty to third parties, who had no way of verifying whether an earlier assignment had taken place other than by asking the assignor. In addition, it was pointed out that a time-of-notification rule would be preferable, if the Working Group were to provide an alternative priority rule, since it provided third parties the possibility of finding out about earlier assignments by asking the debtor. However, it was observed that a time-of-notification rule would be appropriate in case of assignments of single and present receivables, but not in case of bulk assignments involving future receivables.

87. After discussion, the Working Group requested the Secretariat to prepare and include in the optional part of the draft Convention alternative substantive-law priority rules.

88. The Working Group next turned to the question of registration as addressed in the annex. It was noted that the registration system envisaged the non-mandatory entering into a data base of certain information about the assignment. The purpose of such registration was not to create or evidence property rights, but to protect third parties by putting them on notice about assignments that had been concluded and to provide a basis for settling conflicts of priority. Such notice, it was noted, would give only enough information for the searcher to be forewarned and to decide whether to extend credit to a certain person and, if so, on what terms.

89. In addition, it was noted that priority under the draft Convention gave a creditor only the right to be paid before other creditors that were subsequent in the line of priority. Whether the creditor with priority would retain all the proceeds of the receivables depended on whether an outright assignment or an assignment by way of security was involved, a matter that was left to applicable law outside the draft Convention.

90. Because of its limited function, and in marked contrast to classic registration, registration under the draft Convention required the placement on public record of a very limited amount of data. That meant that a single notice could cover a large number of receivables, present or future, arising from one or several contracts, as well as a changing body of receivables and a constantly changing amount of secured credit involved in modern financing (revolving credit). Such registration, it was noted, was inexpensive and simple, required no formalities and only a limited degree of supervision by the registrar.

91. Moreover, it was noted that the registration process (i.e. the entering, archiving and searching of data) could be fully or partly electronic. A purely electronic system (electronic data entry and electronic searching) would maximize efficiency and minimize human involvement, thereby permitting speed, availability at all hours, freedom from the risk of data entry error on the part of the registrar (which reduced its potential liability) and reduction in the cost of registration. A partly electronic system (submission of data in paper form and electronic searching) could also be accommodated, although it would require that the registrar enter the data into the database, which would present a number of disadvantages, including an increase in the risk of error and in the registrar's potential liability.

92. The example was given of a national registration system that was fully electronic. It was observed that the system was operating on the basis of personal property security laws. Under that system, users with a password given from the registry had direct access to the registry's database through a personal computer and could enter data and search the record of the registry directly. It was explained that, in order to register a transaction, users had to fill out a form appearing on the computer screen identifying the assignor, the assignee, the encumbered assets and

the duration of the registration. It was observed that the risk of errors in the registration was on the registering party, since the registrar was not involved at all.

93. When completing the registration, a user could print out a statement verifying the fact of registration. It was pointed out that that verification statement was admissible in court and was *prima facie* evidence of the fact of registration. It was stated that the cost of registration was 5 United States dollars per year for a registration of a duration between one and twenty-five years as selected by the registrant, and that one registration could refer to several assignments and several receivables. With regard to searches of the records of the registry, it was stated that users having direct access could check the records by the name of the assignor and print-out a search report that was admissible in court as *prima facie* evidence of its contents.

B. Discussion of draft articles

Article 1. *Establishment of a registry*

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

“At the request of not less than one third of the Contracting States, the depositary shall convene a conference for designating a registry or registries and enacting[, revising or amending] registration regulations for the registration of data about assignments under this Convention.”

95. It was noted that, after the Working Group’s decision to turn the annex into an optional part of the draft Convention (see para. 27, above), there was no need to provide for a conference for the establishment of a registration system. States wishing to adopt a registration system could do so on their own, establishing a national or international system or a combination of both. In addition, it was noted that, as a result of the same decision of the Working Group, the priority provisions deleted from draft articles 23 and 24 would have to be included in the annex.

96. General support was expressed for the principle that, while the draft Convention should include some basic provisions about registration, the mechanics of the registration process should be left to be dealt with in a set of regulations that could be prepared by the registrars. It was stated that, under such an approach, the flexibility necessary for the system to respond to changing needs and technologies would be preserved.

97. The view was expressed that only a system based on national registries, in which both national and international transactions would be registered at the national level, could avoid duplication and properly address the conflict between domestic and foreign assignees. In addition, it was stated that a system based on an international registry, in which only assignments of receivables would be registered, would not be cost-efficient. While it was agreed that a system based on national registries would be one of the ways in which the registration system could operate, it was pointed out that national registries could be linked with an

international registry. In addition, it was pointed out that, for the various national registries to be compatible with each other, it was essential to agree on standardized registration forms. It was observed that such forms were being prepared at the national level and that international standardization of such forms would be desirable. In that connection, the Secretariat was encouraged to establish links with the organizations involved in the field of standardization of forms and examine with them the possibility of preparing a standard registration form.

98. After discussion, the Working Group requested the Secretariat to revise draft article 1 of the annex so as to allow the necessary flexibility for the registration provisions to apply in the context of any registration system, national or international.

Article 2. *Duties of the registry*

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

“(1) The registry receives data registered under this Convention and the regulations and maintains an index by the name of the assignor [and the registration number] in order to be able to make the data available to searchers upon request.

“(2) Upon receipt of data, the registry shall assign a registration number and issue and send to the assignor and the assignee a verification statement in accordance with the regulations.

“(3) Upon receiving a search request, the registry shall issue a search result in writing listing all data registered with regard to the receivables of a particular person.

“(4) Upon expiration of the period of effectiveness of a registration, or receipt of a notice by the assignee or a court order issued under article 5 of the annex to this Convention, the registrar shall remove data registered from the public records of the registry.”

100. While general support was expressed for the principles embodied in draft article 2 of the annex, a number of suggestions were made. One suggestion was that the registry should maintain an index by assignor and leave it to the regulations to specify how the assignor would be identified. Various options mentioned for the identification of the assignor included the legal name of the assignor and a registration number the use of which could help overcome language problems.

101. With regard to court jurisdiction, it was noted that priority disputes could be left to be resolved by the courts with jurisdiction over the parties to the dispute. However, it was noted that, in order to avoid that conflicting orders would be addressed to the registry, it may be desirable to have only one court with jurisdiction over the registry. It was stated that, in case of a system based on national registries, national courts should have jurisdiction to issue orders to the registrar. In addition, it was observed that, in case of a system based on an international registry, it could be specified that no court had jurisdiction over the international registry and that disputes involving orders to the

registrar should be resolved through an arbitration process that would need to be specified. It was noted that the latter approach was followed in the context of the draft Convention on International Interests in Mobile Equipment currently being prepared by the International Institute for the Unification of Private Law (UNIDROIT).

102. As to the issue of liability of the registrar for errors, it was stated that, in a fully electronic system in which the parties would have direct access to the registry and would be able to effect a registration themselves, the risk of error would be on the registering party and not on the registrar. In a partly electronic system in which the registrar would receive a paper notice which would need to be entered into the registry's database, the risk of error on the part of the registrar, and thus its potential liability, would be higher. However, it was observed that experience gained at the national level showed that there were very few cases in which the issue of liability of the registrar arose. In addition, it was pointed out that the matter could be effectively dealt with if a percentage of the registration fee were to be used to establish a fund from which liability claims could be paid.

103. After discussion, the Working Group approved the substance of draft article 2 of the annex and requested the Secretariat to revise it in order to address the suggestions made.

Article 3. *Registration*

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

“(1) Any person may register data with regard to an assignment at the registry in accordance with this Convention and the registration regulations. The data registered shall include the legal name and address of the assignor and the assignee and a brief description of the assigned receivables.

“(2) Registration is effective from the time that the data referred to in paragraph (1) are available to searchers.

“(3) Data may be registered before or after an assignment is made.

“(4) Data registered may relate to one or more assignments and to receivables not existing at the time of registration.

“(5) Any defect, irregularity, omission or error with regard to the legal name of the assignor that results in data registered not being found upon a search based on the legal name of the assignor renders the registration ineffective.”

Paragraph (1)

105. It was noted that proof of authorization of the registration by the assignor was not part of the data that needed to be registered, since normally lenders obtained such authorization before extending credit and the assignor, in the absence of authorization, could request

that the data registered be removed or amended (draft article 5 of the annex).

106. The concern was expressed that the assignor's interests could be prejudiced if any person was able to register without proof of authorization. In order to address that concern, a number of suggestions were made. One suggestion was that, in the absence of automatic deregistration under draft article 5 of the annex, it could be provided that, in case of a dispute as to the accurateness of the registered data, a notice should be filed alerting searchers of the dispute. Another suggestion was that, in case the assignor disputed the authorization of the registration, the registrar should request the assignee to produce adequate proof of authorization. If the assignee failed to produce such proof within fifteen days, the registrar should remove the registration from the public record. While the former suggestion was found to be acceptable, the latter suggestion was objected to on the grounds that it might result in the assignee losing its priority just because the assignor submitted a request in bad faith and the assignee did not respond properly within the fifteen-day period.

107. With regard to the description of the receivables, it was suggested that “a brief description” might be necessary only in case not all receivables were assigned; when all receivables were assigned, a reference to “all receivables” should be sufficient.

108. After discussion, the Working Group approved the substance of paragraph (1) and requested the Secretariat to revise it so as to address the suggestions made.

Paragraph (2)

109. It was observed that a rule along the lines of paragraph (2) making registration effective as of the time the data registered became available to searchers would be appropriate in case of the original extension of credit, where credit could be withheld until the data registered became available to searchers. However, in case of restructuring of troubled credits, where it was essential to make the credit available in a timely manner, registration might need to be effective once it was made, i.e. even before the data registered became available to searchers. It was pointed out that the problem arose only in partly electronic systems, since in fully electronic systems data would be made available to searchers upon completion of the entry of data by the registering party. Subject to that change, the Working Group approved the substance of paragraph (2).

Paragraphs (3) and (4)

110. The Working Group found paragraphs (3) and (4) to be generally acceptable.

Paragraph (5)

111. The suggestion was made that in paragraph (5) reference should be made to “the assignor” and not to “the

legal name of the assignor". It was observed that the matter could be specified further in the regulations, in order to preserve the flexibility of the registration provisions in the draft Convention and to avoid linking those provisions with any particular search logic or software. Subject to that change, the Working Group approved the substance of paragraph (5).

Article 4. *Duration, continuation and amendment of registration*

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

"(1) A registration under this Convention is effective [for a period of five years after registration] [for the period of time specified by the registering party].

"(2) A registration may be renewed for successive additional periods if it is requested six months before expiry of the period of its effectiveness for an additional period of [five years] [time specified by the registering party].

"(3) A registration may be amended at any time during the period of its effectiveness. The amendment is effective from the time it becomes available to searchers."

113. While the Working Group found draft article 4 of the annex to be generally acceptable, a number of suggestions were made. One suggestion was that paragraphs (1) and (2) could be combined so that parties could specify the time during which the registration should remain effective, and, if they failed to do so, the registration would remain effective for five years. Another suggestion was that there should be no limit to the duration of the effectiveness of registration. That suggestion was objected to on the grounds that the benefit derived from purging the public record outweighed the risk that assignees may lose their priority rights which the assignees could protect by renewing their registrations. As to the exact time of the duration of registration, it was stated that it depended on the average life of a financing agreement. Yet another suggestion was that draft article 4 of the annex should provide that changes in the name of the assignor or in the title to the receivables should be registered.

114. After discussion, the Working Group approved the substance of draft article 4 of the annex and requested the Secretariat to revise it so as to address the suggestions made.

Article 5. *Right of the assignor to remove or amend data registered*

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

"(1) The assignor may demand in writing that the assignee register a notice removing or amending the data registered. [The assignor shall state explicitly the nature of the action requested and the grounds for its request].

"(2) If the assignee fails to comply with such demand within fifteen days of its receipt, the assignor may re-

quest a competent court to order that the data registered be removed or amended on the ground that they refer to receivables in which the assignee has no interest or has a different interest."

116. There was general agreement that a rule providing for automatic deregistration would not be appropriate. It was stated that the assignor could be protected from inaccurate registrations through other means, such as the registration of a notice warning parties that there was a dispute as to the registration and a rule providing for penalties against assignees for inaccurate registrations. In addition, it was stated that the registration did not necessarily affect the creditworthiness of the assignor, since it provided only notice of the possibility that a financing transaction had been concluded and did not require that the amount of the secured credit should be disclosed. On the other hand, it was pointed out that automatic deregistration would expose the assignee to the risk of losing its priority, if it did respond in a timely manner to an erroneous or mischievous demand by the assignor. That risk, it was said, would be even greater in case of a demand made on the eve of insolvency and could affect the cost of credit.

117. As to the court that should be given jurisdiction to issue an order to a registrar to discharge or amend a registration, various suggestions were made. One suggestion was that the courts of the country in which the assignor had its place of business should be given jurisdiction (see para. 101, above). Such an approach, it was stated, would be compatible with a system based on national registries, since registration would normally be effected at the place of business of the assignor. In addition, such an approach would be compatible with draft articles 23 and 24 providing that the law of the country in which the assignor had its place of business applied to questions of priority. Another suggestion was that disputes involving the issuance of orders to the registrar could be settled through arbitration. It was observed that such an approach would be preferable in particular in case an international registration system were to be established, since it would result in avoiding the issuance of possibly conflicting orders to the registrar by national courts. Another suggestion was that requests of assignors relating to the discharge or correction of registrations could be left to the registrar, at least at the first instance.

Article 6. *Registry searches*

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

"(1) Any person may search the records of the registry and obtain a search result in writing.

"(2) A search may be conducted according to the name of the assignor [or the registration number].

"[(3) A search result in writing that purports to be issued from the registry is admissible as evidence and is, in the absence of evidence to the contrary, proof of the data to which the search relates, including:

"(a) the date and time of registration; and

“(b) the order of registration as indicated in the registration number referred to in the written search result.]”

119. It was noted that paragraph (1) provided for a registry open to the public. The concern was expressed that allowing access to data about financing transactions to the public might prejudice the rights of assignors. In order to address that concern, it was suggested that access to the registry be limited to “any person having interest”. That suggestion was objected to on the grounds that normally the amount of the data available on public record was so limited that their disclosure could not negatively affect the interests of assignors. In addition, it was pointed out that the advantage of increased access to lower cost credit outweighed the perceived disadvantage of insufficient privacy for assignors. However, it was stated that States could be given the flexibility of limiting access to the data registered only to certain categories of parties. After discussion, the Working Group approved the substance of draft article 6 unchanged.

TITLE OF THE DRAFT CONVENTION

120. Differing views were expressed as to whether the notion of “financing” in the title should be retained or deleted. One view was that the notion of “financing” should be deleted. It was stated that a title without a reference to the notion of “financing” would be in line with the content of the draft Convention, since that notion was not used for defining the scope of the draft Convention in draft article 1 but only appeared in the title, the preamble and in draft articles 5(4) and 15(3). In addition, it was observed that, in view of the fact that the title might serve for interpretation purposes and that the draft Convention was to cover assignments made outside a financing context, use of the notion of “financing” in the title might be misleading.

121. The prevailing view, however, was that the notion of “financing” in the title should be retained. It was observed that such a title would accurately reflect the main objective of the draft Convention, as expressed in the preamble, to provide a uniform legal regime that would promote the availability of credit at more affordable rates. In addition, it was pointed out that such an approach would be consistent with the decision of the Working Group to focus on assignments made in a financing context without being precluded from covering a wider range of assignments as long as no attempt was made to cover all assignments (A/CN.9/432, paras. 18 and 66). In addition, it was said that adopting a title such as “draft Convention on assignment of receivables” might lead to the draft Convention being misinterpreted as covering the entire field of assignment, thus compromising the acceptability of the draft Convention in countries that did not intend to alter the law of assignments in general.

122. After discussion, the Working Group decided to retain the title of the draft Convention unchanged. It was agreed that the issue of consistency between the title, objectives and contents of the draft Convention might need to be reconsidered at the final stage of the preparation of the draft Convention.

PREAMBLE

123. The text of the preamble to the draft Convention as considered by the Working Group was as follows:

“The Contracting States,

“Considering that international trade cooperation on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

“Being of the opinion that the adoption of uniform rules governing assignments in receivables financing would facilitate the development of international trade and would promote the availability of credit at more affordable rates,

“Have agreed as follows:”

124. The Working Group found the substance of the preamble to be generally acceptable.

Chapter I. Scope of application

Article 1. *Scope of application*

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

“(1) This Convention applies to assignments of international receivables and to international assignments of receivables as defined in this chapter:

“(a) if, [at the time of the assignment,] the assignor and the assignee have their places of business in a Contracting State; or

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

“[(2) The provisions of articles 26 to 28 apply [to assignments of international receivables and to international assignments of receivables as defined in this chapter] independently of paragraph (1) of this article.]”

Paragraph (1)

Opening words

126. It was noted that the opening words of draft article 1 reflected the decision made by the Working Group at its previous two sessions that the substantive scope of the draft Convention should be broadly drafted to cover both assignments of international receivables and international assignments of domestic receivables, thus excluding only domestic assignments of domestic receivables ((A/CN.9/432, para. 24 and A/CN.9/434, para. 18).

127. As regards domestic receivables, the concern was expressed that their assignment raised different issues from the assignment of international receivables and, accordingly, if covered by the draft Convention at all, should be made subject to a different set of rules. Another concern was that applying two competing legal regimes to domestic receivables, depending upon the domestic or the international character of the assignment, would raise dif-

faculties (e.g. a conflict between a domestic and a foreign assignee of domestic receivables). Yet another concern was that covering domestic receivables might expose the debtor to the risks associated with the obligation to pay a foreign assignee.

128. The prevailing view, however, was that, in the absence of concrete examples showing the need to treat different types of assignment differently, the mere fact that assignments of international receivables were practised in the context of transactions (e.g. factoring) that were different from transactions involving international assignments of domestic receivables (e.g. securitization) was no reason to treat those two types of assignment differently. In addition, it was stated that the risk of a conflict between the two legal regimes was mostly theoretical, in particular after the decision of the Working Group to turn draft articles 23 and 24 into conflict-of-laws rules.

129. Moreover, it was pointed out that the concerns relating to the rights and obligations of the debtor could be addressed by an adequate debtor-protection system to be included in the draft Convention. Those concerns, it was added, could not justify the exclusion of the international assignment of domestic receivables from the scope of the draft Convention, in particular in view of the possibility that including such assignments in the scope of the draft Convention could provide debtors increased access to international financial markets, and thus to lower-cost credit.

130. After discussion, the Working Group confirmed its previous decision by retaining the opening words of paragraph (1) unchanged.

Subparagraph (a)

131. At the outset, it was suggested that the Working Group might consider restructuring subparagraph (a) to distinguish between the various relationships between parties to a typical assignment. While it was generally agreed that those various relationships should be borne in mind when discussing the scope of the draft Convention, it was widely felt that it would be impractical to attempt restructuring draft article 1 to cover separately the many possible relationships or conflict situations (assignor-assignee, assignee-debtor, assignee-assignee, assignee-assignor's creditors, assignee-insolvency administrator).

132. It was generally agreed that, for the draft Convention to apply, only the assignor needed to have its place of business in a Contracting State. It was stated that a requirement that the assignee be also located in a Contracting State would create uncertainty as to the application of the draft Convention, since a potential financier could not predict whether there would be competing assignees from non-Contracting States, the conflict of priority with whom would not be subject to the draft Convention. Such uncertainty as to the applicable law to conflicts of priority, it was said, could raise the cost or decrease the availability of credit, a result that would run contrary to the main objective of the draft Convention. In addition, requiring the assignee to be located in a Contracting State for the draft Convention to apply would produce inconsistent results. For example, a conflict of priority among several

assignees obtaining the same receivables from the same assignor, or the assignment to a syndicate of assignees, would be subject to a different legal regime, depending on the country in which the assignees would be located. Moreover, it was widely felt that deleting the reference to the place of business of the assignee from subparagraph (a) would appropriately broaden the scope of the draft Convention.

133. The discussion next focused on whether, in addition to the assignor, the debtor should have its place of business in a Contracting State for the draft Convention to apply. Differing views were expressed. One view was that the debtor should also be located in a Contracting State. It was stated that such an approach would allow the debtor to know whether the draft Convention applied and to avoid situations in which the debtor's rights and obligations would be made subject to a different legal regime, simply because the assignor chose to make an international assignment.

134. The prevailing view, however, was that the debtor did not need to be located in a Contracting State for the draft Convention to apply, with the exception of those provisions that dealt with the rights and obligations of the debtor (e.g. draft articles 13, 14 and 18-22). It was stated that such an approach could enhance predictability as to the application of the draft Convention with regard to the debtor, without unduly limiting the application of the draft Convention as a whole. In addition, it was pointed out that such an approach would be consistent with normal practice, since, even if the draft Convention were to apply in case the debtor were not in a Contracting State, it could not change those debtor-protection provisions of the applicable law that were of a mandatory nature (e.g. the rules on notification of the debtor). Moreover, it was observed that such an approach would be beneficial to the assignor and the assignee to the extent that they could predict whether, having met the requirements of the draft Convention, they could enforce their claim against the debtor.

135. It was generally agreed that the reference to the time at which the assignor needed to be located in a Contracting State, which appeared within square brackets in subparagraph (a), enhanced certainty in the application of the draft Convention and should be retained.

136. After discussion, the Working Group decided that only the assignor needed to have its place of business in a Contracting State for the draft Convention to apply. At the same time, it was decided that for the application of those provisions that dealt with the rights and obligations of the debtor, the debtor too needed to have its place of business in a Contracting State. As to which those exceptional provisions would be, the Working Group decided to defer its decision until it had completed its discussion of the draft Convention as a whole.

Subparagraph (b)

137. Differing views were expressed as to whether subparagraph (b) should be retained or deleted. One view was that subparagraph (b) should be retained. It was stated that provisions along the lines of subparagraph (b) existed

in other international conventions prepared by UNCITRAL (e.g. article 1(1)(b) of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as “the United Nations Sales Convention”)^e, and article 1(1)(b) of the Guarantee and Standby Convention) and that reference to the rules of private international law was generally regarded as a useful extension of the scope of application of those conventions. In addition, it was observed that the uncertainty that might stem from disparities among applicable private international law rules would not be avoided by limiting the applicability of the draft Convention, since the rules of private international law also applied outside the scope of the draft Convention. For example, if private international law rules led to the application of the law of a Contracting State and subparagraph (b) were to be deleted, the law applicable would have to be the law governing domestic assignments, which might also be regarded as a factor of uncertainty.

138. A related view was that the present broad reference to the rules of private international law contained in subparagraph (b) could be replaced by a more specific indication of the private international law rules envisaged (e.g. the draft Convention should apply if the contract of assignment was governed by the law of a Contracting State, or if both the original contract and the contract of assignment were governed by the law of a Contracting State; see article 2(1)(b) of the Ottawa Convention).

139. The prevailing view, however, was that subparagraph (b) should be deleted. It was stated that the level of uncertainty resulting from the reference to the rules of private international law was unacceptable in view of the fact that the draft Convention was intended to apply not only to the contractual aspects of the assignment but also to the transfer of proprietary rights in the context of a complex, multi-party transaction, which was found to justify departing from provisions adopted in previous conventions. In addition, it was observed that the scope of the draft Convention as defined under subparagraph (a) was so broad that no further extension by reference to any rule of private international law was needed. After discussion, the Working Group decided to delete subparagraph (b).

Paragraph (2)

140. The Working Group recalled its decision to consider the purpose or the scope of chapter VI (draft articles 26-28) after it had completed its discussion of the scope of application of the draft Convention (see para. 55, above) and, in that context, considered the question whether paragraph (2) should be retained or deleted.

141. It was pointed out that one possible function of chapter VI was to introduce a degree of certainty as to the application of the draft Convention under draft article 1(1)(b), by providing a set of uniform private international law rules that could trigger the application of the draft

Convention. In view of the decision by the Working Group to delete draft article 1(1)(b), it was agreed that chapter VI could no longer fulfil that function.

142. Another function, it was said, that chapter VI could fulfil was to provide an additional layer of harmonization of law in the field of assignment by supplying the rules to be followed by courts of Contracting States in identifying in any given case the law applicable to an assignment. Should the Working Group decide to follow such an approach, paragraph (2) would be useful in extending the scope of application of chapter VI to cover assignments, irrespective of whether they were connected to a Contracting State or not. In such a case, chapter VI would apply whether or not in a particular case it turned out that the draft Convention was the applicable substantive law for the assignment in question. It was noted that paragraph (2) was inspired from the approach taken in article 1(3) of the Guarantee and Standby Convention.

143. In that connection, the view was expressed that if chapter VI were to constitute what was referred to as a “mini convention” on private international law, as distinct from the main substantive provisions of the draft Convention, the “mini convention” should be made optional for parties to the main provisions, and should also be somewhat expanded to deal in more detail with issues of private international law. Such an approach would overcome the difficulties arising from possible conflicts with other international conventions dealing with the law applicable to assignments. In addition, it would allow States that might be parties to such other conventions to adopt the draft Convention without the optional chapter VI.

144. Should the Working Group decide not to attempt harmonizing conflict-of-laws rules along those lines, it was observed, paragraph (2) would no longer be needed. In such a case, the only remaining function of chapter VI would be to provide for a gap-filling mechanism for matters not expressly settled in the draft Convention (draft article 8(2)).

145. In view of the decision made by the Working Group with respect to draft article 23 (see para. 27, above), the Working Group was generally agreed that further consultations would be required in order to determine the purpose of chapter VI, and decided to retain paragraph (2) within square brackets, for consideration at a future session.

Article 2. Assignment of receivables

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

“(1) For the purposes of this Convention, ‘assignment’ means the transfer by agreement from one party (‘assignor’) to another party (‘assignee’) of its right to payment of a monetary sum (‘receivable’) owed by another party (‘debtor’) in return for value, credit or related services given or promised by the assignee to the assignor.

“(2) ‘Assignment’ includes the transfer of receivables by way of security for indebtedness or other obligation,

^eOfficial 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.

or by any other way, including subrogation by agreement, novation or pledge of receivables.”

Paragraph (1)

147. While general support was expressed in favour of the substance of paragraph (1), a number of suggestions of a drafting nature were made. One suggestion was that the words “to the assignor” at the end of paragraph (1) should either be deleted or be supplemented by the words “or to another person” in order to avoid excluding from the scope of the draft Convention assignments in which value, credit or related services were given or promised not to the assignor but to another person affiliated with the assignor or to whom the assignor owed a debt. Another suggestion was that the words “at any time” should be included after the word “promised” in order to ensure that assignments for value, credit or services received not at the time of assignment but at an earlier time would be covered by the draft Convention (e.g. workouts of debts).

148. Yet another suggestion was that the words “in return for value, credit or related services given or promised by the assignee to the assignor” should be deleted, since they related to the financing transaction and not to the assignment proper. That suggestion was objected to on the grounds that giving or promising value, credit or related services was part of the assignment and not only of the financing contract. In addition, it was stated that those words should be retained as they usefully clarified that an assignment made not for financing purposes but for the purpose of providing financing-related services would be covered by the draft Convention.

149. In response to a question, it was observed that an assignment aimed solely at relieving the assignor from recourse in case of debtor-default would be covered, under the present formulation of paragraph (1), as an assignment made “for value”. In response to another question, it was stated that the current formulation of paragraph (1) clarified sufficiently that both the contract of assignment and the resulting transfer of receivables were covered by the definition of “assignment”.

150. After discussion, the Working Group approved the substance of paragraph (1) and requested the Secretariat to revise it in order to reflect the suggestion referred to in para. 147.

Paragraph (2)

151. While the Working Group found paragraph (2) to be acceptable, it decided that the indicative list of types of transfers contained therein should be deleted. It was stated that the list was unnecessary, since paragraph (2) clarified that all types of transfers of receivables were covered. In addition, it was observed that the list might inadvertently result in excluding some types of assignment from the scope of the draft Convention, since it was not exhaustive. Moreover, it was pointed out that novation did not involve the transfer but rather the extinction of a receivable and the creation of a new receivable.

152. It was observed that the words “the transfer of receivables by way of security” might inadvertently result in excluding assignments involving not the transfer of title for security purposes but the mere creation of a security interest. In order to ensure that such security assignments would be covered by the draft Convention, it was suggested that reference should be made to the transfer as well as to the creation of a security right in receivables.

153. Subject to that change and to the deletion of the indicative list of types of transfers of receivables, the Working Group approved the substance of paragraph (2).

Article 3. Internationality

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

“(1) A receivable is international if, at the time it arises, the places of business of the assignor and the debtor are in different States. An assignment is international if, at the time it is made, the places of business of the assignor and the assignee are in different States.

“(2) For the purposes of this Convention:

“(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the relevant contract [or other agreement or court order giving rise to the assigned receivable];

“(b) if a party does not have a place of business, reference is to be made to its [registered office or] habitual residence.”

Paragraph (1)

155. The Working Group first focused on the question of the time at which the internationality of a receivable should be determined. In order to avoid covering a receivable which at the time it arose was international but at the time of the conclusion of the contract of assignment had become domestic, the suggestion was made that the internationality of a receivable should be determined at the time of the conclusion of the contract of assignment and not at the time the receivable arose. That suggestion was objected to on the grounds that such an approach would result in changing the facts on the basis of which the creditor (assignor) determined whether to extend credit to the debtor and, if so, on what terms. It was explained that normally creditors would make such decisions at the time a receivable arose (which, under draft article 5(2), was the time of the conclusion of the original contract) and affecting such decisions through a rule such as the one suggested would increase uncertainty and, accordingly, the cost of credit.

156. The Working Group next turned to the question whether a receivable owed by several debtors or to several assignors would be international, even if only one debtor or only one assignor was located in a country other than the country in which the other party to the transaction was located, and to the question whether an assignment in which several assignors or several assignees were involved would be international, even if only one assignor and one assignee were located in different countries.

157. It was agreed that in the case of a multiplicity of assignors or assignees, it would be acceptable to consider an assignment or a receivable international even if only one assignor or one assignee was located in a country other than the country in which the other party to the transaction was located. Such an approach would allow assignors and assignees to plan in order to structure their assignment so that it would fall under the scope of the draft Convention or not. A note of caution was struck that such an approach might open ways for manipulations in financing transactions (e.g. in a syndicate of banks, the leading bank could include in the transaction a foreign bank and thus bring the transaction under the scope of the draft Convention). The suggestion was also made that the internationality of an assignment could be determined on the basis of the content of a transaction, e.g. on whether the majority of the receivables assigned would be international.

158. With regard to cases involving a multiplicity of debtors, the view was expressed that covering bulk assignments involving both domestic and international receivables would not raise problems in the context of priority issues, since, under draft articles 23 and 24, the law of the assignor's place of business would address all priority conflicts. In addition, it was stated that, unless the draft Convention applied even if one debtor was located in a country other than the assignor's country, it would be difficult to find an acceptable criterion to limit the application of the draft Convention. However, it was pointed out that such an approach might inadvertently result in debtors being unable to predict whether the draft Convention would apply and possibly affect their rights and obligations. That result, it was said, could be mitigated by providing that the draft Convention would not apply to a debtor, unless that debtor was located in a Contracting State and by including in the draft Convention an adequate debtor-protection system.

159. A related question was whether, in case of a multiplicity of assignors, all of them needed to be in a Contracting State for the draft Convention to apply. It was stated that, for the draft Convention to apply, it should be sufficient if even only one assignor was located in a Contracting State. Otherwise, it was observed, joint assignors could avoid the application of the draft Convention by including in the transaction an assignor located in a non-Contracting State. It was pointed out that the same question would be raised as regards the application of those provisions of the draft Convention that dealt with the rights and obligations of the debtor, in case of a multiplicity of debtors. The Working Group noted the problem but, for lack of sufficient time, referred its resolution to a future session.

160. In response to a question, it was observed that in case of a chain of subsequent assignments under the rule contained in paragraph (1), an assignment of a domestic receivable assigned from country A to country B would be covered as an international assignment of a domestic receivable (assignor and debtor in country A, assignee in country B), a further assignment in country B would also be covered as a domestic assignment of an international receivable (debtor in country A, subsequent assignor and assignee in country B), yet a further assignment

from country B to country A would be covered as an international assignment of an international receivable (assignor in country B, assignee and debtor in country A), but a further assignment in country A would not be covered since it would be a domestic assignment of a domestic receivable (assignor, assignee and debtor in country A).

161. In view of the example mentioned above, a number of suggestions were made with regard to draft article 25 dealing with subsequent assignments. One suggestion was that, in order to ensure that the second assignment mentioned above would be covered, draft article 25 should be revised so as to provide that not only the subsequent assignee should be treated as the initial assignee but also that the subsequent assignor should be treated as the initial assignor. Another suggestion was that, in order to cover the last assignment mentioned above, draft article 25 should include a provision along the lines of article 11(1) of the Ottawa Convention. It was noted that according to that provision, once the initial assignment of a receivable was covered, any subsequent assignment of that receivable would also be covered (the principle of *perpetuatio juris*).

162. However, it was stated that, while the principle "once international, always international" was appropriately included in the Ottawa Convention, which covered only international receivables, it might lead to undesirable results in the context of the draft Convention, if applied to international assignments of domestic receivables as well. It was observed, for example, that, if such a rule were to apply in case the initial assignment was an international assignment of a domestic receivable, parties could assign a domestic receivable internationally in order to bring it within the scope of the draft Convention. In addition, it was said that the last assignee who had obtained a domestic receivable through a domestic assignment would have to examine all the previous assignments in order to determine which law governed the last assignment. In order to address that concern, the suggestion was made that, if the principle of *perpetuatio juris* were adopted in draft article 25, its application should be limited to cases in which the internationality of the assignment was apparent. Otherwise, it was pointed out that, under such a principle, the debtor receiving a notification from the last assignee would have no way of knowing that the draft Convention applied to its rights and obligations.

163. After discussion, the Working Group approved the substance of paragraph (1) and requested the Secretariat to revise it in order to reflect the views expressed and the suggestions made.

Paragraph (2)

164. It was generally agreed that paragraph (2) should provide a clear definition of the term "place of business" or even replace that term with another term. It was stated that, in view of draft articles 1(a), 23 and 24, clarity as to the place of business of the assignor was crucial for the application of the draft Convention and for the determination of the law applicable to questions of priority. Similarly, it was said that clarity as to the place of business of

the debtor was essential for the application of the draft Convention to the rights and obligations of the debtor. It was explained that uncertainty as to the place of business of the assignor or the debtor would run contrary to the main objective of the draft Convention, since it could increase the cost of credit.

165. In view of the fact that the assignment affected the rights of third parties, it was pointed out that the matter should be addressed not along the lines of texts dealing with contractual obligations (e.g. draft article 3(2), which was based on article 10 of the United Nations Sales Convention but rather along the lines of texts dealing with relationships affecting the rights of third parties (e.g. article 2(b) and (f) and article 16(3) of the UNCITRAL Model Law on Cross-Border Insolvency, hereinafter referred to as “the UNCITRAL Model Insolvency Law”)^f.

166. As to the elements of such a definition of “place of business” or other similar term, a number of suggestions were made. One suggestion was that the place of business should be defined by reference to the centre of main interests, to an establishment and to the registered office of the parties. Another suggestion was that reference should be made to the place in which a transaction was concluded, or the head office of the relevant parties. Another suggestion was that the definition should cover the place in which invoices were issued and the place to which invoices were addressed. Yet another suggestion was that it should be left to the parties to the assignment to specify their places of business. If such an approach were followed, it was observed, a default rule would be needed to cover the situation in which the parties failed to specify the place of business of the assignor. In addition, it was said, a connecting factor for the determination of the place of business of the debtor would need to be specified. A related suggestion was that different connecting factors could be used, depending on the purpose for which the place of business of the parties needed to be specified. A note of caution was struck, however, that leaving the determination of the place of business to the parties might lead to uncertainty in case of a chain of subsequent assignments, if the parties to the various assignments specified different places of business.

167. After discussion, the Working Group requested the Secretariat to prepare a definition of the “place of business” or other similar term, presenting alternatives in order to reflect the suggestions made.

Article 4. *Exclusions*

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

“This Convention does not apply to assignments made:

“(a) for personal, family or household purposes;

“(b) solely by endorsement or delivery of a negotiable instrument;

“(c) as part of the sale, or change in the ownership or the legal status, of a business out of which the assigned receivables arose.”

169. General support was expressed in the discussion for draft article 4. The Working Group engaged in a discussion as to whether additional types of receivables should be included in or excluded from the scope of the draft Convention.

170. The Working Group first focused on the question of covering tort receivables. It was noted that, in order to reflect a tentative decision made by the Working Group at its previous session to cover tort receivables (A/CN.9/434, paras. 74 and 81), the text of the draft Convention referred in several places to “the agreement or the court order” confirming a tort receivable. It was noted that that limitation of the tort receivables to be covered in the draft Convention was due to the fact that, in the absence of such a confirmation, a tort receivable arising from an illegal act was of no value for financing purposes.

171. In favour of addressing in the draft Convention the assignment of tort receivables, it was stated that there was a significant practice to assign tort receivables to insurers that was worth covering in the draft Convention. In addition, it was observed that if the draft Convention were to exclude tort receivables, it would need to draw a distinction between tort and contractual receivables, a task which, in view of the diverging meanings given to those terms in the various legal systems, might not be easy to achieve.

172. On the other hand, a number of concerns were expressed with regard to covering tort receivables. One concern was that a contractual priority rule based on registration might not be appropriate in resolving the problem of competing rights in tort receivables. It was stated that insurers having paid a claim and looking for reimbursement through their insured’s tort receivable may be prejudiced, if other financiers could obtain priority by way of registration. In addition, it was observed that a provision giving priority to the first assignee to register, if applied to tort receivables, might impair settlement in which all parties involved in a tort were supposed to participate (this would be particularly so if the registration would operate to establish a priority right even with regard to a future tort receivable). However, it was pointed out that that concern was sufficiently addressed through draft articles 23 and 24, after the Working Group’s decision to turn them into conflict-of-laws provisions (see paras. 27 and 31, above).

173. Another concern was that the draft Convention might run counter to national law, under which tort receivables might not be assignable. That concern, it was said, was also addressed by the fact that draft article 13 did not override statutory prohibitions of assignment. Yet another concern was that the volume of transactions involving financing on the basis of tort receivables may be so small that it may not be worth covering. It was recognized, however, that that matter could not be resolved without consultation with representatives of the insurance industry, as well as other relevant industries.

^fOfficial Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17), annex I.

174. Yet another concern was that the assignment of tort receivables raised a number of complex issues that would need to be addressed by special rules. A number of examples were mentioned, including: the time when a tort receivable arose; the impact of such a rule on national law relating to time limitation for bringing claims; the way in which terms for the payment of a tort claim would be specified; the time of transfer of a future tort receivable; the way in which it could be provided that in tort receivables the assignor could not undertake any representation as to the absence of defences on the part of the debtor; and the way in which a tort receivable could be modified. While it was recognized that some of those issues were already addressed in the text of the draft Convention (e.g. draft article 5(2) dealing with the time at which a receivable might be deemed to arise, draft article 12(b) dealing with the time of transfer of future receivables and draft article 16(1)(c) limiting the representations of the assignor as to the absence of any defences on the part of the debtor to the assignment of contractual receivables), it was observed that other issues still remained to be addressed (e.g. the modification of a tort receivable).

175. After discussion, the Working Group confirmed its tentative decision that tort receivables should be covered and requested the Secretariat to reflect that decision by listing tort receivables in the scope provisions, possibly in draft article 2(2), and to prepare any additional provisions that might be necessary to address issues arising in an assignment of tort receivables.

176. The Working Group next turned to the question whether the assignment of receivables arising from deposit accounts should be covered. It was explained that such receivables involved single, large- or small-amount, claims of depositors against the depository institution. Diverging views were expressed. One view was that such receivables should be excluded from the scope of the draft Convention. It was stated that the banking industry was already sufficiently regulated and might not need an additional set of rules. It was observed that, for the same reason, the assignment of receivables arising from investment securities, letters of credit and the entire cheque-collection system might need to be excluded as well. In addition, it was pointed out that some of the rules of the draft Convention might not be appropriate for deposit accounts. A number of examples were mentioned, including: recognizing the assignability of receivables arising from deposit accounts; requiring a bank to pay an assignee; and resolving priority questions between a bank with a right of set-off and an assignee or a bank and a cheque-holder on the basis of registration.

177. Another view was that there was no reason to exclude the assignment of receivables arising from deposit accounts. It was stated that such assignments were normal practice (e.g. when an account holder signed a cheque, under the law in some countries, it assigned a claim against the depository institution). In addition, it was pointed out that in the absence of a universal understanding of deposit accounts, it might be difficult to define them in order to exclude them from the scope of the draft Convention. Moreover, it was said that the concerns mentioned

above might already be sufficiently addressed in draft article 18 (under which, in the absence of adequate information as to the assignment, a bank did not need to pay an assignee of receivables arising from a deposit account) and draft articles 23 and 24 (under which conflicts of priority were referred to the law of the country in which the assignor, i.e. the account holder, had its place of business). A note of caution was struck, however, that if the assignment of receivables arising from deposit accounts were to be covered, the provisions of the draft Convention dealing with assignability and form of the assignment might need to be reconsidered.

178. After discussion, the Working Group requested the Secretariat to include at the appropriate place in the text of the draft Convention a list of receivables, the assignment of which could be included in the scope of the draft Convention, subject to further consultations with representatives of the relevant practices. It was suggested that the list should include, in addition to receivables arising from deposit accounts, receivables arising from investment securities, repurchase agreements, wire transfers, swaps and cheque-collection systems.

179. At the close of the discussion of draft article 4, the Working Group noted that the draft Convention on International Interests in Mobile Equipment being prepared by UNIDROIT was intended to address the assignment of receivables arising from the lease of aircraft, a matter that was intended to be covered by the draft Convention. It was observed that, in order to avoid such conflicts, close cooperation was called for between the Commission and UNIDROIT. It was suggested that such cooperation could take the form of representation at each other organization's meetings, exchange of documents and direct consultations between States represented in the Commission and experts participating in the work of UNIDROIT. It was agreed that the matter could be discussed in detail at the next session of the Working Group (New York, 2-13 March 1998), during which a more advanced draft of the draft Convention on International Interests in Mobile Equipment would be available.

Chapter II. General provisions

Article 5. *Definitions and rules of interpretation*

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

“For the purposes of this Convention:

“(1) ‘Original contract’ means the contract between the assignor and the debtor from which the assigned receivable arises.

“(2) A receivable is deemed to arise at the time when the original contract is concluded [or, in the absence of an original contract, at the time when it is confirmed in an agreement between the creditor and the debtor or in a court order].

“(3) ‘Future receivable’ means a receivable that might arise after the conclusion of the assignment.

“(4) ‘Receivables financing’ means any transaction in which value, credit or related services are provided for value in the form of receivables. ‘Receivables financing’ includes, but is not limited to, factoring, forfaiting, securitization, project financing and refinancing.]

“(5) ‘Writing’ means any form of communication that [preserves a complete record of the information contained therein] [is accessible so as to be usable for subsequent reference] and provides authentication of its source by generally accepted means or by a procedure agreed upon by the sender and the addressee of the communication.

“(6) ‘Notification of the assignment’ means a statement informing the debtor that an assignment has taken place.

“(7) ‘Insolvency administrator’ means a person or body, including one appointed on an interim basis, authorized to administer the reorganization or liquidation of the assignor’s assets.

“(8) ‘Priority’ means the right of a party to receive payment in preference to another party.

“(9) Priority with regard to the receivables includes priority with regard to cash received upon collection or other disposition of the receivables, provided that the cash may be identified as proceeds of the receivables.”

Paragraph (1)

181. As a matter of drafting, it was suggested that the term “original contract” should be replaced by a more appropriate term that would refer to the “contract generating the receivables”. It was observed that the use of the term “original contract” might introduce uncertainty, since, in some relationships (e.g. deposit account relationship), it might not be easy to determine the contract from which the receivables arose. However, the prevailing view was that the term “original contract” was acceptable as long as it was defined. After discussion, the Working Group retained paragraph (1) unchanged.

Paragraph (2)

182. One suggestion was that paragraph (2) should be deleted, since it might not be appropriate to set the time when a receivable arose for all contracts. It was observed that the time when a receivable arose might differ depending on the type of the contract involved. However, it was generally agreed that the draft Convention could enhance certainty by including a uniform rule on the time when a receivable was deemed to arise, which was essential for the application of the draft Convention, the effect of a bulk assignment and the time of the transfer of a future receivable (draft articles 3(1), 11 and 12). Another suggestion was that, in order to avoid the misinterpretation that the word “concluded” required that the contract had to be performed, that word should be replaced by the words “is entered into, whether or not it has been earned by performance”. In response, it was explained that the term “concluded” referred to the conclusion of the contract and not to its performance. After discussion, the Working Group retained paragraph (2) unchanged. As to the language that

appeared in paragraph (2) within square brackets, it was agreed that it should be retained within square brackets pending a final decision of the Working Group on the question whether tort receivables should be covered in the draft Convention or not.

Paragraph (3)

183. The Working Group approved the substance of paragraph (3) unchanged.

Paragraph (4)

184. The Working Group considered the question whether paragraph (4) should be retained or deleted. One view was that paragraph (4) should be retained. It was stated that paragraph (4) was consistent with the objectives of the draft Convention as set forth in the preamble. In addition, it was observed that paragraph (4) could prove useful in those legal systems that did not already have a legislative definition of receivables financing. Another view was that paragraph (4) should be deleted. It was pointed out that, in its present formulation, paragraph (4) was inconsistent with the scope of the draft Convention which covered practices beyond those described in paragraph (4) (e.g. the assignment of tort receivables). It was said that, if paragraph (4) were to be retained, it would need to be revised, in order to avoid such inconsistencies, or be placed in the preamble to further clarify the objectives of the draft Convention. After discussion, the Working Group decided to retain paragraph (4) within square brackets.

Paragraph (5)

185. The Working Group noted that the purpose of the definition contained in draft paragraph (5) was to allow for the use of other than paper-based means of communication. The definition clarified that, where the draft Convention required a communication to be given, or an act to be performed in writing, that requirement would be satisfied whenever the parties used any means that met the requirements of draft paragraph (5). As for the two options in brackets, it was noted that the second option had been drawn from article 6 of the Model Law on Electronic Commerce of the United Nations Commission on International Trade Law⁸, hereinafter referred to as “the UNCITRAL Electronic Commerce Law.

186. While there was general support for the inclusion of a provision along the lines of draft paragraph (5), it was stated that the provision might require further elaboration, particularly as regards the notion of “authentication”. It was suggested that that result could be achieved if the notion of “authentication” were to be replaced by a reference to signature as specified in article 7 of the UNCITRAL Electronic Commerce Law. Subject to that change, the Working Group approved the substance of paragraph (5).

⁸Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

Paragraph (6)

187. As a matter of drafting, it was suggested that the word “statement” should be replaced by the word “writing”, in order to align paragraph (6) with draft article 17(3). In response, it was observed that, in line with a decision made by the Working Group at its previous session (A/CN.9/434, para. 167), the legal regime of notifications was appropriately split between a short definition in paragraph (6) and the more detailed rules stated in draft article 17(3). After discussion, the Working Group retained paragraph (6) unchanged and requested the Secretariat to consider including in paragraph (6) a cross-reference to draft article 17(3).

Paragraph (7)

188. It was observed that paragraph (7) used language consistent with the UNCITRAL Model Insolvency Law and the European Union Convention on Insolvency Proceedings. Pending final determination of the matter of the rights of an assignee as against an insolvency administrator under draft article 24, the Working Group deferred its decision on paragraph (7) to a future session.

Paragraph (8)

189. The concern was expressed that, while the language contained in paragraph (8) might be adequate in respect of assignments by way of security, it might be somewhat restrictive when applied to outright assignments. In order to address that concern, it was suggested that the words “to receive payment” should be deleted. In support of that suggestion, it was pointed out that in the field of factoring, for instance, recovery under assigned receivables was not limited to collection of cash proceeds, but extended to recovery of goods. In order to cover such proceeds, it was further suggested that the definition of “receivable” contained in draft article 2 should be revised along the lines of article 7 of the Ottawa Convention, or priority in respect of recovery of goods should be expressly included in paragraph (9). Subject to the deletion of the words “to receive payment”, the Working Group approved paragraph (8).

Paragraph (9)

190. The concern was expressed that paragraph (9) might be too restrictive in referring only to cash proceeds. Another concern was that paragraph (9) might be read as conferring priority in proceeds independently of priority in the receivables. Yet another concern was that paragraph (9) was not properly placed in a provision dealing with definitions. In order to address those concerns, it was generally agreed that paragraph (9) should provide a definition of “proceeds”, while the issue of the transfer of rights in proceeds could be dealt with in draft article 11 and the issue of priority in proceeds could be dealt with in draft articles 23 and 24. The Working Group deferred its decision on the contents of such a definition until it had completed its discussion of draft article 11 (see paras. 215-220, below).

Article 6. Party autonomy

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

“(1) As between the assignor and the assignee, articles [...] may be excluded or varied by agreement.

“(2) As between the assignor and the debtor, articles [...] may be excluded or varied by agreement.

“[(3) Nothing in this Convention invalidates an assignment which is valid under rules other than the provisions of this Convention].”

Paragraphs (1) and (2)

192. There was general support for the principle embodied in paragraphs (1) and (2) that party autonomy should not interfere with the certainty required with regard to the rights of third parties.

193. In response to a question, it was observed that, under paragraphs (1) and (2), a choice of the law of a non-Contracting State would result in excluding only those provisions of the draft Convention that dealt with the rights and obligations of the relevant parties agreeing on such an exclusion, and not the provisions dealing with the rights of third parties. In response to another question, it was pointed out that the effect of an agreement between the assignor and the debtor was not limited to receivables assigned after the assignee was notified of such an agreement (article 3(1)(b) of the Ottawa Convention), on the understanding that such agreement could not exclude the application of provisions dealing with the rights of the assignee.

Paragraph (3)

194. It was noted that the purpose of paragraph (3) was to ensure that the draft Convention would not result in invalidating assignment-related practices falling under national law. It was observed, however, that while there was general support in the Working Group for that principle, paragraph (3) might be inconsistent with draft article 10, if that article were to require written form for the assignment to be effective. After discussion, the Working Group retained paragraph (3) unchanged, subject to further consideration of the matter of consistency with draft article 10.

Article 7. Debtor's protection

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

“(1) Except as otherwise provided in this Convention, an assignment does not have any effect on the rights and obligations of the debtor.

“(2) Nothing in this Convention affects the debtor's right to pay in the currency and in the country specified in the payment terms contained in the original contract [or in any other agreement or court order giving rise to the assigned receivable].”

196. In view of the fact that the draft Convention might affect the rights and obligations of the debtor, it was suggested that the law applicable to those rights and obligations should be specified. That suggestion was objected to on the grounds that that concern would be met by the requirement that, for the provisions dealing with the debtor's rights and obligations to apply, the debtor had to be in a Contracting State. It was stated that a Contracting State, before adopting the draft Convention, would need to determine whether the draft Convention contained an adequate debtor-protection system and one that would be compatible with fundamental policy considerations in that State. In addition, it was stated that the matter could be discussed in the context of specific provisions that might affect the rights and obligations of the debtor (e.g. draft articles 13, 18, 19(3), 20(2), 21 and 22). Moreover, it was pointed out that draft article 27 already dealt with the question of the law applicable to the rights and obligations of the debtor.

197. After discussion, the Working Group retained paragraph (1) unchanged. As to the question of the specific provisions of the draft Convention that might affect the rights and obligations of the debtor, the Working Group referred its resolution to the discussion of the individual articles of the draft Convention.

Paragraph (2)

198. The Working Group approved the substance of paragraph (2) unchanged. As to the language that appeared within square brackets, it was decided that it should be retained in square brackets pending a final decision by the Working Group on the question whether tort receivables should be covered in the draft Convention or not.

Article 8. Principles of interpretation

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

“(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.”

200. The Working Group approved the substance of draft article 8 unchanged.

Article 9. International obligations of the Contracting State

201. The text of draft article 9 as considered by the Working Group was as follows:

“Variant A

“(1) [Subject to paragraph (2) of this article,] this Convention does not prevail over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention.

“(2) If an international convention [or other international or bilateral agreement] contains a provision similar to that contained in paragraph (1) of this article, this Convention prevails.”

“Variant B

This Convention prevails over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention, unless a Contracting State makes a declaration under article 29.”

202. Diverging views were expressed as to which variant was preferable. One view was that variant A should be preferred. It was stated that an approach along the lines of variant A would be consistent with the approach followed in a number of UNCITRAL texts (e.g. article 90 of the United Nations Sales Convention). In addition, it was observed that such an approach would result in avoiding conflicts with other conventions (e.g. the Ottawa Convention). However, it was pointed out that variant A did not allow the flexibility necessary for States to be able to benefit from improvements achieved in the context of future conventions. In addition, it was said that paragraph (2) could create conflicts with other conventions that might include a similar provision.

203. The prevailing view was that variant B was preferable, since it provided States with a right to decide which international convention should prevail. It was observed that States should have that right at any time and not only at the time when they adopted the draft Convention (see draft article 29). However, it was suggested that an exception should be made for the Ottawa Convention, in order to avoid placing on assignees the burden of having to determine not only whether a State had adopted the draft Convention or the Ottawa Convention, but also whether that State had made a declaration along the lines of draft article 29. In response, it was said that further consultations might be necessary in order to determine the potential for conflict with the Ottawa Convention. After discussion, the Working Group decided to retain variant B, possibly combining it with draft article 29 of the final clauses and to revisit the matter at a future session.

Chapter III. Form and effect of assignment

Article 10. Form of assignment

204. The text of draft article 10 as considered by the Working Group was as follows:

“(1) An assignment [in a form other than in writing is not effective, unless it is effected pursuant to a contract

between the assignor and the assignee which is in writing] [shall be evidenced by writing].

“(2) [Unless otherwise agreed,] an assignment of one or more future receivables is effective without a new writing being required for each receivable when it arises.”

Paragraph (1)

205. It was noted that paragraph (1) currently contained two options within square brackets: under the first option, an assignment would be invalid if it was not effected in writing; under the second option, the instrument of assignment itself did not need to be in writing, as long as the existence of the assignment could be evidenced by a writing, such as a list of receivables with the signature of the assignor or the financing contract document.

206. The Working Group considered at length the need for and the implications of the requirement of writing. As was the case at its twenty-sixth session (A/CN.9/434, para. 104), the prevailing view in the Working Group was in favour of requiring written form for the assignment to be effective. As regards the two options offered in paragraph (1), although some support was expressed in favour of requiring a writing for evidentiary purposes, there was general preference for the written form being a condition of the effectiveness of the assignment.

207. However, the concern was expressed that such an approach would run counter to the current practice in many legal systems and would inadvertently result in invalidating informal financing practices, such as those involving a prolonged retention of title. It was stated that the assignor and the assignee could protect their own interests and did not need a writing to warn them of the implications of the assignment. In addition, it was observed that, although written form could serve evidentiary purposes, it should not constitute the only permitted means of evidence. In order to address that concern, it was suggested that, at least, it should be provided that not all essential elements of the transaction had to be in writing; it would be sufficient if only the general terms and conditions of the contract were in writing; and that the notion of “writing” would not include the element of a signature. It was pointed out that, in practice, an assignment was often not effected by means of a written instrument, but resulted from an exchange of communications between the assignor and the assignee which might be followed by a writing or not.

208. With a view to addressing those concerns, the Working Group was invited to consider an alternative formulation to paragraph (1) along the following lines:

“Variant A

“(1) Subject to paragraph (2), an assignment is not effective, unless it is evidenced by a writing signed by the assignor which describes the receivables to which it relates.

“(2) An assignment which is not in compliance with paragraph (1) is effective if it complies with the rules concerning form of the assignment of the country of the assignor’s place of business.”

“Variant B

“The form of the assignment and the effect of any non-compliance with such form is governed by the law of the country of the assignor’s place of business.”

209. It was observed that the proposed variant A combined elements of a substantive rule on the form requirements with a conflict-of-laws rule as a fall-back solution, while variant B set forth a pure conflict-of-laws provision. After discussion, the Working Group requested the Secretariat to revise paragraph (1) of draft article 10 so as to reflect the generally preferred approach along the lines of the first set of bracketed language contained in paragraph (1), as well as the above-mentioned variants A and B. It was generally felt that, before resorting to a conflict-of-laws approach, the Working Group should try to find a generally acceptable substantive law solution to the problem.

Paragraph (2)

210. The Working Group noted that the purpose of paragraph (2) was to provide that, once there was a master agreement in writing, no further writing was needed for the assignment of future receivables to become effective. Subject to the elimination of the square brackets around the opening words, the Working Group approved the substance of paragraph (2).

Article 11. *Effect of assignment*

211. The text of the draft article 11 as considered by the Working Group was as follows:

“(1) [Without prejudice to the rights of several assignees obtaining the same receivables from the same assignor, the insolvency administrator and the assignor’s creditors:]

“(a) an assignment of receivables that are specified individually is effective to transfer the receivables to which it relates;

“(b) an assignment of receivables that are not specified individually is effective to transfer receivables that can be identified as receivables to which the assignment relates, at the time agreed upon by the assignor and the assignee and, in the absence of such agreement, at the time when the receivables arise.

“(2) An assignment may relate to existing or future, one or more, receivables, and to parts of or undivided interests in receivables.

“(3) An assignment of receivables is effective to transfer the rights to cash received upon collection or other disposition of receivables, provided that the cash may be identified as proceeds of the receivables.”

Paragraph (1)

Chapeau

212. The Working Group was agreed that the *chapeau* of paragraph (1) created uncertainty and should be replaced by a cross-reference to draft articles 23 and 24.

Subparagraphs (a) and (b)

213. In order to address both the transfer of title in the receivables and the creation of security rights in receivables, it was agreed that reference should be made in subparagraphs (a) and (b) to “the transfer of rights in receivables” rather than to the “transfer of receivables”. Subject to that change, the Working Group approved the substance of subparagraphs (a) and (b).

Paragraph (2)

214. The Working Group approved the substance of paragraph (2) unchanged.

Paragraph (3)

215. The Working Group recalled its decision to include a definition of “proceeds” in draft article 5 and to address the issue of the transfer of rights in proceeds in draft article 11 and the issue of priority in proceeds in draft articles 23 and 24. It also recalled its decision to consider the contents of a definition of “proceeds” in the context of its discussion of draft article 11 (see para. 190, above).

216. As to the definition of “proceeds”, language was suggested along the following lines: “Proceeds includes whatever is received upon the collection or disposition of the receivables or of the proceeds.” With regard to the issue of the transfer of rights in proceeds, it was suggested that paragraph (3) should be replaced by wording along the following lines: “An assignment of receivables also assigns the assignor’s rights to their proceeds”. Alternative proposals made included the following: “[All movable] property received on collection, discharge or disposition is assigned as part of the receivables”. With regard to priority in proceeds, it was suggested that it could be dealt with in the same way as priority in receivables (which under draft articles 23 and 24 was left to the law of the country in which the assignor had its place of business). In addition, it was suggested that the issue of identification of proceeds and traceability (in case the proceeds were commingled with other similar assets, e.g. when money was paid in a deposit account) could be left to the law of the country in which the assignor had its place of business.

217. In order to emphasize the importance of covering proceeds in the draft Convention, it was stated that, in practice, an assignee rarely received cash upon collection of the receivable. Debts were more frequently discharged by credit transfers or by means of cheques, promissory notes or other negotiable instruments delivered by the debtor to the assignee. In addition, it was observed that, if the debtor retained the possibility to discharge its debt by delivering or returning goods directly to the assignor, the rights in such goods should vest with the assignee by virtue of the assignment. It was added that, in bulk assignments of receivables, often a proportion of the receivables was actually discharged through the delivery of goods, for instance, because the debtor returned certain goods for non-conformity with the original contract.

218. While it was agreed that the assignee should be given effective rights to obtain whatever was received in

satisfaction of the receivable, differences were identified as to legal concepts and methods in achieving the desirable result. It was stated that in some legal systems the asset referred to as “proceeds” was a separate asset subject to a different legal regime and could not be brought under the legal regime governing receivables. In those legal systems, it was observed, the assignee would have a personal claim to obtain the asset received by the assignor in payment of the receivable (which could be, e.g. a claim based on the principles of unjust enrichment) but not a property right in that asset (i.e. the assignee had a right *ad personam* and not *in rem* in that asset). In addition, it was said that, where security over goods and other property were offered as a collateral to the assignment, the assignee’s rights to such assets were covered under draft article 14.

219. Moreover, it was pointed out, in some legal systems a sum paid into an account of the assignor was deemed to be a fungible asset which could not be separated as pertaining to one particular receivable. It was explained that, in those legal systems, the assignee lacked title in the proceeds; it only had a claim against the assignor, and would not have the right to trace the proceeds. Accordingly, it was suggested that a general provision along the following lines should be considered: “If payment of the receivable due under the underlying contract is received by the assignor, the assignor [shall] [is bound to] return to the assignee what it has received.” It was stated that, under such an approach, conflicts of priority would be resolved by the law applicable to the type of payment involved in each case.

220. After deliberation, the Working Group requested the Secretariat to formulate alternative provisions reflecting the suggestions mentioned above for consideration by the Working Group at its next session.

Article 12. Time of transfer of receivables

221. The text of draft article 12 as considered by the Working Group was as follows:

“[Without prejudice to the rights of the insolvency administrator and the assignor’s creditors:]

“(a) a receivable arising up to the time of the assignment is transferred at the time of the assignment; and

“(b) a future receivable is deemed to be transferred [at the time agreed upon between the assignor and the assignee and, in the absence of such agreement,] at the time of the assignment [or, in the case of a receivable arising from an agreement other than the original contract or from a court order, at the time when it [arises] [becomes payable]].”

Opening words

222. It was observed that the opening words of draft article 12 might undermine the rights of an assignee in case a national insolvency law took a very restrictive approach as to the rights of an assignee as against the administrator in the insolvency of the assignor. In response, it was noted that the approach of the Working

Group, reflected in draft article 24(5) and (6), was that, while the draft Convention could recognize the basic effectiveness of an assignment, thus having a limited effect on the rights of the insolvency administrator, it could not unduly interfere with those rights of the insolvency administrator existing under national insolvency law. After discussion, in line with its decision with regard to the opening words of draft article 11(1), the Working Group decided that the opening words of draft article 12 should be replaced by a cross-reference to draft article 24.

Subparagraph (a)

223. The Working Group approved the substance of subparagraph (a) unchanged.

Subparagraph (b)

224. There was general support for the principle that a future receivable should be deemed as having been transferred at the time of the contract of assignment. It was observed that, in view of the risk that, after the conclusion of the contract of assignment, the assignor might assign the same receivables to another assignee or become insolvent, it was essential to set the time of the transfer of the assigned receivables at the time of the conclusion of the contract of assignment. It was stated that, in practice, the assignee would acquire rights in future receivables only when they arose, but in legal terms the time of transfer would be deemed to be the time of the contract of assignment.

225. However, it was pointed out that, in order to avoid creating uncertainty as to the time of the transfer of the assigned receivable, the time of the contract of assignment should be specified. The suggestion was made that that time should be the time mentioned in the assignment contract or, if the assignment contract was not in writing, the time determined on the basis of any other writing or other means of evidence. As a matter of drafting, it was suggested that the first set of bracketed language that appeared in subparagraph (b) within square brackets should be revised so as to ensure that the parties could not manipulate the transaction by setting as the time of transfer a time earlier than the time of the conclusion of the assignment contract.

226. Subject to the suggested changes, the Working Group approved the substance of subparagraph (b). As for the second set of bracketed language, the Working Group decided that it should be retained within square brackets, pending final determination by the Working Group of the question whether tort receivables should be covered by the draft Convention or not.

Article 13. *Agreements limiting the assignor's right to assign*

227. The text of draft article 13 as considered by the Working Group was as follows:

“(1) A receivable is transferred to the assignee notwithstanding any agreement between the assignor and the debtor limiting in any way the assignor's right to assign its receivables.

“(2) Nothing in this article affects any obligation or liability of the assignor to the debtor in respect of an assignment made in breach of an agreement limiting in any way the assignor's right to assign its receivables, but the assignee is not liable to the debtor for such a breach.”

Paragraph (1)

228. There was general support in favour of the principle embodied in paragraph (1). It was pointed out that a provision along the lines of paragraph (1) would result in an enhanced access to lower-cost credit for small- and medium-size enterprises on which often anti-assignment clauses were imposed by large enterprises.

229. However, the concern was expressed that paragraph (1) might override national law rules aimed at protecting the debtor. In order to address that concern, the suggestion was made that paragraph (1) should allow States to express a reservation as to the application of paragraph (1) along the lines of article 6 of the Ottawa Convention. In response, it was noted that paragraph (1) was the result of a compromise between those legal systems that invalidated the assignment and those legal systems that invalidated anti-assignment clauses. In addition, it was noted that the concerns expressed might be addressed by the debtor-protection provisions contained in the draft Convention. Moreover, it was noted that States considering the adoption of the draft Convention would need to weigh the potential inconvenience to the debtor as a result of the assignment against the advantage of increased availability of lower-cost credit. It was stated that another way of dealing with the matter was to allow the debtor to discharge its obligation by paying the assignor in case an assignment was made in violation of an anti-assignment clause. It was recalled that that suggestion had been briefly discussed at the twenty-fifth session of the Working Group (A/CN.9/432, paras. 125-126).

230. It was observed that, in addressing only contractual prohibitions of assignment, paragraph (1) left some uncertainty as to its effect on statutory prohibitions. In order to address that problem, it was suggested that language along the following lines should be included in paragraph (1): “Nothing in this article affects any limitations to the assignor's right to assign its receivables that does not result from an agreement between the assignor and the debtor”. It was observed that, for the suggested language to provide the desirable degree of certainty, it would need to be supplemented by a conflict-of-laws rule specifying the law applicable to statutory prohibitions of assignment (or legal assignability). It was pointed out that, while contractual assignability would be subject to a single law (i.e. the law governing the assigned receivable), legal assignability would be subject to different laws depending on the country in which the debtor had its place of business. As a result, in a bulk assignment involving receivables owed by debtors located in different countries, the assignee would have to look at the law of the country of each debtor in order to determine whether there were any legal limitations of the assignment. In view of the difficulty in dealing with that issue, the Working Group confirmed its

earlier decision not to deal with statutory prohibitions of assignment (A/CN.9/434, para. 136) and approved the substance of paragraph (1) unchanged.

Paragraph (2)

231. General support was expressed in favour of paragraph (2). It was understood that paragraph (2) did not create liability in cases where the law applicable to the original contract gave no effect to anti-assignment clauses. However, it was observed that, as a result of the approach taken in paragraph (2) to preserve the validity of anti-assignment clauses and the assignor's potential liability for their violation, parties which may be liable for concluding an assignment in violation of an anti-assignment clause would be less inclined to assign their receivables, thus being deprived of access to lower-cost credit. After discussion, the Working Group approved the substance of paragraph (2) unchanged.

Article 14. *Transfer of security rights*

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

“(1) Unless otherwise provided by law or by agreement between the assignor and the assignee, any personal or property rights securing payment of the assigned receivables are transferred to the assignee without a new act of transfer.

“(2) Without prejudice to the rights of parties in possession of the goods, a right securing payment of the assigned receivables is transferred to the assignee, notwithstanding any agreement between the assignor and the debtor, or the person granting the security right, limiting in any way the assignor's right to assign such a security right.

“(3) Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any security rights.”

Paragraph (1)

233. The concern was expressed that the reference contained in paragraph (1) to “law” might introduce uncertainty. In order to address that concern, it was suggested that reference should be made instead to the law of the assignor's place of business. That suggestion was objected to on the grounds that the application of the assignor's

place of business might not be appropriate in all cases. It was stated that often the application of the law governing the security right might be more appropriate (e.g. in case of property security rights which should be governed by the *lex rei sitae*).

234. In order to cover assignments in which the receivable was discharged through the return of goods by the debtor or their recovery by the assignor, it was suggested that after the words “property rights” language along the following lines should be included: “including the assignor's rights to any goods subject to the original contract that may be returned by the debtor or recovered by the assignor”. The Working Group requested the Secretariat to include that suggestion at the appropriate place in the text of the draft Convention for consideration at the next session of the Working Group. After discussion, the Working Group approved the substance of paragraph (1) unchanged.

Paragraphs (2) and (3)

235. For lack of sufficient time, the Working Group deferred its discussion of paragraphs (2) and (3) to its next session.

Chapter IV. Future work

236. A number of issues were suggested for consideration during the upcoming deliberations of the Working Group. Those included: the question of the scope of the draft Convention, including whether the assignment of tort receivables, receivables arising from deposit accounts, repurchase agreements, the check-collection system and swaps would be covered; the question whether proceeds of receivables, as well as the assignor's rights under the original contract should be covered; the matter of a more specific definition of the place of business, which was important for achieving certainty as regards the application of the draft Convention and the rights of third parties; the question of the form of assignment; the relationship between the draft Convention and national insolvency law; the question whether the substantive law provisions of the draft Convention needed to be supplemented by a set of conflict-of-laws rules; and the question of the role and the content of the optional part of the draft Convention.

237. It was noted that the next session of the Working Group was scheduled to take place in New York from 2 to 13 March 1998.

**B. Working paper submitted to the Working Group on International
Contract Practices at its twenty-seventh session: receivables financing:
revised articles of draft Convention on Assignment in Receivables Financing:
note by the Secretariat**

(A/CN.9/WG.II/WP.93) [Original: English]

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I. INTRODUCTION

1. At its twenty-seventh session, the Working Group on International Contract Practices continued its work, undertaken pursuant to a decision taken by the Commission at its twenty-eighth session (Vienna, 2-26 May 1995), on the preparation of a uniform law on assignment in receivables financing.¹ It was the fourth session devoted to the preparation of that uniform law, tentatively entitled the draft Convention on Assignment in Receivables Financing.

2. The Commission's decision to undertake work on assignment in receivables financing was taken in response to suggestions made to it in particular at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century" (held in New York in conjunction with the twenty-fifth session, 17-21 May 1992). A related suggestion made at the Congress was for the Commission to resume its work on security interests in general, which the Commission at its thirteenth session (New York, 14-25 July 1980) had decided to defer for a later stage.²

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.³

4. At its twenty-fourth session (Vienna, 13-24 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled "Discussion and preliminary draft of uniform rules" (A/CN.9/412). At that session, the Working Group was urged to

¹Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

²Ibid., Thirty-fifth Session, Supplement No. 17 (A/35/17), paras. 26-28 (UNCITRAL Yearbook, vol. XI:1980, part one, II, A).

³Ibid., Forty-eighth Session, Supplement No. 17 (A/48/17), paras. 297-301; *ibid.*, Forty-ninth Session, Supplement No. 17 (A/49/17), paras. 208-214; and *ibid.*, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

strive for a legal text aimed at increasing the availability of lower cost credit (A/CN.9/420, para. 16).

5. At its twenty-fifth session (New York, 8-19 July 1996), the Working Group considered a note prepared by the Secretariat, which contained provisions on a variety of issues, including form and content of assignment, rights and obligations of the assignor, the assignee, the debtor and other third parties, subsequent assignments and conflict-of-laws issues (A/CN.9/WG.II/WP.87). At that session, the Working Group decided to continue its work on the assumption that the text being prepared would take the form of a convention (A/CN.9/432, para. 28).

6. At its twenty-sixth session (Vienna, 11-22 November 1996), the deliberations of the Working Group were based on newly revised articles of the draft Convention prepared by the Secretariat (A/CN.9/WG.II/WP.89). At that session, the Working Group had before it a note by the Secretariat containing comments submitted by the Permanent Bureau of the Hague Conference on International Private Law on the conflict-of-laws provisions of the draft Convention (A/CN.9/WG.II/WP.90). Having exhausted the time available for deliberations at that session, the Working Group decided that conflict-of-laws issues should be addressed at the beginning of the current session on the basis of a revised draft of the conflict-of-laws rules contained in document A/CN.9/WG.II/WP.87 (A/CN.9/434, para. 262).

7. This note sets forth a revised version of the draft Convention, reflecting the deliberations and decisions of the Working Group thus far. In addition, it includes an annex dealing with registration, which has been prepared by the Secretariat pursuant to a request by the Working Group (A/CN.9/432, para. 251). Additions and modifications to the text are indicated by underlining.

II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

References:

A/CN.9/434, para. 14 (Twenty-sixth session, 1996)

Remarks

1. In its present formulation, the title suggests that the scope of the draft Convention is narrower than it actually is (the term "receivables financing" does not appear in draft article 1, it only appears in the title of and the preamble to the draft Convention, as well as in draft articles 5(4) and 15(3); the terms "assignment" and "receivable" have been defined broadly in draft articles 2 and 3; and the list of exclusions in draft article 4 has been kept short).

2. Should the Working Group decide to cover only financing transactions, the term "receivables financing" in the title should be retained, and the terms "assignment" and "receivable" should be defined in a narrower way (for a discussion on scope, see remarks to draft article 1).

Preamble

The Contracting States,

Considering that international trade cooperation on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

Being of the opinion that the adoption of uniform rules governing assignments in receivables financing would facilitate the development of international trade and would promote the availability of credit at more affordable rates,

Have agreed as follows:

References:

A/CN.9/434, paras. 15-16 (Twenty-sixth session, 1996)

Chapter I. Scope of application

Article 1 [1(1)].⁴ *Scope of application*

(1) This Convention applies to assignments of international receivables and to international assignments of receivables *as defined in this chapter*:

(a) if, [*at the time of the assignment,*] the assignor and *the assignee* have their places of business in a Contracting State; or

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

[*(2) The provisions of articles 26 to 28 apply [to assignments of international receivables and to international assignments of receivables as defined in this chapter] independently of paragraph (1) of this article.*]

References:

A/CN.9/434, paras. 17-25 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 14-18 and 29-32 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 19-25 and 30-31 (Twenty-fourth session, 1995)

Remarks

I. *Substantive scope of application*

1. The Working Group's approach thus far has been that, while the focus of the draft Convention should be on assignments made in order to secure financing and other related services, other types of assignment might be covered as well (A/CN.9/432, para. 66 and A/CN.9/434, para. 43). The Working Group may wish to review that approach. An attempt to cover assignments beyond receivables financing could be seen as an objectionable wholesale reform of all assignment law and compromise the acceptability of the draft Convention to States. In addition, such an approach would require the preparation of specific rules to address the needs of particular practices (e.g. a registration approach would not be suitable for assignments of tort receivables, deposit accounts or insur-

⁴The numbers in square brackets refer to the articles of the previous version of the draft Convention (A/CN.9/WG.II/WP.89).

ance policies; a different rule on no-assignment clauses might be required in refinancing transactions; further examples are given below).

Tort receivables

2. In order to reflect a tentative decision made by the Working Group at its previous session to cover tort receivables (A/CN.9/434, paras. 74 and 81), the text of the draft Convention refers in several places to “the agreement or the court order” confirming a tort receivable (this limitation is due to the fact that, in the absence of such a confirmation, a tort receivable arising from an illegal act is of no value for financing purposes). In a number of articles, a specific rule is introduced with regard to tort receivables (e.g. draft article 5(2) dealing with the time at which a receivable might be deemed to arise, draft article 12(b) dealing with the time of transfer of future receivables, draft article 12(1)(c) limiting the representations of the assignor as to the absence of any defences on the part of the debtor to the assignment of contractual receivables). As to the modification of the original receivable, draft article 21 would need to be revised in order to cover it (see remark 3 to draft article 21).

3. In addition, a specific rule would need to be devised in order to address the problem of conflicting rights in tort receivables. Insurers having paid a claim and looking for reimbursement through their insured’s tort receivable may be prejudiced, if other financiers could obtain priority by way of registration. In addition, a provision giving priority to the first assignee to register, if applied to tort receivables, might impair settlement in which all parties involved in a tort are supposed to participate (this is particularly so if the registration would operate to establish a priority right even with regard to a future tort receivable).

Insurance policies

4. Statutes providing for a registration system usually exclude the assignment of receivables arising under insurance policies, leaving priority disputes to other law. Such an approach is considered to be desirable, since insurers maintain records of title and claims to policies and, therefore, there is no need for another registry of these interests. However, insurance money payable as compensation for collateral damaged or destroyed (which would include insurance proceeds) are covered by those statutes as proceeds of collateral. Whether the insurer, having paid the person with a right in the proceeds, acquires the rights of the insured against the tortfeasor by subrogation is left to other law. Should the Working Group decide to adopt a registration system in dealing with conflicting claims, it may wish to reconsider its decision to cover the assignment of insurance premiums or to develop a different priority rule for such assignments.

5. As to life insurance policies, it might be argued that if the assignment by the policy owner were to be further facilitated, the main purpose of such policies, i.e. to provide the beneficiaries a substitute for support, might be frustrated. In addition, insurance policies could be inadvertently assigned in case of an assignment of all present and future receivables of the policy owner (“omnibus clause”). As to term insurance, it may be argued that there

is no real advantage in facilitating their assignment. The policy would have no present value for the assignee. In addition, facilitating such assignments may expose the assignor to abuse (e.g. if the policy owner-assignor is unable to buy additional insurance at an affordable price due to advancing age or illness or injury, the assignee may try to induce the assignor to provide security out of other assets, perhaps at great cost to the assignor, its unsecured creditors and dependants).

Deposit accounts

6. Covering the assignments of deposit accounts might lead to undesirable results for the banking sector. For example, the depositary institution, which is the debtor in the context of a deposit account, may not wish to have to pay to anyone else other than the depositor. In addition, separate provisions would need to be developed with regard to a number of matters, e.g. discharge of the debtor, defences and set-offs, the right of the depositary institution to dispose of the funds in the account and conflicts of priority (between assignees of the deposit account and between the depositary institution and the assignee).

Conclusion

7. In view of the above, it may be more realistic in terms of what can be achieved within a reasonable period of time to focus on the main receivables financing transactions (e.g. those involving receivables arising from the provision of goods and services, including financing-related services). If the draft Convention becomes so successful that it would be desirable to cover additional types of receivables, this could be done in the context of a revision of the draft Convention that would include the preparation of additional provisions addressing particular needs of certain practices.

II. *Territorial scope of application*

8. The Working Group may wish to review its decision that both the assignor and the assignee need to have their places of business in a Contracting State (A/CN.9/434, para. 23). At the previous session of the Working Group, the concern was expressed that requiring the assignee to be located in a Contracting State would both unnecessarily limit and create uncertainty as to the scope of application of the draft Convention (A/CN.9/434, paras. 123, 127, 134 and 192). A third disadvantage of the present formulation of draft article 1(1)(a) is that an assignor, located in a Contracting State the law of which does not allow the assignment of future receivables, would not be able to benefit from the draft Convention simply because the assignee is not located in a Contracting State.

9. As to the argument that the assignee should be in a Contracting State since the draft Convention addresses the relationship between the assignor and the assignee, it might need to be considered in the light of the fact that the only provisions dealing with that relationship (i.e. draft articles 15 and 16) are non-mandatory provisions (with the exception of draft article 15(1), which, however, is of no consequence for the rights of the assignee as against the assignor).

10. Moreover, even with an expanded scope, to the extent that the draft Convention affects the rights of the debtor, it cannot change the otherwise applicable law, unless the debtor is located in a Contracting State (e.g. only the type of notification prescribed by the law of the State in which the debtor is located will trigger its obligation to pay the assignee instead of the assignor; see remark 1 to draft article 7).

III. Conflict of laws

11. Under paragraph (1)(b), the draft Convention would be applicable if the law governing the assignment, or the law governing the receivable (e.g. the contract from which the receivable arises), or the law governing a particular relationship (e.g. the law governing insolvency) is the law of a Contracting State. The Working Group may wish to consider requiring instead that both the original contract and the contract of assignment are governed by the law of a Contracting State (see article 2(1)(b) of the UNIDROIT Convention on International Factoring, hereinafter referred to as “the Factoring Convention”).

12. Paragraph (2) is modelled on article 1(3) of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit^a, hereinafter referred to as “the United Nations Guarantee and Standby Convention”. It is intended to extend the scope of application of the conflict-of-laws rules of the draft Convention to cover assignments, irrespective of whether they are connected to a Contracting State or not. Such an approach may be justified, should the Working Group decide to harmonize the conflict-of-laws rules on assignment and not to formulate gap-filling rules (see remark 1 to draft article 26).

Article 2 [3(1) and (3)]. *Assignment of receivables*

(1) For the purposes of this Convention, “assignment” means the transfer by agreement from one party (“assignor”) to another party (“assignee”) of its right to payment of a monetary sum (“receivable”) owed by another party (“debtor”) in return for value, credit or related services given or promised by the assignee to the assignor.

(2) “Assignment” includes the transfer of receivables by way of security for indebtedness or other obligation, or by any other way, including subrogation by agreement, novation or pledge of receivables.

References:

- A/CN.9/434, paras. 62-70 and 72-77 (Twenty-sixth session, 1996)
- A/CN.9/432, paras. 40-49 and 53-69 (Twenty-fifth session, 1996)
- A/CN.9/420, paras. 33-43 and 53-69 (Twenty-fourth session, 1995)

Remarks

1. Draft article 2, which is intended to function as a scope provision, contains a brief, basic definition of “assignment”, “receivable”, “assignor”, “assignee” and

“debtor”. Under the modified definition of “assignment”, the explicit exclusion of gratuitous assignments, automatic assignments by operation of law and assignments of contracts in draft article 4 is unnecessary. No reference is made in paragraph (2) to absolute assignments, since such assignments are intended to be covered by the definition of assignment contained in paragraph (1), and paragraph (2) merely states a rule of interpretation.

2. The Working Group may wish to consider whether the definition of “assignment” is adequate so that the draft Convention validates both the transfer and the agreement to transfer (in some legal systems the invalidity of the agreement may invalidate the transfer, while in other legal systems the invalidity of the agreement may give rise to a claim against the assignee based on the principle of unjust enrichment).

Article 3 [1(2)]. *Internationality*

(1) A receivable is international if, *at the time it arises*, the places of business of the assignor and the debtor are in different States. An assignment is international if, *at the time it is made*, the places of business of the assignor and the assignee are in different States.

(2) *For the purposes of this Convention:*

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the relevant contract [*or other agreement or court order giving rise to the assigned receivable*];

(b) if a party does not have a place of business, reference is to be made to its [*registered office or*] habitual residence.

References:

- A/CN.9/434, paras. 26-33 (Twenty-sixth session, 1996)
- A/CN.9/432, paras. 19-25 (Twenty-fifth session, 1996)
- A/CN.9/420, paras. 26-29 (Twenty-fourth session, 1995)

Remarks

1. Under the definition of internationality contained in paragraph (1) of draft article 3, the draft Convention will apply to the following situations: the assignor is in country A, the assignee is in country B and the debtor is in country C (international assignment of international receivables); the assignor and the assignee are in country A and the debtor is in country B (domestic assignment of international receivables); and the assignor and the debtor are in country A and the assignee is in country B (international assignment of domestic receivables).

2. The term “relevant contract” in paragraph (2) means the assignment, in case of an internationality-test relating to the assignment, and the original contract, in case of an internationality-test relating to the receivable. The words within square brackets are intended to address situations in which tort receivables are involved.

3. In order to enhance certainty and predictability as to the application of the draft Convention, the reference to

^aGeneral Assembly resolution 50/48, annex I, of 11 December 1995.

the circumstances known to or contemplated by the parties, as a criterion to be used in the “closest relationship” test, has been deleted from paragraph (2) (such an approach is followed in article 1(4)(a) of the UNCITRAL Model Law on International Commercial Arbitration^b). It should be noted, however, that in case a contract is negotiated by the branch office of a large corporation located in country A, concluded by another branch office in country B, while payments are made by yet another branch office in country C, it may be difficult to determine which is the place with the closest relationship to that contract.

4. The Working Group may wish to consider the following additional questions: whether a receivable owed by several debtors or to several assignors would be international, even if only one debtor or only one assignor is located in a country other than the country in which the other party to the transaction is located; and whether an assignment, in which several assignors or several assignees are involved, would be international, even if only one assignor and one assignee are located in different countries.

5. The reference to the “registered office” is intended to cover legal entities registered in one place and doing business in a number of other places (e.g. post-office box companies). It was drawn from article 12(4) of the draft UNCITRAL Model Legislative Provisions on Cross-border Insolvency (annex to A/CN.9/435).

Article 4 [2]. *Exclusions*

This Convention does not apply to assignments *made*:

- (a) for personal, family or household purposes;
- (b) solely by endorsement or delivery of a negotiable instrument;
- (c) as part of the sale, *or change in the ownership or the legal status*, of a business out of which the assigned receivables arose.

References:

- A/CN.9/434, paras. 42-61 (Twenty-sixth session, 1996)
- A/CN.9/432, paras. 17 and 62-66 (Twenty-fifth session, 1996)

Chapter II. General provisions

Article 5 [3 and 15(1)]. *Definitions and rules of interpretation*

For the purposes of this Convention:

- (1) “Original contract” means the contract *between the assignor and the debtor* from which *the assigned* receivable arises.
- (2) A receivable *is deemed to arise at the time* when the original contract is concluded [*or, in the absence of an original contract, at the time when it is confirmed in*

an agreement between the creditor and the debtor or in a court order].

(3) “Future receivable” means a receivable that might arise after the conclusion of the assignment.

[(4) “Receivables financing” means any transaction in which value, credit or related services are provided for value in the form of receivables. “Receivables financing” includes, but is not limited to, factoring, forfaiting, securitization, project financing and refinancing.]

(5) “Writing” means any form of communication that [preserves a complete record of the information contained therein] [*is accessible so as to be usable for subsequent reference*] and provides authentication of its source by generally accepted means or by a procedure agreed upon by the sender and the addressee of the communication.

(6) “Notification of the assignment” means a statement informing the debtor that an assignment has taken place.

(7) “Insolvency administrator” means a person or body, including one appointed on an interim basis, authorized to administer the reorganization or liquidation of the assignor’s assets.

(8) “Priority” means the right of a party to receive payment in preference to another party.

(9) *Priority with regard to the receivables includes priority with regard to cash received upon collection or other disposition of the receivables, provided that the cash may be identified as proceeds of the receivables.*

References:

- A/CN.9/434, paras. 70-72, 75-76, 78-85, 166-194 and 244 (Twenty-sixth session, 1996)
- A/CN.9/432, paras. 40-72 (Twenty-fifth session, 1996)
- A/CN.9/420, para. 44 (Twenty-fourth session, 1995)

Remarks

1. In paragraph (5), alternative language, drawn from article 6 of the Model Law on Electronic Commerce of the United Nations Commission on International Trade Law^c, has been added within square brackets for the consideration of the Working Group. It is intended to ensure that assignments made by way of electronic means of communication would be covered by the draft Convention. The definitions set forth in paragraph (7) and in draft article 24 are drawn from article 2 of the draft UNCITRAL Model Legislative Provisions on Cross-border Insolvency (annex to A/CN.9/435).

2. Priority under the draft Convention means that a party may satisfy its claim in preference to other claimants, under the implicit conditions that there is a valid assignment as between the assignor and the assignee and that the assignee has extended credit to the assignor. In draft article 11, it is provided that an assignment is effective as of the time it is made, but such effectiveness should not prejudice

^bOfficial Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17), annex I.

^cOfficial Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

the rights of several assignees of the same receivables, the insolvency administrator and the assignor's creditors. Draft articles 23 and 24 specify further that, after the establishment of an appropriate registration system, the first assignee to register has priority among several assignees and that the assignee has priority over the insolvency administrator and the assignor's creditors if the assignment and registration take place before the opening of the insolvency proceeding or attachment, unless a State adopting the draft Convention declares that it will not be bound by the registration provisions.

3. The exact meaning of priority depends on whether an absolute assignment or an assignment by way of security is involved, a matter not addressed in the draft Convention but left to the parties and other applicable law. In case of an absolute assignment, priority means that the assignee obtains payment and does not need to account or return to the assignor any remaining balance. As a result, other assignees are left only with a remedy against the assignor. In case of an assignment by way of security, the assignee obtaining payment first has to turn over to the assignor, or the assignee next in line of priority, any remaining balance. Again, if there is nothing left after the assignee with priority satisfies its claim, other assignees may have recourse only against other assets of the assignor as unsecured creditors.

4. In draft article 23, it is implied that several assignments of the same receivables may be valid. The Working Group may wish to express that idea explicitly, since in some legal systems after the first assignment the assignor has nothing more to assign ("*nemo dat quod non habet*"). As a matter of drafting, the Working Group may wish to refer, rather than to the effectiveness of an assignment and priority, to the validity of an assignment as between the parties thereto and its effectiveness as against the debtor and other parties.

5. Paragraph (9) is intended to achieve that the party with priority as to the receivables would have priority as to their identifiable cash proceeds. It is supplemented by draft article 11(3) providing that the assignee would have a right to claim identifiable cash proceeds of receivables. If the right in the receivables does not extend to their proceeds, it is of little value. On the other hand, some types of proceeds (non-cash proceeds or cash proceeds that are not identifiable) may be better left to other law, since they raise complicated problems that might not lend themselves to unification. The Working Group may wish to define cash proceeds as "including money, checks, deposit accounts and the like".

Article 6. *Party autonomy*

(1) *As between the assignor and the assignee, articles [...] may be excluded or varied by agreement.*

(2) *As between the assignor and the debtor, articles [...] may be excluded or varied by agreement.*

[(3) *Nothing in this Convention invalidates an assignment which is valid under rules other than the provisions of this Convention.*]

References:

- A/CN.9/434, paras. 35-41 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 33-38 (Twenty-fifth session, 1996)

Remarks

1. Draft article 6 is based on the assumption that: the assignor and the assignee should not be able to exclude or vary the provisions dealing with the protection of the debtor or the rights of third parties such as other assignees, the insolvency administrator and the assignor's creditors; and that the assignor and the debtor should not be able to exclude or vary the provisions dealing with the rights of such third parties.

2. The Working Group may wish to address the question whether the parties may exclude the relevant provisions of the draft Convention only explicitly, or whether they may do so implicitly as well, e.g. by choosing the law of a non-Contracting State (a choice, which under draft article 6 in its present formulation would not result in the exclusion of the rules dealing with the rights of third parties). In addition, should the Working Group prefer to allow parties to exclude the draft Convention as a whole, the question might need to be addressed whether the draft Convention may apply, under paragraph (1)(b), only if the parties had not excluded its application explicitly (this approach is followed in article 1(1)(b) of the Guarantee and Standby Convention).

3. Paragraph (3) is intended to recognize the contractual freedom of the parties to conclude an assignment and to make explicit that one of the goals of the draft Convention is to validate assignments that might be invalid under other applicable law and not to invalidate assignments that are otherwise valid (the conflict between a Convention and a non-Convention assignee is addressed in draft article 23(4)).

Article 7 [4]. *Debtor's protection*

(1) *Except as otherwise provided in this Convention, an assignment does not have any effect on the rights and obligations of the debtor.*

(2) *Nothing in this Convention affects the debtor's right to pay in the currency and in the country specified in the payment terms contained in the original contract [or in any other agreement or court order giving rise to the assigned receivable].*

References:

- A/CN.9/434, paras. 86-94 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 87-92 and 244 (Twenty-fifth session, 1996)
A/CN.9/420, para. 101 (Twenty-fourth session, 1995)

Remarks

1. Paragraph (1) has been revised in view of the fact that the draft Convention may effect a number of changes to the legal status of the debtor, including: the validity of

an assignment in breach of a no-assignment clause (draft article 13); a change in the way the debtor may discharge its obligation (draft article 18); the inability of the debtor to raise against the assignee defences or rights of set-off that it could raise against the assignor for breach of a no-assignment clause (draft article 19(3)); the limitation of the debtor's right to modify the original contract after notification (draft article 20(2)); the ability of the debtor to agree not to raise certain defences (draft article 21); and the inability of the debtor to recover from the assignee payments made despite the fact that the assignor may have failed to earn the assigned receivables by performance (draft article 22). An additional change may be that, in financing transactions with a floating interest, the assignee acquires the right to set the new rate and the debtor may be faced with an unexpected rate. In view of the above, the Working Group may wish to reconsider the question whether the debtor needs to be in a Contracting State for the draft Convention to apply to the rights and obligations of the debtor.

2. Paragraph (2) is intended to ensure that the debtor will not be required to pay in a different country or currency from the one that was initially envisaged. Such a provision is necessary, since, under draft article 18(2), after notification the debtor is discharged by paying in accordance with the instructions set forth in the notification.

Article 8 [6]. *Principles of interpretation*

(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.

References:

- A/CN.9/434, paras. 100-101 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 76-81 (Twenty-fifth session, 1996)
 A/CN.9/420, para. 190 (Twenty-fourth session, 1995)

Article 9 [5]. *International obligations of the Contracting State*

Variant A: (1) [Subject to paragraph (2) of this article,] this Convention does not prevail over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention.

(2) If an international convention [or other international or bilateral agreement] contains a provision similar to that contained in paragraph (1) of this article, this Convention prevails.

Variant B: This Convention prevails over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention, unless a Contracting State makes a declaration under article 29.

References:

- A/CN.9/434, paras. 96-99 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 73-75 (Twenty-fifth session, 1996)
 A/CN.9/420, para. 23 (Twenty-fourth session, 1995)

Remarks

Under variant A, the draft Convention does not prevail, except in case of a "negative conflict" between two conventions, i.e. a situation in which two conventions may give precedence to each other, as a result of which it may not be clear which one applies. Under variant B, the draft Convention prevails, unless a State makes a declaration to the contrary listing the international agreements to which it will give precedence (the question of the effect of a determination made by a State in violation of its international obligations would need to be addressed). The Working Group may wish to combine variants A and B in a rule providing that the draft Convention would not prevail unless the requirements of variant A or B were met.

Chapter III. Form and effect of assignment

Article 10 [7]. *Form of assignment*

(1) An assignment [in a form other than in writing is not effective, unless it is effected pursuant to a contract between the assignor and the assignee which is in writing] [shall be evidenced by writing].

(2) [Unless otherwise agreed,] an assignment of one or more future receivables is effective without a new writing being required for each receivable when it arises.

References:

- A/CN.9/434, paras. 102-106 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 82-86 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 75-79 (Twenty-fourth session, 1995)

Remarks

Under the first set of bracketed language in paragraph (1), writing would be a condition of the validity of the assignment. The underlined language is intended to ensure that one writing is sufficient (which is important in view of the fact that stamp duty would have to be paid). Under the second set of bracketed language, writing is not a condi-

tion of validity but serves evidentiary purposes (this may include a list of receivables with the signature of the assignor, or the financing contract document). Such an approach would address the problem of post-default fraudulent behaviour by the assignor disputing, in collusion with one of several assignees, the assignor's creditors or the insolvency administrator, that an assignment has taken place. In addition, it would be consistent with the approach taken in draft article 6(3) that the draft Convention should not invalidate assignments that may be valid under other applicable law.

Article 11 [9]. *Effect of assignment*

(1) [Without prejudice to the rights of several assignees obtaining the same receivables from the same assignor, the insolvency administrator and the assignor's creditors:]

(a) *an assignment of receivables that are specified individually is effective to transfer the receivables to which it relates;*

(b) *an assignment of receivables that are not specified individually is effective to transfer receivables that can be identified as receivables to which the assignment relates, at the time agreed upon by the assignor and the assignee and, in the absence of such agreement, at the time when the receivables arise.*

(2) *An assignment may relate to existing or future, one or more, receivables, and to parts of or undivided interests in receivables.*

(3) *An assignment of receivables is effective to transfer the rights to cash received upon collection or other disposition of receivables, provided that the cash may be identified as proceeds of the receivables.*

References:

A/CN.9/434, paras. 66-67, 113, 126 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 101-108 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 45-56 (Twenty-fourth session, 1995)

Remarks

The opening words of paragraph (1) are intended to ensure that, while the assignment is effective as of the time it is made, the rights of several assignees of the same receivables, the insolvency administrator and the assignor's creditors should not be prejudiced (in that priority may be based on time of registration; see draft articles 23 and 24).

Article 12 [8]. *Time of transfer of receivables*

[Without prejudice to the rights of the *insolvency administrator* and the assignor's creditors:]

(a) a receivable arising up to the time of the assignment is transferred at the time of the assignment; and

(b) a future receivable is *deemed to be transferred [at the time agreed upon between the assignor and the*

assignee and, in the absence of such agreement,] at the time of the assignment [or, in the case of a receivable arising from an agreement other than the original contract or from a court order, at the time when it [arises] [becomes payable]].

References:

A/CN.9/434, paras. 108 and 115-122 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 109-112 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 57-60 (Twenty-fourth session, 1995)

Remarks

1. Under draft article 12(a) in combination with draft article 5(2), a receivable is transferred at the time of the assignment, if the contract or other legal act from which it might arise exists at the time of assignment. The opening words may be retained if the Working Group wishes to preserve the rights of an insolvency administrator or the assignor's creditors with regard to existing receivables that have not been fully earned by performance at the time of the opening of the insolvency proceeding or attachment (draft article 12(a)) or with regard to receivables that have not arisen at that time (draft article 12(b)). Draft article 12(b) reflects a decision taken by the Working Group at its previous session (A/CN.9/434, para. 121). By establishing the rule that a receivable may be transferred even before it comes into existence, draft article 12(b) is aimed at establishing certainty as to the rights of the assignee and at facilitating the use by the assignor of its future receivables for financing purposes.

2. In order to enhance certainty and uniformity, the Working Group may wish to specify the exact time of assignment (the time of assignment is referred to in draft articles 15(1)(c) and 23-24). On the assumption that the Working Group decides that the assignment must be in writing, one approach might be to provide that the time of assignment is the time referred to in the assignment document. However, such an approach might create the risk of fraudulent behaviour of the assignor in collusion with the assignee (or one of the assignees) at the detriment of the insolvency administrator or the assignor's creditors (or other assignees).

Article 13 [10]. *Agreements limiting the assignor's right to assign*

(1) A receivable is transferred to the assignee notwithstanding any agreement between the assignor and the debtor *limiting in any way the assignor's right to assign its receivables.*

(2) Nothing in this article affects any obligation or liability of the assignor to the debtor in respect of an assignment made in breach of an agreement *limiting in any way the assignor's right to assign its receivables*, but the assignee is not liable to the debtor for such a breach.

References:

- A/CN.9/434, paras. 128-133 and 135-136 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 113-126 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 61-68 (Twenty-fourth session, 1995)

Remarks

1. The Working Group may wish to consider whether: the borrower in a syndicated bank loan may preclude the lenders from assigning the loan to a competitor of the borrower (which would not be a true assignment but a part of a take-over scheme); the assignor may preclude the assignee from assigning the receivables further (a no-assignment clause in the assignment); the assignee may preclude a subsequent assignee from assigning the receivables further (a no-assignment clause in a refinancing contract).

2. In addition, the Working Group may wish to consider whether a different approach is warranted in case the debtor is a State by providing, for example, that the assignment is effective for all purposes, but the State-debtor may discharge its obligation by paying the assignor. In such a case, if payment is made to the assignor, the assignee could still prevail over the assignor's creditors and the insolvency administrator with regard to the proceeds of the receivables.

Article 14 [11]. *Transfer of security rights*

(1) Unless otherwise provided by law or by agreement between the assignor and the assignee, any personal or property rights securing *payment of the assigned receivables* are transferred to the assignee without a new act of transfer.

(2) *Without prejudice to the rights of parties in possession of the goods, a right securing payment of the assigned receivables is transferred to the assignee, notwithstanding any agreement between the assignor and the debtor, or the person granting the security right, limiting in any way the assignor's right to assign such a security right.*

(3) *Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any security rights.*

References:

- A/CN.9/434, paras. 138-147 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 127-130 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 69-74 (Twenty-fourth session, 1995)

Remarks

1. Paragraph (2) has been prepared by the Secretariat in order to address concerns expressed at the previous session

of the Working Group (A/CN.9/434, paras. 143-145). It is intended to reflect the decision of the Working Group that: the transfer of security rights should be effective despite agreements between the assignor and the debtor restricting their transferability; and that the transfer of those security rights should not prejudice the rights of the guarantor/issuer of an independent undertaking or a party who is in possession of the goods (A/CN.9/434, para. 146).

2. Paragraph (2) does not refer to independent undertakings, since the rule in paragraph (1) cannot apply to such undertakings for the reason that they are not "security rights" and are normally not transferred automatically. Should the Working Group decide to extend the application of the rule in paragraph (1) to independent guarantees and stand-by letters of credit, a reference should be added in paragraph (1), e.g. to "supporting rights", while in paragraph (2) it should be ensured that such a transfer of "supporting rights" does not prejudice the rights of a guarantor/issuer of an independent undertaking (that would need to be defined, possibly along the lines of article 3 of the United Nations Guarantee and Standby Convention).

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Article 15 [12]. *Rights and obligations of the assignor and the assignee*

(1) Subject to the provisions of this Convention, the rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

(3) *In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage of which they knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to the particular receivables financing practice.*

References:

- A/CN.9/434, paras. 148-151 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 131-144 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 73, 81 and 95 (Twenty-fourth session, 1995)

Remarks

The Working Group may wish to merge paragraph (1) into draft article 11(1) and to delete paragraphs (2) and

(3). Paragraph (2) may not be necessary, since parties may, in any case, agree to be bound by usages or not to be bound by practices established between themselves. Paragraph (3) may introduce uncertainty since there does not seem to be a distinct body of usages on receivables financing practices.

Article 16 [13]. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents that:

(a) notwithstanding an agreement between the assignor and the assignee limiting in any way the assignor's rights to assign its receivables, the assignor has, at the time of assignment, the right to assign the receivable;

(b) the assignor has not [neither] previously assigned [, nor will later assign,] the receivable to another assignee; and

(c) the debtor does not have, at the time of assignment, any defences or rights of set-offs arising from the original contract or any other agreement with the assignor, other than those specified in the assignment.

(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.

References:

- A/CN.9/434, paras. 152-161 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 145-158 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 80-88 (Twenty-fourth session, 1995)

Remarks

1. In the context of its discussion on paragraph (1)(b), the Working Group may wish to consider the question whether a representation of the assignor that it will not assign the same receivables again should be retained in a default rule such as draft article 16. Normally, such "negative pledge" types of representations are a matter of negotiation and are undertaken only in the context of specific transactions.

2. Paragraph (1)(c) is intended to limit the representation as to the absence of defences of the debtor to situations involving contractual receivables, since such a representation would not be appropriate in the case of non-contractual receivables. The Working Group may wish to consider whether the representation as to the absence of defences of the debtor should also refer to defences arising after the time of the assignment.

Article 17 [14, 15]. *Notification of the assignment*

(1) The assignor and the assignee may agree as to which of them is entitled to notify the debtor and request payment and as to whether payment shall be made to the assignor or the assignee, or that no noti-

fication of the assignment shall be given to the debtor. In the absence of an agreement, both the assignor and the assignee are entitled to notify the debtor and request payment to the assignee.

(2) Notification of the assignment given to the debtor in breach of an agreement under paragraph (1) is effective, but may make the assignee liable to the assignor for breach of contract.

(3) Notification shall be in writing and shall reasonably identify the receivables and the person to whom or for whose account or the address to which the debtor is required to make payment.

(4) Notification of the assignment may relate to receivables arising after notification. [Such notification is effective for a period of five years after the date it is received by the debtor, unless:

(a) otherwise agreed between the assignee and the debtor; or

(b) the notification is renewed in writing during the period of its effectiveness [for a period of five years unless otherwise agreed between the assignee and the debtor.]

References:

- A/CN.9/434, paras. 162-165 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 159-164 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 89-97 (Twenty-fourth session, 1995)

Remarks

With the exception of the bracketed language in paragraph (4), draft article 17 is intended to reflect the agreement already reached by the Working Group on the issues addressed in this provision. The bracketed language in paragraph (4) is intended to protect the assignor by limiting the types of future receivables in respect of which notification may be given. While financiers may wish to obtain a right in all future receivables, they usually advance credit only on the basis of future receivables that may arise within a limited period of time. On the other hand, introducing such a time limit would place on the assignee and the debtor the burden of having to keep track of the time of effectiveness of notifications, and might increase uncertainty and the cost of credit.

Section II. Debtor

Article 18 [16]. *Debtor's discharge by payment*

(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying the assignor.

(2) After the debtor receives notification of the assignment, subject to paragraph (5) of this article, it is discharged only by paying in accordance with the payment instructions set forth in the notification.

(3) In case the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying in accordance with the payment instructions set forth in the first notification.

(4) [In case the debtor receives notification of the assignment from the assignee,] the debtor is entitled to request the assignee to furnish within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, [the writing evidencing assignment or] any [other] writing emanating from the assignor and indicating that the assignment has taken place.

(5) This article does not affect any other ground on which payment by the debtor to the party entitled to payment or to a competent judicial [or non-judicial] body, or to a public deposit fund discharges the debtor.

References:

A/CN.9/434, paras. 176-191 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 165-172 and 195-204 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 98-115 and 124-131 (Twenty-fourth session, 1995)

Remarks

1. Draft article 18 is intended to set forth the ways in which the debtor may discharge its obligation by payment. It is not meant to establish an obligation of the debtor to pay, which is left to the contract or other legal relationship between the assignor and the debtor and the law governing that relationship (see A/CN.9/432, paras. 173 and 181). The rule is that up to notification the debtor may discharge its obligation by paying the assignor (it may discharge by paying the assignee, but, in such a case, the debtor exposes itself to the risk of having to pay twice); after notification, discharge is obtained by payment to the assignee or to the person entitled to payment under paragraph (5).

2. Under paragraph (2), the debtor's obligation to pay the assignee or as instructed by the assignee is triggered by the receipt of the notification by the debtor. The assignee bears the burden of ensuring that the notification is received by the debtor and, if something goes wrong (e.g. the assignor undertakes to notify the debtor but fails to do so), the risk of loss may be allocated by agreement between the assignor and the assignee.

Article 19 [17]. *Defences and rights of set-off of the debtor*

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences arising from the original contract [or from any other agreement or court order giving rise to the assigned receivable] of which the debtor could avail itself if such claim were made by the assignor.

(2) The debtor may raise against the assignee any right of set-off arising from contracts between the assignor and the debtor other than the original contract [or any agreement or court order other than that giving rise to the assigned receivable], provided that they were available to the debtor at the time notification of the assignment was received by the debtor.

(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 13 against the assignor for breach of agreements limiting in any way the assignor's right to assign its receivables are not available to the debtor against the assignee.

References:

A/CN.9/434, paras. 194-204 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 205-209 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 132-151 (Twenty-fourth session, 1995)

Remarks

The Working Group may wish to address the question whether the debtor may raise against the assignee rights of set-off, the basis for which was created before notification, although they may have not been "available" to the debtor at that time (e.g. a reciprocal and similar claim which becomes payable only after notification).

Article 20 [19]. *Agreement not to raise defences and rights of set-off*

(1) Without prejudice to [the law governing consumer-protection] [public policy requirements] in the State in which the debtor has its place of business, the debtor may agree with the assignor in writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 19.

(2) The following defences may not be waived:

(a) defences arising from fraudulent acts on the part of the assignee or the assignor;

(b) defences based on the debtor's incapacity to incur liability; and

(c) the defence that the debtor has not signed the original contract [or other agreement giving rise to the assigned receivable], that the signature of the debtor has been forged, that the original contract [or other agreement giving rise to the assigned receivable] has been materially altered after the debtor signed it, that the agent who signed the original contract [or other agreement giving rise to the assigned receivable] for the debtor lacked authority to sign or exceeded such authority, or the signatory signed in a capacity other than as a representative of the debtor.

(3) An agreement between the assignor and the debtor not to raise any or certain defences and rights of set-off precludes the debtor from raising against the assignee those defences and rights of set-off.

(4) Such an agreement may only be modified by written agreement. [*Subject to article 21, such a modification is effective as against the assignee.*]

References:

A/CN.9/434, paras. 205-212 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 218-238 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 136-144 (Twenty-fourth session, 1995)

Remarks

The reference to the place of business of the debtor in paragraph (1) should be understood in the light of draft article 3(2)(b) (i.e. if the debtor does not have a place of business, reference is to be made to its registered office or its habitual residence). Paragraph (2) was drawn from article 30(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes^d (hereinafter referred to as "the United Nations Bills and Notes Convention"; see A/CN.9/434, para. 211). The words within square brackets in paragraph (2)(c) are intended to cover agreements whereby disputes arising from torts are settled. The second sentence of paragraph (4) is aimed at protecting the assignee from a modification of an agreement not to raise defences or rights of set-off, which may be agreed upon between the assignor and the debtor without the knowledge of the assignee. The Working Group may wish to consider whether the modification of such an agreement should be subject to the consent of the assignee.

Article 21 [18]. *Modification of the original contract*

(1) *An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee's right to payment is effective as against the assignee and the assignee acquires corresponding rights.*

(2) *After notification of the assignment, an agreement under paragraph (1) of this article is effective as against the assignee and the assignee acquires corresponding rights, [if it is made in good faith and in accordance with reasonable commercial standards or, in case of a modification relating to a receivable fully earned by performance, it is consented to by the assignee [if the modification is provided for in the assignment or is later consented to by the assignee].*

[(3) Paragraphs (1) and (2) of this article do not affect any right of the assignee against the assignor for breach of an agreement between the assignor and the assignee that the assignor will not modify the original contract without the assignee's consent.]

^dOfficial Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17), annex I; see also General Assembly resolution 43/165, annex, of 9 December 1988.

References:

A/CN.9/434, paras. 198-204 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 210-217 (Twenty-fifth session, 1996)

Remarks

1. The purpose of draft article 21 is twofold, first to protect the debtor by allowing the debtor to pay under the modified contract, and second to protect the assignee from such modifications and to ensure that the assignee acquires rights under the modified contract. The draft article covers contractual modifications (e.g. a modification of the time of payment or the amount owed, or an agreement not to raise defences; see also draft article 20(4)), but not modifications by operation of law or resulting from a court decision.

2. Under paragraph (2), a choice needs to be made. Reference to good faith may create some uncertainty, but avoids putting on the parties the burden of having to obtain the consent of the assignee to every little modification of an unperformed contract, a procedure that might be burdensome for the assignee as well.

3. The rule contained in paragraph (1) might well apply to cases in which non-contractual receivables might be modified by agreement. Paragraph (2), however, might not be appropriate in case of non-contractual receivables. In such cases, the consent of the assignee may be required if the modification is in the form of an agreement between the assignor and the debtor, but not if the modification takes the form of a court order.

Article 22 [20]. *Recovery of advances*

Without prejudice to [*the law governing consumer-protection*] [*public policy requirements*] in the country in which the debtor has its place of business and the debtor's rights under article 19, failure of the assignor to perform the original contract [*or other agreement or court order giving rise to the assigned receivable*] does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignee.

References:

A/CN.9/434, paras. 213-215 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 239-244 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 145-148 (Twenty-fourth session, 1995)

Section III. *Third parties*

Remarks

Rule based on registration

1. The Working Group has failed so far to reach agreement on a rule dealing with conflicts of priority. Draft

articles 23 and 24, as well as draft articles 1 to 6 of the annex to the draft Convention, constitute an effort to assist the Working Group in resolving this difficult issue. They are based on the assumption that a registration-based approach can provide more certainty and address more adequately conflicts of priority than any other system based on the time of the assignment or of notification of the debtor (no system can provide full certainty; see remark 2 to draft article 6 of the annex).

Interim or alternative rule

2. However, the priority rules of the draft Convention cannot be based on registration in the absence of an appropriate registration system. Therefore, an alternative regime needs to be provided for the intervening period until the establishment of an appropriate registration system, as well as for the period thereafter for those countries that may not wish to adopt a registration-based approach (ultimately, achieving real uniformity would depend on how successful the one or the other system proves to be in practice). Such an interim or alternative regime may be based on the time of the assignment, a conflict-of-laws rule, or no uniform rule at all.

Time-of-assignment rule

3. A priority rule based on the time of the assignment may work well in the context of local markets, in which potential assignees have a way to know assignors sufficiently well and, in addition, to acquire information about the financing transactions that take place through means other than, e.g. a public registry. However, in the context of a global market such an approach would not provide adequate protection to potential assignees, since they would have no other alternative but to rely on representations of the assignor or any other means of obtaining information about domestic financing transactions. In addition, an interim rule based on the time of the assignment would prevent the States that might be interested in a registration-based system from adopting the draft Convention since, until the registration system becomes operational, under a time-of-assignment rule, a prior foreign assignee would prevail over a domestic assignee who has registered under domestic rules.

4. However, the conflict between the assignee and the insolvency administrator or the assignor's creditors may be resolved without reference to registration. If an assignment is effective towards the assignor, it should be effective towards the insolvency administrator and the assignor's creditors. In addition, the element of reliance on the receivables by potential lenders and the need to forewarn them does not exist in case of conflicts with the insolvency administrator or the assignor's creditors. The situation may be different in the case of creditors relying on the receivables when they take legal action against the assignor, but even in that case the potential damage to those creditors as a result of the lack of publicity would be limited to the costs of the legal proceedings (the counter-argument should not be overlooked, namely that insolvency laws may, in principle, be against "secret rights" compromising the equal distribution of assets among creditors).

Conflict-of-laws rule

5. A uniform conflict-of-laws rule may not provide the desired uniformity with regard to the priority rights of assignees, since assignees, depending on the law applicable in each case, would have to follow a different process in order to obtain priority. In particular, a uniform conflict-of-laws rule providing that priority conflicts are governed by the law governing the receivable (e.g. the law governing the contract from which the receivable arises) would not provide the desired degree of certainty (draft article 28(1)). In order to determine the applicable law, the assignee would have to examine the agreement between the assignor and the debtor, and if there is no choice of law clause included in that agreement, the assignee would have to determine, e.g. which is the law with the closest relationship with the contract from which the receivable arises. In addition, as a result of such a rule, receivables arising from different contracts and assigned in bulk by the same assignor to the same assignee would be governed by different priority rules which would not be acceptable in practice.

6. However, a uniform conflict-of-laws approach would constitute an improvement of the present situation in that the same law would be applicable if a priority dispute were to be brought before the courts of any Contracting State. In particular, a rule, based on the place of business of the assignor or the place where insolvency proceedings are opened, would provide sufficient certainty, since assignees would normally be able to know which is that place at the time of assignment (draft article 28(2) and (3)). It should be noted that the Convention on the Law Applicable to Contractual Obligations^e, (Rome, 1980), hereinafter referred to as the "Rome Convention", does not deal with conflicts of priority (although the view has been expressed that, under article 12(2) of the Rome Convention, the law governing the receivable to which the assignment relates governs some conflicts of priority).

7. After the establishment of an international registration system, draft article 28 could function as a uniform conflict-of-laws rule. If the forum is in a Contracting State, the substantive provisions of the draft Convention would apply, provided that the assignor and the assignee are located in a Contracting State (draft article 1(1)(a)); otherwise, they would apply if the law applicable under draft article 28 is the law of a Contracting State (draft article 1(1)(b)). If the forum is in a non-Contracting State, the substantive provisions of the draft Convention would apply, provided that the conflict-of-laws provisions of the forum (not those of the draft Convention, which the forum does not have to apply since it is in a non-Contracting State) lead to the law of a Contracting State.

No interim or alternative rule

8. A regime based on registration without a substantive or conflict-of-laws rule, as an interim or alternative rule, would fail to provide the desired certainty and predictability with regard to the rights of assignees under the draft Convention. In addition, it would prevent States that might not wish to follow a registration-based approach from adopting the draft Convention.

^eUnited Nations, *Treaty Series*, vol. 1605, No. 28023.

Notification of the assignment

9. The regime contemplated in the draft Convention sets aside notification of the debtor as a way to determine priority. A priority system based on notification of the debtor could not work in international receivables financing, since, in order to find out whether earlier assignments have been made, assignees would have to contact and rely on information provided by debtors, which, if provided at all, may not be accurate or complete. In bulk assignments involving, e.g. hundreds of debtors in several countries, even if such a procedure were reliable, it would be time-consuming and costly; and if future receivables were involved, such a procedure would not be feasible, since the identity of the debtors would not be known at the time of assignment. In addition, an approach based on notification could not work in non-notification financing transactions (in which the assignment is a matter between the assignor and the assignee and the debtor is not notified).

Article 23 [22]. *Competing rights of several assignees*

(1) *Until the establishment of a registration system as provided in article 1 of the annex to this Convention, priority among several assignees of the same receivables from the same assignor [is determined on the basis of the time of the assignment] [will be governed by the law determined in accordance with paragraph (1) of article 28].*

(2) *After the establishment of a registration system as provided in article 1 of the annex to this Convention, priority among several assignees of the same receivables from the same assignor will be governed by paragraphs (3) and (4) of this article. However, if a State makes a declaration under paragraph (1) of article 30, priority will be [determined on the basis of the time of the assignment] [governed by the law determined in accordance with paragraph (1) of article 28].*

(3) *An assignee who has registered certain information about the assignment under this Convention has priority over another assignee of the same receivables from the same assignor who has registered later or not registered at all. If neither assignee registers, priority is determined on the basis of the time of the assignment.*

(4) *An assignee asserting priority under the provisions of this Convention has priority over an assignee asserting priority based on grounds other than the provisions of this Convention. However, if the State the law of which is applicable under paragraph (1) of article 28 has made a declaration under paragraph (2) of article 30, priority will be determined on the basis of the time of the assignment.*

(5) *Notwithstanding the preceding paragraphs of this article, conflicts of priority may be settled by agreement between competing assignees.*

References:

- A/CN.9/434, paras. 238-254 (Twenty-sixth session, 1996)
 A/CN.9/432, para. 247-252 (Twenty-fifth session, 1996)

Remarks

1. Draft article 23 deals with conflicts between several assignees of the same receivables from the same assignor (double financing). It is based on the assumption that an assignment made subsequent to the first assignment may be valid, a matter that the Working Group may wish to clarify further.

2. Paragraph (1) is intended to set forth a rule that would apply before the establishment of a registration system for the registration of assignments under the draft Convention. Even after the establishment of such a registration system, the system envisaged in paragraph (1) would apply in case a State declares that it will not be bound by the registration provisions of the draft Convention (see draft article 23(2) and 30(1)). Under the first set of bracketed language, the basis for resolving priority conflicts among several assignees of the same receivables from the same assignor would be the time of assignment, while, under the second set of bracketed language, such conflicts would be governed by the law applicable under draft article 28(1) (should that approach be preferred by the Working Group, paragraph (1) may be merged with the conflict-of-laws rule dealing with conflicts of priority, i.e. draft article 28). Paragraph (2) is aimed at introducing paragraphs (3) and (4), i.e. the priority regime that would prevail after the establishment of a registration system, unless a State makes a declaration under draft article 30(1). Under paragraph (3), priority conflicts would be resolved on the basis of registration and, in the absence of registration, on the basis of the time of the assignment.

3. Paragraph (4) deals with priority conflicts between a domestic and a foreign assignee of domestic receivables (such conflicts would be covered if both the domestic and the foreign assignee are located in a Contracting State; see draft article 1(1)(a)). Such conflicts could arise if the priority rules of the draft Convention are not identical with those applicable to domestic assignments of domestic receivables. They could also arise if the priority rules of the draft Convention and those of other applicable law require different types of registration (e.g. one requires international and the other requires local registration, although, in such a case, the problem may be addressed by requiring that data registered locally should be transmitted to the international registry; see introductory remark 8 to the registration provisions and remark 5 to draft article 3 of the annex).

4. Granting priority to a Convention assignee over a non-Convention assignee would result in maximum certainty with regard to the rights of Convention assignees, but could be objectionable to States, since the priority rule of the draft Convention would displace the non-Convention priority rule (this would be the result of the first set of bracketed language in paragraph (1)). The second sentence of paragraph (4) allows Contracting States to "opt out" of the rule contained in the first sentence of paragraph (4). The same result may be achieved through paragraph (2) allowing a State to opt out of the registration provisions of the draft Convention as a whole. Another way to approach this matter might be to leave it to the parties of a domestic assignment of domestic receivables to opt into the priority

rule of the draft Convention, e.g. by registering at the international registry.

5. Paragraph (5) is intended to preserve party autonomy in the settlement of priority disputes by allowing competing claimants to settle such disputes by agreement. Such an approach may enhance the chances of the assignor to obtain new financing on the basis of its receivables.

6. The Working Group may wish to address the conflict that might arise between an assignee and a person who extends to the assignor credit secured by a security interest in all the assignor's inventory (or a seller of goods retaining title until full payment of their price). Such a conflict may often arise since the right of the inventory financier may extend to the receivables generated from the sale of the inventory. If priority is given to the inventory financier, assignors whose receivables are created by the sale of inventory will not be able to obtain credit on the basis of those receivables (that would be the result of the first set of bracketed language in paragraph (1)). On the other hand, if priority is given to the first to register, an inventory financier would have to register at the international registry, although the draft Convention would not cover rights in inventory. Such an approach would present the advantage of providing certainty as to the rights of third parties, but also the disadvantage that it would supplant otherwise applicable law. The Working Group may wish to address the conflict that might arise between an assignee and an inventory financier in the same way as a conflict between a domestic and a foreign assignee of domestic receivables.

Article 24 [21, 23 and 24]. *Competing rights of assignee and insolvency administrator or creditors of the assignor*

(1) *Until the establishment of a registration system as provided in article 1 of the annex to this Convention, priority between an assignee and the insolvency administrator or the assignor's creditors will be governed by [paragraph (3) of this article] [the law determined in accordance with paragraphs (2) and (3) of article 28].*

(2) *After the establishment of a registration system as provided in article 1 of the annex to this Convention, conflicts of priority referred to in paragraph (1) of this article will be governed by paragraph (4) of this article. However, if a State makes a declaration under paragraph (1) of article 30, priority will be governed by [paragraph (3) of this article] [the law determined in accordance with paragraphs (2) and (3) of article 28].*

[(3) *An assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:*

(a) *the receivables [were assigned] [arose] [were earned by performance] before the opening of the insolvency proceeding or attachment; or*

(b) *the assignee has priority on grounds other than the provisions of this Convention].*

(4) *An assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:*

(a) *the receivables [were assigned] [arose] [were earned by performance], and information about the assignment was registered under this Convention, before the opening of the insolvency proceeding or attachment; or*

(b) *the assignee has priority on grounds other than the provisions of this Convention.*

(5) *Except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor's creditors.*

[(6) *This Convention does not affect:*

(a) *any right of creditors of the assignor to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer;*

(b) *any right of the administrator in the insolvency of the assignor,*

(i) *to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer,*

(ii) *to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment of receivables that have not arisen at the time of the opening of the insolvency proceeding,*

(iii) *to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract, or*

(iv) *to encumber the assigned receivables with the expenses of the insolvency administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee;*

(c) *in case the assigned receivables constitute security for indebtedness or other obligations,] any insolvency rules or procedures generally governing the insolvency of the assignor:*

(i) *permitting the insolvency administrator to encumber the assigned receivables with privileged claims for taxes, wages and similar privileges, provided that the assignee is treated fairly and equitably with other creditors whose receivables may be so encumbered,*

(ii) *providing for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding;*

(iii) *permitting substitution of the assigned receivables for new receivables of at least equal value,*

(iv) *providing for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured, or*

(v) *other rules and procedures of similar effect and of general application in the insolvency*

of the assignor [specifically described by a Contracting State in a declaration made at the time of signature, ratification, acceptance, approval of or accession to this Convention.]

(7) *An assignee asserting rights under this article has no fewer rights than an assignee asserting rights under other law.]*

[(8) *For the purposes of this article:*

(a) *“insolvency proceeding” means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the assignor are subject to control or supervision by a court for the purpose of reorganization or liquidation;*

(b) *“opening of an insolvency proceeding” is deemed to have taken place when the order opening the proceeding becomes effective, whether or not [final] [subject to appeal]; and*

(c) *“attachment” is deemed to have taken place when the order attaching the assigned receivables becomes effective, whether or not [final] [subject to appeal].]*

References:

A/CN.9/434, paras. 255-258 and 216-237 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 253-258 and 260 (Twenty-fifth session, 1996)

Remarks

1. Same as in draft article 23, paragraphs (1) and (2) of draft article 24 set forth a priority regime based on a distinction between the time before and the time after the establishment of a registration system under the draft Convention. In paragraph (1), a choice has to be made between a substantive rule based on the time of assignment and a conflict-of-laws rule.

2. In paragraph (3) or (4), whichever is preferred, a decision needs to be made as to whether the time of assignment or the time when the receivables arise or are fully earned by performance needs to be before the opening of the insolvency proceedings or attachment. An approach based on the time of assignment would result in receivables that may not have arisen or not been fully earned by performance before the opening of the insolvency proceedings or before attachment being taken away for the estate of the assignor, a result that might be considered as an undue interference with national law. The assignment of future receivables or not fully earned receivables is ineffective towards the insolvency administrator and the assignor's creditors in many legal systems since it is considered as being a disposition after the opening of the insolvency proceeding or after attachment.

3. Paragraph (5) is based on the assumption that, once the validity of an assignment has been established by the draft Convention, nothing inhibits the insolvency administrator or the assignor's creditors to challenge the assignment on any grounds other than its basic validity. Under paragraph (6), which appears within square brackets for the considera-

tion of the Working Group, certain matters are generally left to national insolvency law (e.g. the rights of the insolvency administrator with regard to post-insolvency future and unearned receivables, and its rights to assign or encumber the assigned receivables in certain circumstances); other matters would be left to national insolvency law only under certain conditions (e.g. if “equal value” is given to the assignee, or if a security assignment is involved). By listing the rights of an insolvency administrator that are not affected by the draft Convention, paragraph (6) may enhance certainty and predictability to the extent that an assignment may not be challenged on grounds other than those listed. On the other hand, to the extent that the list may not be exhaustive, such an approach may result in excluding rights of insolvency administrators currently existing under national insolvency law.

4. Paragraph (7) is intended to reflect the principle of national treatment of a foreign assignee, a principle that was broadly supported at the previous session of the Working Group (A/CN.9.434, para. 234).

Chapter V. Subsequent assignments

Article 25 [25]. *Subsequent assignments*

(1) This Convention applies to international assignments of receivables and to assignments of international receivables by the initial or any other assignee to subsequent assignees, even if the initial assignment is not governed by this Convention.

[(2) A subsequent assignee has the rights afforded by this Convention to an assignee and is subject to the debtor's defences and *rights of set-off* recognized by this Convention.]

[(3) A receivable assigned by the assignee to a subsequent assignee is transferred notwithstanding any agreement *limiting in any way the assignor's right to assign its receivables*. Nothing in this article affects any obligation or liability for breach of *such* an agreement, but the subsequent assignee is not liable for breach of that agreement.]

(4) Notwithstanding that the invalidity of an assignment renders all subsequent assignments invalid, the debtor is entitled to discharge its obligation by paying *in accordance with the payment instructions set forth in the first notification*.

References:

A/CN.9/432, paras. 264-268 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 188-195 (Twenty-fourth session, 1996)

Chapter VI. Conflict of laws

Article 26. *Law applicable to the rights and obligations of the assignor and the assignee*

(1) [With the exception of matters which are settled in this Convention,] *the [effectiveness] [validity] of an as-*

assignment as between the assignor and the assignee and the mutual rights and obligations of the assignor and the assignee are governed by the law [expressly] chosen by the assignor and the assignee.

(2) In the absence of a [valid] choice, *the [effectiveness] [validity] of an assignment as between the assignor and the assignee and the mutual rights of the assignor and the assignee are governed by the law of [the country in which the assignor has its place of business] [the country with which the [contract of] assignment is most closely connected].*

[(3) Unless the [contract of] assignment is clearly more closely connected with another country, it is deemed to be most closely connected with the country where the party who is to effect the performance which is characteristic of the [contract of] assignment has, at the time of conclusion of the [contract of] assignment, its place of business].

References:

- A/CN.9/WG.II/WP.87, article 21
 A/CN.9/WG.II/WP.90, paras. 4-7 and 15-18
 A/CN.9/420, paras. 185-195 (Twenty-fourth session, 1995)

Remarks

1. The Working Group may wish to consider the question of the scope of the conflict-of-laws rules (draft article 1(2)). If these rules are aimed at filling the gaps left in the draft Convention, their scope of application should be limited to the scope of the draft Convention (and, in order to avoid a *renvoi* situation, they should apply only in case the forum is in a Contracting State and not by way of the conflict-of-laws provisions of the forum). If, however, the Working Group prefers to establish a uniform conflict-of-laws regime with regard to assignment, as suggested by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.II/WP.90, paras. 4-7), the scope of the conflict-of-laws provisions of the draft Convention should be broader than the scope of the draft Convention (articles 21 and 22 of the United Nations Guarantee and Standby Convention constitute a precedent for such an approach).

2. The expression “the mutual rights and obligations of the assignor and the assignee”, drawn from the Rome Convention, is intended to cover both the contractual and the proprietary effects of the assignment as between the parties thereto (the term “relationship between the assignor and the assignee” may be too broad in that it could cover the financing contract as a whole; while the term “assignment” may be too narrow in that it would not cover the issue of the validity of the assignment, or too broad in that it could cover the effects of assignment towards the debtor).

3. Paragraph (3) is intended to supplement one of the options being offered in paragraph (2) (“the closest relationship” option, which is drawn from the Rome Convention).

Article 27. *Law applicable to the rights and obligations of the assignee and the debtor*

[With the exception of matters which are settled in this Convention,] *the assignability of a receivable, the right of the assignee to request payment, the debtor’s obligation to pay as instructed in the notification of the assignment, the discharge of the debtor and the debtor’s defences are governed by the law [governing the receivable to which the assignment relates] [of the country in which the debtor is located].*

References:

- A/CN.9/WG.II/WP.87, article 22
 A/CN.9/WG.II/WP.90, paras. 19-20
 A/CN.9/420, paras. 197-201 (Twenty-fourth session, 1995)

Remarks

Paragraph (1), following the approach of the Rome Convention, lists the matters covered by draft article 27. Such an approach may be justified, since: the general reference to “the rights and obligations” might create some uncertainty; there is no contractual relationship between the assignee and the debtor; and some issues that might be covered by draft article 27 might not fall under the “relationship” between or the “rights and obligations” of the assignee and the debtor, e.g. the assignability of a receivable, or even priority among several assignees of the same receivables. Such a list of rights and obligations could also include the obligation of the assignee, if any, to notify the debtor (the right of the assignee to notify the debtor might be part of the assignor-assignee relationship).

Article 28. *Law applicable to conflicts of priority*

(1) *The priority among several assignees obtaining the same receivables from the same assignor is governed by the law [governing the receivable to which the assignment relates] [of the country in which the assignor has its place of business].*

(2) *The [priority between an assignee and] [the effectiveness of an assignment as against] the insolvency administrator is governed by the law [governing insolvency] [of the country in which the assignor has its place of business].*

(3) *The [priority between an assignee and] [the effectiveness of an assignment as against] the assignor’s creditors is governed by the law of the country in which the assignor has its place of business.*

References:

- A/CN.9/WG.II/WP.87, article 23
 A/CN.9/WG.II/WP.90, paras. 21-22
 A/CN.9/420, para. 154 (Twenty-fourth session, 1995)

Chapter VII. Final clauses

Annex

Remarks

In view of the fact that the substantive provisions of the draft Conventions refer to a number of declarations, the Secretariat has prepared a tentative draft of certain final clauses dealing with declaration-related issues. Pending determination of the declarations in the substantive provisions of the draft Convention, draft articles 29 to 31 are aimed at raising the issues that should be addressed rather than resolving them in any final way.

[...]

Article 29. *Conflicts with international agreements*

A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that the Convention will not prevail over international conventions [or other multilateral or bilateral agreements] listed in the declaration, to which it has or will enter and which contain provisions concerning the matters governed by this Convention.

Article 30. *Registration*

(1) A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that it will not be bound by the registration provisions of this Convention.

(2) A State may declare, at [the time of signature, ratification, acceptance, approval or accession] [any time], that it will not be bound by paragraph (4) of article 23.

Article 31. *Effect of declaration*

(1) Declarations made under article 29 at the time of signature are subject to confirmation upon ratification, acceptance or approval.

(2) Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

(3) A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the expiration of six months after the date of its receipt by the depositary.

(4) Any State which makes a declaration under articles 29 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.

Article 32. *Reservations*

No reservations are permitted except those expressly authorized in this Convention.

Registration

Meaning and purpose

1. Registration under the draft Convention means the non-mandatory entering into a database of certain information about the assignment. The purpose of such registration is not to create or evidence property rights, but to protect third parties by putting them on notice about assignments, that have been concluded or will be concluded, and to provide a basis for settling conflicts of priority.

2. With regard to potential assignees, the effect of registration is that they are put on notice as to earlier or later assignments. The notice gives only enough information for the searcher to be forewarned and thereby enabled to make such further inquiry and take such further action as it deems appropriate under the circumstances. If no transaction is registered, potential lenders may obtain priority by registering (in such a case, however, an earlier assignee, who has not registered, may not be able to obtain payment; for a discussion of the concept of "priority", see remarks 2-4 to draft article 5). If a transaction is registered, they may request more information from their potential borrower or from registered lenders, seek to negotiate with registered lenders a subordination agreement (i.e. an agreement settling priority conflicts), or avoid to provide financing on the basis of the receivables in respect of which an assignment has been registered.

Key features

3. Because of its limited function, and in marked contrast to classic registration, registration under the draft Convention requires the placement on public record of a very limited amount of data, i.e. identification of the assignor and the assignee and a brief non-specific description of the receivables to be covered, which may be existing or future. This means that a single notice can cover a large number of present or future receivables, arising from one or several contracts, as well as a changing body of receivables and a constantly changing amount of secured debt often involved in modern financing ("revolving credit"). In addition, such registration is inexpensive and simple, requires no formalities (such as notarial involvement) and requires no supervision by the registrar, who performs the non-discretionary service of receiving, archiving and disclosing the data submitted for registration for the appropriate fee.

4. Registration of the entire transaction cannot accommodate the needs of modern financing in that it does not permit the registration of a transaction before the actual transaction has taken place and in that it would require multiple registration for successive transactions between the same parties, which would serve no purpose, burden the registry and entail additional cost. In addition, such registration would raise difficult legal issues, such as authentication.

5. Another key feature of registration under the draft Convention is that the registration process, i.e. the submission of data by the registering party to the registry, the

receipt of the data by the registry and the handling of the data by the registry so that the data become available to searchers, would need to be computerized.

6. With regard to the submission of data, two systems could be envisaged, the submission in paper and the submission in electronic form. Submission of data in paper form would require that the data be entered into the data base manually by the registry staff, which would increase the risk of error and the potential liability of the registry. A system that provides for direct electronic data entry, which is easily accommodated by existing telecommunication systems, would eliminate this problem. Either system of data submission could accommodate electronic, remote access, searching.

7. A purely electronic system (electronic data entry and electronic searching) would maximize efficiency and minimize human involvement, thereby permitting speed, availability at all hours, freedom from the risk of data entry error on the part of the registrar (which reduces its potential liability) and reduction in cost of registration. Users could enter data or conduct a search through a simple desktop or even a laptop computer via secure, private communications networks ("value added network" or "VAN"). In order to be able to make the data entered into the registry available to searchers, the registry needs to have software to convert the data entered to the format used by the registry and to archive and index the data.

8. A registration system could be based on an international registry/data base that could be linked to existing national registries. Countries that do not currently have such a registry would not need to establish one; registration could take place directly at the international registry. In countries that do have a registration system compatible with that of the draft Convention, registration could take place through the national registry. Such an approach would require, however, effective coordination between the several registration places, namely that all the data registered locally would be transmitted promptly to the international database.

Article 1. *Establishment of a registry*

At the request of not less than one third of the Contracting States, the depositary shall convene a conference for designating a registry or registries and enacting[, revising or amending] registration regulations for the registration of data about assignments under this Convention.

Remarks

1. In the absence of an international registration system, draft article 1 of the annex provides for a mechanism to trigger the application of the registration provisions of the draft Convention, i.e. the appointment of an organization to act as registry and the preparation of registration regulations by Contracting States (i.e. States in respect of which the draft Convention has entered into force).

2. While the basic principles applying to registration are set out in the text of the draft Convention, the mechanics

of the registration process that may need to be amended from time to time to fit changing needs and changing technologies are better dealt with in a separate body of rules, the regulations. Under draft article 1 of the annex, the initial set of regulations would need to be prepared by the Contracting States appointing an organization to act as registry. The Working Group may wish to consider whether the authority to revise or amend the regulations should stay with the Contracting States or be delegated to the registry. Under the draft UNIDROIT Convention on International Interests in Mobile Equipment (hereinafter referred to as "the draft Convention on Mobile Equipment"), the Governing Council of UNIDROIT is to determine the location of and manage the international registry envisaged, as well as promulgate from time to time the regulations necessary for the operation of the registry (UNIDROIT, Study LXXII, Doc. 30, 1996, draft article 16(2)).

Article 2. *Duties of the registry*

(1) *The registry receives data registered under this Convention and the regulations and maintains an index by the name of the assignor [and the registration number] in order to be able to make the data available to searchers upon request.*

(2) *Upon receipt of data, the registry shall assign a registration number and issue and send to the assignor and the assignee a verification statement in accordance with the regulations.*

(3) *Upon receiving a search request, the registry shall issue a search result in writing listing all data registered with regard to the receivables of a particular person.*

(4) *Upon expiration of the period of effectiveness of a registration, or receipt of a notice by the assignee or a court order issued under article 5 of the annex to this Convention, the registrar shall remove data registered from the public records of the registry.*

Remarks

1. Draft article 2 of the annex describes in general terms the duties of the registry. The verification statement referred to in paragraph (2) is aimed at allowing the assignor and the assignee to verify that the data entered into the registry correspond with the data that they wished to have entered and to correct any errors.

2. The Working Group may wish to consider the additional questions of court jurisdiction and liability. Registration-related disputes would normally involve priority conflicts between competing parties, or occasionally requests to the courts to issue orders binding on the registry. With regard to priority disputes, they could be left to be resolved by courts having jurisdiction with regard to the parties to such disputes. However, in order to avoid that conflicting orders are addressed to the registry, it may be desirable to have only one court with jurisdiction over the registry (e.g. a court in the country where the registry might be located, although if all that is established is a database, it might be difficult to determine its "location"). Alternatively, the international registry could be exempted

from the jurisdiction of any national court and registration-related disputes could be referred to alternative methods of dispute resolution. The draft Convention on Mobile Equipment vests the international registry with the privileges and immunities of an international organization and exempts it from the jurisdiction of national courts, subject to agreement to the contrary between the registry and the host State (UNIDROIT, Study LXXII, Doc. 30, 1996, draft article 16(3)).

3. With regard to the liability of the registry, it should be noted that national registration systems similar to that envisaged by the draft Convention have worked well with and without a liability rule. In jurisdictions in which the registry is liable for errors in the operation of the system, there have been very few liability suits. In some of those jurisdictions, a percentage of the registration fee is directed to a fund, the proceeds of which may be used to pay liability claims. Such an approach is considered as increasing the confidence of the users in the system. However, the risk of errors (and, therefore, the cost of insurance) would be significantly reduced in a fully electronic system, in which the only role of the registrar would be to maintain an operational system.

4. The determination of the issues of jurisdiction and liability depend to some extent on whether a governmental or private organization would run the registry. A governmental organization would normally enjoy sovereign immunity, while a private organization would be subject to the jurisdiction of a court and could be made liable more easily.

Article 3. *Registration*

(1) *Any person may register data with regard to an assignment at the registry in accordance with this Convention and the registration regulations. The data registered shall include the legal name and address of the assignor and the assignee and a brief description of the assigned receivables.*

(2) *Registration is effective from the time that the data referred to in paragraph (1) are available to searchers.*

(3) *Data may be registered before or after an assignment is made.*

(4) *Data registered may relate to one or more assignments and to receivables not existing at the time of registration.*

(5) *Any defect, irregularity, omission or error with regard to the legal name of the assignor that results in data registered not being found upon a search based on the legal name of the assignor renders the registration ineffective.*

Remarks

1. Following the example of modern national legislation, paragraph (1) limits the information that needs to be entered into the registry to the absolutely necessary for the registration to fulfil its "warning" function (additional identification elements may be provided for in the regula-

tions, e.g. the number given to a company by the company registry or another identification number, the date of birth of a person; "legal name" may be defined in the regulations).

2. The assignor's authorization is not part of the minimum data that need to be registered for the registration to be effective. Authorization is a matter between the parties and does not concern the registry in receiving data. In addition, parties may adequately protect their interests: lenders, by obtaining authorization from the assignor before extending credit; and assignors by demanding that data registered be removed from the public record of the registry (see draft article 5 of the annex; assignors are informed through the verification statement foreseen in draft article 2(2) of the annex). Additional remedies, e.g. for slander of title, may be provided in the draft Convention or left to national law.

3. The Working Group may wish to address the following questions: the effect of a change in the name of the assignor on the effectiveness of registration relating to receivables arising after the change (some statutes provide that the registration remains effective for a certain period of time after the assignee learns of the change of the name and the new name of the assignor); whether an all-encompassing description of the assigned receivables should be sufficient (e.g. "all present and future receivables") or whether a more specific description should be required (e.g. receivables arising in May, or receivables from sales of equipment or from sales to a particular debtor or from x, y, z contracts).

4. An additional question which the Working Group may wish to consider is the effect of a change in the place of business of the assignor with respect to receivables arising after the change. If the assignor's new place of business is in a Contracting State which has not declared that it will not be bound by the registration provisions of the draft Convention, no additional registration may be necessary. However, if the assignor moves to a non-Contracting State, the assignee may need to follow the process prescribed by the law of that State in order to ensure priority (although, under draft article 1(1)(a), the draft Convention is applicable as long as the assignor has its place of business in a Contracting State at the time of assignment, even if subsequently the assignor moves to a non-Contracting State).

5. Normally only assignments with an international element would be entered into the international registry. However, a domestic assignee of domestic receivables should be able to register ("opting into" the priority rules of the draft Convention). In jurisdictions with a registration system, the question might arise whether both local and international registration would be required. Local registration in the jurisdiction in which the assignor is located would sufficiently protect the assignee towards the insolvency administrator. However, for the assignee to ensure priority towards international assignees, international registration would be required. Problems might be overcome if the two registration systems were linked so that data registered locally would be transmitted to the international database. In such a case, local registration

would amount to international registration (see remark 5 to draft article 23 and introductory remark 8 to the registration provisions).

6. Paragraph (2) provides that registration is effective when the data become available to searchers. In a fully electronic system, the data would become searchable upon receipt by the registry. On the other hand, in case of a paper notice where the data would need to be entered into the database by the registry staff, the registration would become searchable and, therefore, effective only after the entry of the data in the computerized index. In such a case, the registering party could protect itself from the risk of losing its priority by withholding credit until the registration becomes effective.

7. Under paragraph (3), if A registers and receives an assignment subsequently, A will have priority from the time of registration, not the time of assignment. Such pre-registration is aimed at addressing the time-gap between the time of financing and the time of registration, during which uncertainty would prevail as to the rights of an assignee towards third parties.

Article 4. *Duration, continuation and amendment of registration*

(1) *A registration under this Convention is effective [for a period of five years after registration] [for the period of time specified by the registering party].*

(2) *A registration may be renewed for successive additional periods if it is requested six months before expiry of the period of its effectiveness for an additional period of [five years] [time specified by the registering party].*

(3) *A registration may be amended at any time during the period of its effectiveness. The amendment is effective from the time it becomes available to searchers.*

Remarks

Limiting the duration of the effectiveness of a registration is intended to ensure that the registration system is not over-burdened with data relating to non-existing rights. Often parties are not prepared to promptly cause the removal of data from the record of the registry, in particular if some cost is involved. Paragraph (1) presents two alternatives, one with a fixed time-limit and another, more flexible, that allows the parties to set the time during which a registration would be effective. In the large majority of cases, a 5-year time period might be sufficient. On the other hand, the ability of the parties to “buy” a longer time period *ab initio* would lessen the need for registering continuation statements.

Article 5. *Right of the assignor to remove or amend data registered*

(1) *The assignor may demand in writing that the assignee register a notice removing or amending the data registered. [The assignor shall state explicitly the nature of the action requested and the grounds for its request].*

(2) *If the assignee fails to comply with such demand within fifteen days of its receipt, the assignor may request a competent court to order that the data registered be removed or amended on the ground that they refer to receivables in which the assignee has no interest or has a different interest.*

Remarks

1. Under paragraph (1), the assignor may request from the assignee to cause the removal or amendment of data that are on the public record. If the assignee does not comply with that request, the assignor has to go to court (there is no automatic deregistration). Automatic deregistration would expose the assignee to the risk of losing its priority position, if it does not act to respond to an erroneous or mischievous demand by the assignor. This risk would be even greater in case of a demand made on the eve of insolvency and could affect the cost of credit. On the other hand, in favour of automatic deregistration, it could be argued that placing on the assignee the burden of having to go to court would be more appropriate, since the assignee may register without having to prove authorization by the assignor or that an assignment has taken place.

2. The Working Group may wish to specify the court with jurisdiction to issue the order referred to in paragraph (2).

Article 6. *Registry searches*

(1) *Any person may search the records of the registry and obtain a search result in writing.*

(2) *A search may be conducted according to the name of the assignor [or the registration number].*

[(3) *A search result in writing that purports to be issued from the registry is admissible as evidence and is, in the absence of evidence to the contrary, proof of the data to which the search relates, including:*

(a) *the date and time of registration; and*

(b) *the order of registration as indicated in the registration number referred to in the written search result.]*

Remarks

1. Paragraph (1) provides for a registry open to the public. In practice, a searching party will be either an actual or potential assignee or a third party acting on behalf of an assignee. In order not to exclude new methods of search, no method of search is specified in paragraph (1) (it is left to be addressed in the regulations). Paragraph (2) identifies two search criteria: the name of the assignor and the registration number (the number given to a company by the registry under draft article 2(2) of the annex). A search result may need to match only one of those criteria.

2. A search based on the name of the assignor may not reveal all prior assignments. For example, A (assignee) registers the assignment of receivables owned by B (assignor) after ensuring that B has not already assigned those receivables to someone else; B then assigns the same

receivables to C, who will be able to discover the existence of A's rights through a search using B's name. However, if C assigns to D, D will not be able to discover A's rights through a search based on C's name. The significance of this problem should not be exaggerated, since no registration system can provide absolute certainty. In the example given above, D will have to find the name of the initial assignor by relying on representations of its immediate assignor.

3. Another problem is the language to be used for the data entered into the international database to be reasonably retrievable (in particular for the name of the assignor, since this would be the relevant search criterion). The experience gained at the national level indicates that it would be possible for the international registry to operate, at some cost, in more than one language. This would mean

that certain languages would need to be identified as official languages of the registry. The Working Group may wish to consider whether the language problem may be addressed by the use of numbers (e.g. by using the registration number assigned by the registry as an alternative search criterion, or by using a number issued by a company registry or other authority to identify an assignor).

4. Paragraph (3), which appears within square brackets for the consideration of the Working Group, is intended to ensure that once a search result appears to be authentic, it should be admissible as *prima facie* evidence of the data it contains. However, a party may always challenge the authenticity of a search result. The Working Group may wish to consider whether paragraph (3) is necessary, since the admissibility and evidential value of a search result might be left to be freely evaluated by courts.

**C. Report of the Working Group on International Contract Practices
on the work of its twenty-eighth session
(New York, 2-13 March 1998) (A/CN.9/447) [Original: English]**

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I. INTRODUCTION

1. At its twenty-eight session, the Working Group on International Contract Practices continued its work on the preparation of a uniform law on assignment in receivables financing, pursuant to a decision taken by the Commission at its twenty-eighth session (Vienna, 2-26 May 1995)¹. It was the fifth session devoted to the preparation of that uniform law, tentatively entitled the draft Convention on Assignment in Receivables Financing.

2. The Commission's decision to undertake work on assignment in receivables financing was taken in response to suggestions made to it in particular at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century", held in New York from 17 to 21 May 1992 in conjunction with the twenty-fifth session. A related suggestion made at the Congress was for the Commission to resume its work on security interests in general, which the Commission at its thirteenth session (1980) had decided to defer for a later stage.²

3. At its twenty-sixth to twenty-eighth sessions (1993-1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.³

4. At its twenty-fourth session (Vienna, 8-19 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled "Discussion and preliminary draft of uniform rules" (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower-cost credit (A/CN.9/420, para. 16).

5. At its twenty-ninth session (1996), the Commission had before it the report of the twenty-fourth session of the Working Group (A/CN.9/420). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously.⁴

6. At its twenty-fifth session (New York, 8-19 July 1996), the deliberations of the Working Group were based on a note prepared by the Secretariat, which contained provisions on a variety of issues, including form and content of assignment, rights and obligations of the assignor, the assignee, the debtor and other third parties, subsequent assignments and conflict-of-laws issues (A/CN.9/WG.II/WP.87). At its twenty-sixth session (Vienna, 11-22 November 1996), the Working Group considered a note prepared by the Secretariat, which contained a revised version of the draft Convention on Assignment in Receivables Financing (A/CN.9/WG.II/WP.89).

7. At its thirtieth session (1997), the Commission had before it the reports of the twenty-fifth and twenty-sixth sessions of the Working Group (A/CN.9/432 and A/CN.9/434). The Commission noted that the Working Group had reached agreement on a number of issues and that the main outstanding issues included the effects of the assignment on third parties, such as the creditors of the assignor and the administrator in the insolvency of the assignor.⁵ In addition, the Commission noted that the draft Convention had aroused the interest of the receivables financing community and Governments, since it had the potential of increasing the availability of credit at more affordable rates.⁶

8. At its twenty-seventh session (Vienna, 20-31 October 1997),⁷ the Working Group continued its work by considering a revised version of the draft Convention contained in a note prepared by the Secretariat (A/CN.9/WG.II/WP.93). At that session, the Working Group adopted the working assumption that the text being prepared would include conflict-of-laws provisions dealing in particular with questions of priority (A/CN.9/445, paras. 27 and 31).

¹Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

²Ibid., Thirty-fifth Session, Supplement No. 17 (A/35/17), paras. 26-28.

³Ibid., Forty-eighth Session, Supplement No. 17 (A/48/17), paras. 297-301; *ibid.*, Forty-ninth Session, Supplement No. 17 (A/49/17), paras. 208-214; and *ibid.*, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

⁴Ibid., Fifty-first Session, Supplement No. 17 (A/51/17), para. 234.

⁵Ibid., Fifty-second Session, Supplement No. 17 (A/52/17), para. 254.

⁶Ibid., para. 256.

⁷The twenty-seventh session, which was originally scheduled to take place in New York from 23 June to 3 July 1997, had to be rescheduled as a result of the decision of the General Assembly to hold its nineteenth special session on Agenda 21 in New York from 23 to 27 June 1997.

9. The Working Group, which was composed of all States members of the Commission, held its twenty-seventh session in New York from 2 to 13 March 1998. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Botswana, Bulgaria, Chile, China, Ecuador, Egypt, Finland, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Poland, Russian Federation, Saudi Arabia, Singapore, Slovakia, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

10. The session was attended by observers from the following States: Benin, Canada, Côte d'Ivoire, Czech Republic, Democratic People's Republic of Korea, Democratic Republic of the Congo, Gabon, Guinea-Bissau, Indonesia, Iraq, Ireland, Kuwait, Mongolia, Qatar, Republic of Korea, Romania, Senegal, Sweden, Switzerland, Syrian Arab Republic, Turkey and Venezuela.

11. The session was attended by observers from the following international organizations: Association of the Bar of the City of New York (ABCNY), Banking Federation of the European Union, Cairo Regional Centre for International Commercial Arbitration, Commercial Finance Association (CFA), European Federation of National Factoring Associations (EUROPAFACTORING), Factors Chain International (FCI), International Association of Lawyers and International Bar Association (IBA).

12. The Working Group elected the following officers:

Chairman: Mr. David Morán Bovio (Spain)

Rapporteur: Mr. Abu Algassim Mergehni Mohammad (Sudan)

13. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.95) and a note by the Secretariat entitled "Revised articles of draft Convention on Assignment in Receivables Financing" (A/CN.9/WG.II/WP.96).

14. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of draft Convention on Assignment in Receivables Financing.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

15. Recalling that draft articles 14 to 22 had not been discussed at its previous session for lack of sufficient time, the Working Group decided to begin its deliberations by discussing draft article 14. The Working Group considered draft articles 14-22 and 25-28, as set forth in document A/CN.9/WG.II/WP.96.

16. The deliberations and conclusions of the Working Group, including its consideration of various draft provisions, are set forth below in chapters III and IV. The Working Group adopted the substance of draft articles 14-16 and 18-21 and referred them to a drafting group established by the Secretariat to align the various language versions of the draft articles adopted. In addition, the Working Group requested the Secretariat to revise draft article 17, taking into account the deliberations and conclusions of the Working Group.

III. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Article 14. *Rights and obligations of the assignor and the assignee*

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

"(1) Subject to the provisions of this Convention, the rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

"(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

"(3) In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage of which they knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to the particular receivables financing practice."

Paragraph (1)

18. The Working Group adopted the substance of paragraph (1) unchanged.

Paragraph (2)

19. The view was expressed that paragraph (2) should be deleted. In support, it was stated that the paragraph was redundant, since parties might in any case agree to be bound by usages and were normally bound by practices established between themselves. In addition, it was observed that, in situations where successive assignments were to be expected in the normal course of a transaction (e.g. in the case of an international factoring agreement), the paragraph might create uncertainty as to which usages and practices would be binding on subsequent assignees who would not necessarily be aware of those usages and practices agreed upon between the initial assignor and the initial assignee.

20. The prevailing view, however, was that the paragraph should be retained. It was pointed out that while in many countries a provision along the lines of paragraph (2) might be regarded as stating the obvious, there might also exist jurisdictions where the principles on which the paragraph was based might not be taken for granted. That was said to be a reason for which those principles had been expressed in the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)^a, hereinafter referred to as “the United Nations Sales Convention”. In addition, it was observed that any discrepancy between the draft Convention and the United Nations Sales Convention in that regard might create difficulties in the interpretation of both instruments. With respect to the objection raised regarding successive assignments, it was widely felt that since the paragraph dealt with the two-party relationship between each assignor and its assignee, there might be no ambiguity as to which usages and practices were binding in the context of that relationship. After discussion, the Working Group adopted the substance of paragraph (2) unchanged.

Paragraph (3)

21. The view was expressed that paragraph (3) should be deleted since it merely restated a widely accepted principle, under which certain usages would be made applicable to a contractual relationship in the absence of a contrary agreement. In addition, it was stated that the paragraph might introduce uncertainty since currently there did not seem to exist a distinct body of usages on receivables financing practices. In favour of deletion of paragraph (3), it was also observed that, as currently drafted, it might result in the assignor and the assignee being bound by usages of which they might not be aware. In that context, it was pointed out that recognizing the faculty of the parties to agree otherwise might not provide a satisfactory solution, since it would be extremely difficult for the parties who were unaware of a given usage to agree upon the exclusion of that usage.

22. The prevailing view, however, was that paragraph (3) might serve a useful purpose in limiting the reference to trade usages to those usages that were regularly observed in international trade. Regarding the objection that there currently existed no generally accepted usages or practices for receivables financing in international trade, it was stated that, pending the emergence of such international usages, paragraph (3) would appropriately result in excluding those purely domestic usages that should not be binding upon parties to an international assignment. It was also pointed out that the need to prevent international transactions from being subject to domestic usages was a reason why references to internationally accepted usages had been inserted in the United Nations Sales Convention. It was generally felt that the possibility for parties to adjust the contents of their contractual relationship provided them with sufficient protection against any usage which they might regard as unsuitable.

^aOfficial 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.

23. However, in order to accommodate the concerns expressed, a number of suggestions were made. One suggestion was that the text should indicate more clearly that the parties to the assignment could exclude the application of usages to their assignment by way of an explicit or an implied agreement. That suggestion was objected to on the grounds that: it could raise problems in the interpretation of other provisions of the draft Convention where reference was made to the contrary agreement of the parties; and such an approach would unnecessarily interfere with contract law applicable outside the draft Convention.

24. Another suggestion was that the reference to actual or constructive knowledge reflected in the words “knew or ought to have known” should be deleted. In support of deletion, it was stated that while such a reference to the subjective knowledge of the parties might be useful in a two-party relationship, it would be inappropriate in a tripartite relationship, since it would be extremely difficult for third parties to determine what the assignor and the assignee knew or ought to have known. General support was expressed in favour of that suggestion. Subject to that change, the Working Group adopted the substance of paragraph (3).

Article 15. Representations of the assignor

25. The text of draft article 15 as considered by the Working Group was as follows:

“(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents that:

“(a) [notwithstanding an agreement between the assignor and the assignee limiting in any way the assignor’s rights to assign its receivables,] the assignor has, at the time of assignment, the right to assign the receivable;

“(b) the assignor has not previously assigned [, nor will later assign,] the receivable to another assignee; and

“(c) the debtor does not have, at the time of assignment, any defences or rights of set-off arising under the original contract or any other agreement with the assignor, other than those specified in the assignment.

“(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.”

Paragraph (1)

Chapeau

26. There was general agreement in the Working Group that the *chapeau* should include a reference to the point of time when the assignor had to make the representations referred to in draft article 15. As to the question what that time should be, after discussion, the Working Group decided that it should be the time of the conclusion of the contract of assignment. Subject to that change, the Working Group adopted the substance of the *chapeau*.

Subparagraph (a)

27. It was generally felt that the bracketed language contained in subparagraph (a) was repetitious, since it was implicit in draft article 12 that the assignor had a right to transfer its receivables despite the existence of an anti-assignment clause contained in the contract under which the receivables arose ("the original contract"). While the view was expressed that despite its being repetitious the bracketed language should be retained for the purpose of ensuring absolute clarity, the prevailing view was that the matter was sufficiently clear and that the bracketed language could thus be deleted.

28. As to statutory limitations of the assignor's right to assign its receivables, it was generally agreed that subparagraph (a) properly allocated between the assignor and the assignee the risk that the assignment might be invalidated as a result of such limitations, since the assignor was in a better position to know whether there was a statutory limitation of its right to assign its receivables.

29. The Working Group noted that, as a result of its decision to include in the *chapeau* a reference to the point of time when the assignor had to make the representations referred to in draft article 15, the reference to the time of the assignment contained in subparagraph (a) was no longer necessary. The view was expressed, however, that a distinction should be drawn between the time when the representations were made and the time when they had to take effect.

30. While it was agreed that it was appropriate to draw such a distinction, a number of concerns were expressed with regard to the reference to the time of assignment, a term defined in draft article 5 (k). One concern was that such a reference was incomplete, since draft article 15 was based on the assumption that the parties to the assignment had not dealt with the issue of representations in their agreement and yet draft article 5 (k) failed to cover the situation in which the parties had not specified the time of the assignment in their agreement. Another concern was that, as a result of the formulation of the definition of the time of the assignment contained in draft article 5 (k), the representation referred to in subparagraph (a) could inadvertently take effect even after the conclusion of the contract of assignment, a result which was said to be inappropriate. After discussion, the Working Group adopted the substance of subparagraph (a), subject to the deletion of the bracketed language and the reference to the time of the assignment.

Subparagraph (b)

31. The Working Group first considered the question whether the reference to the representation that the assignor would not assign the same receivables again, which appeared in subparagraph (b) within square brackets, should be retained. In support of retention, it was observed that in assignments involving the transfer of property in receivables the assignee would normally require the assignor to undertake that the assignor would not assign the same receivables again. In support of deletion,

it was stated that such a representation would not be appropriate in an assignment by way of security in which only a part of a receivable was encumbered. In that connection, it was observed that the right of the assignor to offer to different lenders different parts of the receivables was at the heart of important financing practices and should be preserved. In addition, it was said that such a representation was normally negotiated in the context of specific transactions and did not belong in a default rule that was intended to apply to various types of transactions.

32. As to the words "previously assigned", it was generally felt that they would be meaningful only if a point of time were to be included, in respect of which it could be determined what "previous" assignment meant. Further to the decision of the Working Group to include in the *chapeau* a reference to the point of time at which the representations were to be made, it was generally agreed that the words "previously assigned" could be retained. Subject to the deletion of the bracketed language, the Working Group adopted the substance of subparagraph (b).

Subparagraph (c)

33. A number of concerns were expressed with regard to the representation as to the defences and rights of set-off of the debtor contained in the subparagraph. One concern was that in bulk assignments by way of security a representation along the lines of subparagraph (c) would not be appropriate, since the assignor might have no way of knowing whether the various debtors had such defences. In order to address that concern, it was suggested that the subparagraph should be deleted and that the matter should be left to the trade usages and practices that would be applicable under draft article 14, paragraph (2). That suggestion was objected to on the ground that credit was normally extended on the basis of receivables that were not subject to defences. In addition, it was stated that, in the case of bulk assignments involving receivables that were likely to be subject to defences on the part of the debtors, assignors received credit representing only the amount of those receivables that were not subject to any defences, while they had to repay a higher amount. Moreover, it was said that, in the so-called "recourse financing", if the assignee was unable to obtain payment as a result of defences raised by the debtor, the assignor had to take the receivables back and replace them with other receivables.

34. Another concern was that limiting the representations to be undertaken by the assignor under subparagraph (c) to contractual defences and rights of set-off would inappropriately expose the assignee to defences and rights of set-off that might not be of a contractual nature. It was therefore suggested that the bracketed language contained in subparagraph (c) should be deleted. As to the words "other than those specified in the assignment", it was generally felt that they should be deleted, since: they were redundant in view of the reference to a contrary agreement between the assignor and the assignee contained in the *chapeau* of paragraph (1); and they introduced a rather rigid approach in that failure to specify all possible defences of the debtor in the assignment would inadvertently result in the assignor being in breach if such defences arose.

35. Yet another concern was that, by referring to the time of the conclusion of the contract of assignment, subparagraph (c) could inadvertently result in the assignor making representations as to the absence of defences and rights of set-off, the existence of which would be unknown to the assignor at the time of the conclusion of the contract of assignment (i.e. defences and rights of set-off that might arise under contracts to be concluded in the future). It was stated that that result would be inappropriate.

36. In order to address that concern, it was suggested that subparagraph (c) should be revised with a view to ensuring that, in the case of future receivables, the representation as to the absence of defences on the part of the debtor should take effect at the time when the receivables arose. That suggestion was objected to on the ground that such a different treatment of defences arising from existing or from future contracts was not justified. It was explained that the assignee needed the representations to take effect at the time of transfer of the receivable and, under draft article 11, that time was the time of the assignment in the case of both existing and future receivables.

37. While it was generally recognized that the time of transfer of the receivables should be the time of the assignment, the Working Group was reminded of the concerns raised with regard to the definition of the “time of the assignment” contained in draft article 5 (k) (see para. 30, above). It was thus suggested that subparagraph (c) should be rephrased to reflect the general understanding of the Working Group without referring to draft article 5 (k). According to that suggestion, subparagraph (c) should read along the following lines: “if the receivable is an existing receivable, the debtor does not have and will not have any defences or rights of set-off and, if the receivable is a future receivable, the debtor will not have any defences or rights of set-off at or after the time when the receivable arises”. While the thrust of that suggestion was found to be generally acceptable, the Working Group preferred a simpler formulation along the following lines: “the debtor does not have and will not have any defences or rights of set-off”.

38. In the discussion, the question was raised as to whether future rights of set-off arising under contracts that were unrelated to the original contract would be covered in subparagraph (c). In response, it was stated that such rights of set-off that were available to the debtor under draft article 19, paragraph (2) would indeed be covered. In addition, it was observed that the assignee could protect itself against such rights of the debtor by notifying the debtor.

39. After discussion, the Working Group adopted the substance of subparagraph (c) as suggested at the end of paragraph 37 above.

Paragraph (2)

40. It was generally agreed that paragraph (2) appropriately allocated the credit risk as between the assignor and the assignee. After discussion, the Working Group adopted the substance of paragraph (2) unchanged.

Article 16. Notification of the debtor

41. The text of draft article 16 as considered by the Working Group was as follows:

“(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment and request that payment be made to the assignee.

“(2) Notification of the assignment or request for payment made by the assignor or the assignee in breach of an agreement under paragraph (1) is effective. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

“(3) Notification shall be in writing and shall reasonably identify the receivables and the person to whom or for whose account or the address to which the debtor is required to make payment.

“(4) Notification of the assignment may relate to receivables arising after notification. [Such notification is effective for a period of five years after the date it is received by the debtor, unless:

“(a) otherwise agreed between the assignee and the debtor; or

“(b) the notification is renewed in writing during the period of its effectiveness [for a period of five years unless otherwise agreed between the assignee and the debtor.]]”

Paragraph (1)

42. It was generally agreed that paragraph (1) was appropriately cast with a view to establishing a right and not an obligation to notify the debtor. It was stated that an obligation to notify the debtor could undermine useful financing practices in which the debtor was not notified of the assignment and was expected to continue paying the assignor. With regard to the final words of paragraph (1), the view was expressed that they unnecessarily restricted the scope of the provision to situations where the notification would involve a request of payment to the assignee. It was widely felt that wording along the lines of article 18, paragraph (2), would more appropriately refer to payment being made “in accordance with the payment instructions set forth in the notification”. Subject to that modification, the Working Group adopted the substance of paragraph (1) (in the context of its discussion of draft article 18, paragraph (2), the Working Group modified the reference to “payment instructions”, see paras. 72-73 and 78, below).

Paragraph (2)

43. It was stated that, as currently drafted, paragraph (2) could be used to settle questions other than the discharge of the debtor’s obligations, such as priority between competing assignees (e.g. where applicable law would give priority to the assignee who first notified the debtor), which was said to be inappropriate. On the other hand, it was observed that the purpose of paragraph (2) was to overcome situations where there might exist restrictions to the freedom of the parties to notify the debtor.

44. As a matter of drafting, it was widely felt that the words “an agreement under paragraph (1)” might be misinterpreted as requiring the conclusion of a specific agreement between the assignor and the assignee. It was decided that those words should be replaced by the words “an agreement referred to in paragraph (1)”. Subject to that modification, the Working Group adopted the substance of paragraph (2).

Paragraph (3)

45. It was generally felt that the draft Convention should contain a provision regarding the language in which the notification should be made. As to how that provision might be structured, there was general agreement that it should recognize any language which was reasonably designed to inform the debtor about the content of the notification. In addition, in view of the important consequences of notification under the draft Convention, that provision should establish certainty by way of a “safe harbour” rule, i.e. a rule under which the effectiveness of a notification in a specified language would be recognized. Moreover, that provision should recognize the effectiveness of multilingual notifications.

46. It was thus suggested that wording along the following lines should be added to the text of paragraph (3) or in a new paragraph of draft article 16: “Notification shall be in any language that is reasonably designed to inform the debtor about the content of the notification. For the purpose of this paragraph, it shall be sufficient if notification is given in the language of the original contract.” After discussion, the Working Group adopted the substance of paragraph (3) and of the new paragraph. In the context of its discussion on draft articles 18, paragraphs (2) and (3), 19, paragraph (2), and 21, new paragraph (4), the Working Group reopened discussion on draft article 16, paragraph (3) (see paras. 74-76, 82-83, 99-100 and 135, below).

Paragraph (4)

47. With respect to the second sentence of paragraph (4), which currently appeared within square brackets, it was generally felt that the reference to a fixed period of effectiveness of the notification was inappropriate. It was pointed out that: there normally existed no agreement between the assignee and the debtor; it would be difficult for the assignee to establish the date at which the notification had been received by the debtor; the debtor would be overly burdened with the obligation to verify the date of notification in order to assess whether it could obtain discharge by paying the assignee; and the period of five years was arbitrary and would not necessarily correspond to a limitation period in all contracting States. Subject to the deletion of the second sentence, the Working Group adopted the substance of paragraph (4).

Article 17. Right of the assignee to payment

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

“(1) The assignee is entitled to payment of the assigned receivable. Unless otherwise agreed between the

assignor and the assignee, if payment is made to the assignee, the assignee is entitled to retain whatever it receives.

“(2) Unless otherwise agreed between the assignor and the assignee, if payment is made to the assignor, the assignee has a right in whatever is received by that assignor.

“(3) If payment is made to another person, including another assignee, a creditor of the assignor or the insolvency administrator, the assignee has a right in whatever is received by that person.”

Paragraphs (1) and (2)

49. While support was expressed in favour of the principles embodied in paragraphs (1) and (2), a number of suggestions were made with regard to their exact formulation. One suggestion was that the first sentence of paragraph (1) should be deleted. In support of deletion, it was stated that the right of the assignee to payment would sufficiently result from the agreement between the assignor and the assignee. That suggestion was objected to on the ground that the first sentence of paragraph (1), as the core provision of draft article 17, was necessary to establish the right of the assignee to payment.

50. Another suggestion was that, in order to avoid affecting the rights of third parties, the rule under which the assignee was entitled to payment should be limited in scope by inserting at the beginning of the first sentence of paragraph (1) the words “as between the assignor and the assignee”. It was stated that the matter of the right of the assignee to request payment from the debtor had already been established in draft articles 2, paragraph (1), 10 and 16, paragraph (1), and was implicit in draft article 18, while the rights of third parties were dealt with in draft articles 23, 24, 34, 35, 39 and 40. The view was expressed, however, that not dealing clearly with the right of the assignee to claim payment from the debtor in the core provision of the draft Convention dealing with the right of the assignee to payment might cast uncertainty as to whether the assignee could request payment from the debtor, in particular before notification.

51. Yet another suggestion was that the words “to the extent of its right in the receivable” should be added at the end of paragraph (1). It was explained that the proposed language would address situations in which the assignee in an assignment by way of security had to account for and return to the assignor any surplus remaining after satisfaction of the assignee’s claim against the assignor. The Working Group found that suggestion to be generally acceptable.

52. Yet another suggestion was that, in order to address situations in which payment of the assigned receivable was effected in kind, the words “discharge of the debtor’s obligation” should be substituted for the term “payment”. It was observed that, while payment of receivables was normally made by tendering money, in some situations goods might be offered in discharge of the assigned receivable. In particular in the context of factoring transactions, it was

said to be important to establish the right of the assignee to recover from the assignor or to retain returned goods in discharge of the assigned receivable.

53. It was stated that the concern regarding a possible payment in kind might sufficiently be taken care of under draft article 2, paragraph (3), which had been patterned after article 7 of the UNIDROIT Convention on International Factoring (Ottawa, 1988), hereinafter referred to as “the Ottawa Convention”. It was also observed that since the definition of “receivable” included any right arising under the original contract, “payment of the receivable” would include discharge of the receivable in kind.

54. It was widely felt, however, that an additional provision might need to be prepared to deal with the limited number of cases where goods were returned to or recovered by the assignee in discharge of the assigned receivable. On the other hand, it was generally agreed that the reference to “payment” should be maintained in draft article 17. In that connection, the suggestion was made that a definition of “payment” might be introduced in draft article 17 to include payment in kind. That suggestion was objected to on the grounds that introducing a definition of “payment” for the sole purpose of draft article 17 might create interpretation problems with respect to the provisions of the draft Convention in which the term “payment” was used.

New proposed paragraph (1)

55. With a view to addressing the various suggestions made with respect to paragraphs (1) and (2), it was proposed that the two paragraphs might be merged and reworded along the following lines:

“(1) As between the assignor and the assignee, unless otherwise agreed between them, the assignee is entitled to payment of the assigned receivable and is entitled:

“(a) to whatever is or will be received by the assignor in total or partial discharge of the receivable, and

“(b) to retain whatever it receives in such discharge.

“The assignee may not under this paragraph retain an amount in excess of its right in the receivable.”

56. While the proposed wording was found to provide an acceptable basis for continuation of the discussion, various amendments were suggested. One suggestion was to replace the words “as between the assignor and the assignee” with the words “without prejudice to the rights of third parties”, to the effect that the right of the assignee to claim payment from the debtor would be preserved under draft article 17. Another suggestion was that the reference to “discharge” might not be equally meaningful in all legal systems and that the notion of “payment” should be re-introduced, since payment was a familiar concept in all legal systems. Yet another suggestion was to insert in draft article 17 a provision dealing with the right of the assignee to claim payment before notification of the assignment. In response to that suggestion, it was pointed out that the right of the assignee to claim payment before notification

had been established implicitly in draft article 10, while in such a situation a defence was provided to the debtor in draft article 18. Yet another suggestion was that the provisions of draft articles 16 and 17 might need to be clarified with respect to the possible interplay between the notification on the one hand and the request for payment on the other.

57. After discussion, the Working Group requested the Secretariat to prepare a revised version of paragraphs (1) and (2), taking into account the above-mentioned views and suggestions.

Paragraph (3)

58. The view was expressed that it was necessary to indicate more clearly in paragraph (3) a principle that was already implied in the current draft, namely that the assignee had a right in any proceeds of the assigned receivables received by another person in payment of the receivables, provided that the assignee had priority over that person. In order to achieve that result, it was suggested that paragraph (3) should be revised to read along the following lines:

“If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to whatever is or will be received by that person in total or partial discharge of the receivable. The assignee may not under this paragraph claim or retain an amount in excess of its right in the receivables.”

59. As to the use of the word “priority”, the view was expressed that it was too vague and should be supplemented by a reference to the priority rules of the draft Convention. However, it was observed that such an approach would inadvertently result in leaving unaddressed situations in which the right of the person receiving payment was based not on priority but on other considerations (e.g. good faith). In order to cover such situations, it was suggested that reference should rather be made to the assignee’s “superior right under applicable law”.

60. That suggestion was objected to on the ground that if, e.g. the proceeds of the receivables were received in good faith by a depositary institution and were commingled with other assets so that they could no longer be identified as proceeds of the receivable, the assignee should not be able to claim those proceeds, even if it had priority. It was not uncommon for such conflicts to arise in situations where, e.g. a dealer of equipment assigned to different financing institutions receivables arising from sales distinguished per type of equipment. Such conflicts could be usefully addressed by agreement between the various creditors (so-called “inter-creditor agreements”). It was observed, however, that in situations in which the proceeds of the receivables were deposited in a financing institution by or on behalf of the assignor, even under the proposed wording which referred to priority, the assignee would have to claim the proceeds from the assignor, who in fact would be the person that received payment, and not from the institution in which the proceeds might have been deposited.

61. With regard to the second sentence of the proposed wording, the concern was expressed that it might run counter to normal practice under which the assignee obtained payment of the full amount of the receivable and had to give account and return to the assignor or its other creditors any remaining surplus. In order to address that concern, the suggestion was made that the words "claim or" should be deleted.

62. After discussion, the Working Group requested the Secretariat to prepare a revised version of paragraph (3) taking into account the views expressed and the suggestions made.

Priority in proceeds of receivables

63. The Working Group next turned to the question whether the assignee's right in the proceeds of the assigned receivables should be a personal or a proprietary right (*ad personam* or *in rem*). It was widely felt that the issue was an important one, in particular in case the assignor became insolvent, and should be addressed in the draft Convention. As to the specific way in which that issue could be addressed, differing views were expressed. One view was that the assignee's right in the proceeds of receivables should be treated as a right *in rem*. Such an approach would reduce the risk of non-payment of the assignee, since in case of insolvency the assignee could take the receivables out of the insolvency estate or, at least, be treated as a secured creditor. Such a result was said to have the potential of decreasing the cost of credit. It was widely felt, however, that the assignee's right in the proceeds of receivables should be cast as a right *ad personam*. It was pointed out that attempting to follow another approach would run counter to national law involving public policy considerations. It was further observed that, in view of its inconsistency with basic principles of national law in many jurisdictions, an approach based on a right *in rem* of the assignee in the proceeds of the assigned receivables could jeopardize the acceptability of the draft Convention to many States. After discussion, the Working Group concluded that the issue could not be addressed by a substantive law rule and decided to explore the possibility of devising a private international law rule.

64. A number of suggestions were made in that connection. One suggestion was that priority in proceeds of receivables should be left to the law of the country in which the assignor was located. Such an approach would be consistent with the approach followed in the context of priority with regard to receivables. In addition, it was observed that such an approach would result in the law governing priority being the law of the jurisdiction in which insolvency proceedings with regard to the assignor were most likely to be opened (i.e. the law of the country in which the assignor was located). That suggestion was opposed on the ground that it would not be acceptable to subject the rights of, e.g. a holder of a negotiable instrument or the beneficiary of a funds transfer or the person in possession of goods received in discharge of the assigned receivable, to the law of the country in which the assignor was located.

65. Another suggestion was that priority in proceeds of receivables should be left to the law of the country in

which the proceeds were located. Such an approach would ensure that mandatory rules of law dealing, e.g. with rights in negotiable instruments or goods would prevail. That suggestion was also objected to on the ground that it would be inappropriate to subject to different laws different stages of the same transaction (i.e. payment in cash, then in the form of a negotiable instrument, then in the form of a funds transfer) or different forms of the same assets (i.e. receivables and different types of proceeds). In addition, it was pointed out that such an approach could inadvertently result in assignees structuring transactions in an artificial way in order to subject them to the law of a convenient jurisdiction ("forum shopping"). Yet another suggestion was that priority in proceeds of receivables should be made subject to the law of the country in which the assignee was located. That suggestion was objected to on grounds similar to those mentioned in opposition to the approach based on the location of the proceeds.

66. In view of the difficulty in addressing priority in all types of proceeds even by way of a private international law rule, the suggestion was made that the private international law rule to be prepared might address issues of priority only in proceeds that were receivables. Under such an approach, it would be easier for the Working Group to agree on a private international law rule along the lines of draft articles 23 and 24 that provided for the application of the law of the country in which the assignor was located. Alternatively, it was observed, priority in other types of proceeds could be addressed as well, presumably through a rule based on the location of the proceeds, e.g. in the form of negotiable instruments or goods.

67. The concern was expressed that, irrespective of the approach to be taken with regard to the law applicable to issues of priority in proceeds of receivables, the matter would remain unaddressed if the law applicable did not deal with it. In order to address that concern, it was suggested that a substantive law rule might be included in the draft Convention which would apply only in case the applicable law did not deal with the matter. Alternatively, it was suggested, the draft Convention might provide alternative substantive law rules for Contracting States to choose from. Both suggestions were objected to on the grounds that the approach suggested could inadvertently result in fragmentation of the law applicable and thus in increased uncertainty.

68. After discussion, the Working Group requested the Secretariat to prepare a draft text to address issues of priority in proceeds of receivables, taking into account the views expressed and the suggestions made.

Section II. Debtor

Article 18. Debtor's discharge by payment

69. The text of draft article 18 as considered by the Working Group was as follows:

"(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying the assignor.

“(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (5) of this article, it is discharged only by paying in accordance with the payment instructions set forth in the notification.

“(3) In case the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying in accordance with the payment instructions set forth in the first notification received by the debtor.

“(4) [In case the debtor receives notification of the assignment from the assignee,] the debtor is entitled to request the assignee to furnish within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, [the writing evidencing assignment or] any [other] writing emanating from the assignor and indicating that the assignment has taken place.

“(5) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.”

Paragraph (1)

70. The Working Group adopted the substance of paragraph (1) unchanged.

Paragraph (2)

71. General support was expressed in favour of the principle embodied in paragraph (2) that, subject to the exceptions established in paragraphs (3) to (5), after notification the debtor could discharge its obligation only by paying the person identified in the notification.

72. However, the reference to payment instructions contained in paragraph (2) raised a number of concerns. One concern was that it could be read as giving the assignee the right to change the payment terms contained in the original contract, in particular the country and the currency of payment, a result that would run counter to draft article 7, paragraph (2). Another concern was that a reference to payment instructions could inadvertently result in uncertainty as to whether the debtor could be discharged by paying the assignee in case of a notification containing incomplete instructions. It was generally agreed that that matter needed to be clarified by including in draft article 5 (f) a cross-reference to draft article 16, paragraph (3). However, the view was expressed that an exception had to be made in draft article 19 to the effect that a notification that would not include payment instructions could cut off the debtor's rights of set-off acquired after notification based on contracts with the assignor that were unrelated to the original contract.

73. In order to address those concerns, it was suggested that paragraph (2) should be aligned with draft article 16, paragraph (3), and the reference to “payment instructions” should be replaced by the words “the person or to the account or address identified in the notification”.

74. The Working Group then went on to consider the relationship between the notification and the payment instructions. The view was expressed that a clear distinction should be drawn between the notification of the assignment and the payment instructions (in other terms, the request for payment). According to that view, the notification should identify the assigned receivables and the request for payment should identify the payee. In order to reflect that view, it was suggested that draft article 16, paragraph (3), should be revised along the following lines:

“(3) Notification of the assignment shall be in writing and shall reasonably identify the receivables.

“(4) A request for payment shall be in writing and, subject to article 7(2), shall identify the person to whom or for whose account or the address to which the debtor is required to make payment. A request for payment may be included in the notification or may be sent later.”

75. Some support was expressed in favour of the approach suggested on the ground that it accurately reflected practice in which a clear distinction was drawn between notification and request for payment. It was stated that that approach was justified in view of the difference, both in purpose and in timing, between a notification and a request for payment. In addition, it was pointed out that, under its current formulation, draft article 16, paragraph (3), would inadvertently result in invalidating notifications that failed to identify the payee, a result that would hamper currently existing practices.

76. The suggested approach was objected to on a number of grounds. It was stated that it unnecessarily formalized a distinction that had practical importance only in some practices. For example, it was observed that in factoring transactions a notification normally included a request for payment to the assignee. It was also pointed out that even in those transactions in which assignees notified debtors of the assignment without requesting payment to be made to them, a notification would normally include an instruction that the debtor should keep paying the assignor. Such notifications were said to be merely intended to cut off any rights of set-off that the debtor might acquire based on dealings with the assignor that were unrelated to the original contract. In addition, it was observed that such an approach could inadvertently result in an increase in the cost of credit, since, if notification did not specify the assignee or the person authorized to issue payment instructions on behalf of the assignee, assignees would always have to send a request for payment. Moreover, such an approach would complicate the matter of the discharge of the debtor's obligation, in particular in case the debtor received several notifications and several requests for payment.

77. In the discussion, the question was raised as to whether payment to the assignor with the consent of the assignee, which could take place, e.g. in the context of situations involving a prolonged retention of title, could discharge the debtor's obligation. In response, it was observed that, under paragraph (1), in the absence of notification of the assignment the debtor had the right to discharge its obligation by paying the assignor. In the case of notification, the same result could be reached through a

combined application of paragraph (2) and draft article 16, paragraph (3), since the assignee could request that payment be made to the assignor.

78. After discussion, the Working Group adopted the substance of paragraph (2), subject to replacing the reference to payment instructions with the words "the person or to the account or address identified in the notification".

Paragraph (3)

79. It was noted that paragraph (3) was intended to cover situations in which the debtor received several notifications relating to more than one assignment of the same receivables made by the same assignor. It was generally agreed that in such situations the debtor should be able to discharge its obligation by paying the person identified in the first notification. It was stated that the debtor should be provided with an easy mechanism to discharge its obligation and could not be expected to find out who among several assignees of the same receivables was the rightful claimant. In response to a question, it was explained that the issue as to whether the assignee who received payment by the debtor could retain the proceeds of payment was not addressed in draft article 18 but in the provisions dealing with priority. A suggestion to revise paragraph (3) in order to allow the debtor to discharge its obligation by paying the person identified in any notification was not met with approval.

80. Noting that paragraph (3) was not intended to cover situations in which several notifications related to one and the same assignment, the Working Group considered the question whether the paragraph should be revised in order to address the issue of corrections of mistakes or changes in payment instructions contained in a notification. It was pointed out that a rule along the lines of paragraph (3) could inadvertently result in the assignee being unable to correct mistakes made in the first notification or to change its payment instructions.

81. As to the specific way in which those issues should be addressed, a number of suggestions were made. One suggestion was that the issuer of the first notification should be allowed to correct or to change it. That suggestion was objected to on the ground that, if the issuer of the first notification was the assignor, it should not be allowed to change the payment instructions given in the notification, since the assignor was divested of its rights in the receivables. It was thus suggested that the right to correct or to change the payment instructions should be reserved for the assignee. That suggestion was also objected to on the ground that, if the first notification was given by the assignor, only the assignor could correct or change it. Both of the above-mentioned suggestions were objected to on the ground that a rule subjecting the debtor's discharge to corrections or changes made in the notification by the assignor or the assignee would inappropriately require the debtor to determine the correct or accurate content of the notification. Such a result would place on the debtor the risk of loss for mistakes made by, or changes in the intentions of, the assignor or the assignee and could thus jeopardize the certainty needed in a rule dealing with the debt-

or's protection. It was therefore suggested that the matter should be left to be resolved by national law and practice.

82. In view of its discussion of the issue of payment instructions, the Working Group decided that a reference to the assignee should be added in draft article 16, paragraph (3). It was widely felt that the debtor needed to know, in addition to the identity of the payee, the identity of the assignee who could issue payment instructions. The suggestion to also refer to the person authorized by the assignee to issue payment instructions was objected to on the ground that the assignee's right to authorize someone else to issue payment instructions was sufficiently based on agency law and did not need to be explicitly mentioned in draft article 16, paragraph (3).

83. Still with regard to draft article 16, paragraph (3), it was stated that the notification should be kept as simple as possible in order to avoid that an incomplete notification would be invalid. The validity of the notification, it was said, should depend exclusively on the identification of the assignee and the receivables assigned, while identification of the payee or any payment instructions should not constitute a necessary element. It was, therefore, pointed out that it would be necessary to reconsider the wording of draft article 16, paragraph (3).

84. In the discussion, the question was raised as to whether paragraph (3) was inconsistent with draft article 17 which established the right of each assignee to payment. In response, it was pointed out that, by allowing the debtor to discharge its obligation through payment to the person identified in the first notification, the paragraph established a defence that the debtor could raise against all other assignees.

85. After discussion, the Working Group adopted the substance of paragraph (3), subject to replacing the reference to payment instructions by the words "the person or to the account or address identified in the first notification received".

Paragraph (4)

86. While general support was expressed in favour of the substance of the rule contained in paragraph (4), a number of suggestions were made. One suggestion was that the assignee should be under a general obligation to attach to the notification adequate proof of the assignment. That suggestion was objected to on the ground that such an approach would inadvertently result in an increase in the cost of credit.

87. Another suggestion was that the words "and until" should be inserted after the word "unless" in order to make it clear that the proof of the assignment should be submitted by the assignee to the debtor "within a reasonable period of time" and prior to the time of payment. That suggestion did not attract support in view of the general understanding that, under paragraph (4), the debtor who had requested proof of the assignment should suspend payment until such proof had been received or the reasonable period had elapsed. It was generally felt that the sug-

gested wording might be misinterpreted as allowing the debtor to discharge its payment obligation by paying the assignor during the “reasonable period” referred to in paragraph (4).

88. Yet another suggestion was that the scope of the paragraph should be expanded to cover defective notifications and thus that the paragraph should be rephrased along the following lines:

“In case the debtor receives payment instructions which are incomplete, unclear or otherwise defective, the debtor is entitled to request the assignee or the person identified in the notification as the person entitled to issue payment instructions to furnish within a reasonable period of time such information as is needed to complete, clarify or correct such payment instructions and, unless the assignee or such person entitled to issue payment instructions does so, the debtor is discharged by paying the assignor.”

89. It was generally felt that adding the proposed wording was unnecessary, since a defective notification, i.e. a notification that did not contain all the elements described in draft article 16, paragraph (3), would be ineffective. It was generally agreed that the opening words (“In case the debtor receives notification of the assignment from the assignee”) adequately reflected the need to protect the debtor in case notification was received by a person unknown to the debtor and should thus be retained.

90. As a matter of drafting, it was suggested that the reference to the proof of the assignment being “furnished” by the assignee should be avoided since, in certain jurisdictions, it might be interpreted as prescribing that the original documents evidencing the assignment should be delivered to the debtor, to the exclusion of any copy of such documents. It was generally felt that words such as “exhibited”, “displayed” or “provided” would be preferable. For the same reasons, it was agreed that, pending a final decision as to the form of the assignment, the words between square brackets (“the writing evidencing the assignment or”) should be deleted. Subject to those modifications, the Working Group adopted the substance of paragraph (4).

Paragraph (5)

91. General support was expressed in favour of the principle embodied in paragraph (5) that draft article 18 was not intended to exclude other grounds for discharge of the debtor that might exist under law applicable outside the draft Convention.

92. However, the view was expressed that the words “any other ground” might not make it sufficiently clear that the paragraph referred to the provisions of applicable law outside the draft Convention, including contractual and non-contractual law. It was generally agreed that such an interpretation, in conformity with the interpretation given of references to “any other ground” in the Ottawa Convention, could appropriately be given in a commentary to the draft Convention, to be prepared at a later stage.

93. A related view was that the words “to the person entitled to payment” might raise some uncertainty as to how the debtor was to determine who was the rightful claimant. It was generally felt, however, that the reference being made to payment “to the person entitled to payment” was particularly useful and provided the necessary degree of flexibility by establishing a “safe harbour rule” under which, irrespective of whether payment was made in accordance with the other provisions of draft article 18, the debtor could obtain discharge of its obligation by paying the rightful claimant. After discussion, the Working Group adopted the substance of paragraph (5) unchanged.

Article 19. Defences and rights of set-off of the debtor

94. The text of draft article 19 as considered by the Working Group was as follows:

“(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences arising from the original contract [or from a decision of a judicial or other authority giving rise to the assigned receivable] of which the debtor could avail itself if such claim were made by the assignor.

“(2) The debtor may raise against the assignee any rights of set-off arising from contracts between the assignor and the debtor other than the original contract [or from a decision of a judicial or other authority other than that giving rise to the assigned receivable], provided that they were available to the debtor at the time notification of the assignment was received by the debtor.

“(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 12 against the assignor for breach of agreements limiting in any way the assignor’s right to assign its receivables are not available to the debtor against the assignee.”

Paragraph (1)

95. The Working Group found the substance of the paragraph to be generally acceptable. It was pointed out, however, that the term “defences” might insufficiently cover rights to raise a counter-claim arising under the original contract. It was thus decided that the words “or rights of set-off” should be inserted after the words “all defences” in paragraph (1). Subject to that change, the Working Group adopted the substance of paragraph (1).

Paragraph (2)

96. While support was expressed in favour of the principle that notification should cut off certain rights of set-off that the debtor might have against the assignee, a number of concerns were expressed with regard to the current formulation of paragraph (2). One concern was that the paragraph might inappropriately limit the rights of set-off arising from contractual sources, thus excluding rights of set-off arising from non-contractual sources or rights based on law or a judicial or other decision. In order to address that concern, it was suggested that the words “aris-

ing ... the assigned receivable]” should be deleted and that paragraph (2) should be rephrased to refer to “any other” rights of set-off. That suggestion was broadly supported.

97. Another concern was that the reference to the rights of set-off being “available” to the debtor when the notification was received might be insufficiently precise regarding the required degree of maturity of a right of set-off at the time of notification. In order to address that concern, the suggestion was made that rights of set-off should not only be “available” but also “actual and ascertained” at the time when notification was received. That suggestion was objected to on the ground that it would inappropriately limit the rights of set-off of the debtor to those in which the amount of the counter-claim was fixed at the time of notification. It was suggested that such an approach would unnecessarily interfere with national law on set-off, a matter on which national systems were said to differ widely.

98. As to how rights of set-off arising prior to notification and not quantified at the time when notification was received might be accommodated by the draft Convention, it was suggested that a distinction should be drawn between rights of set-off arising from contracts related (“*connex*”) to the original contract and those rights of set-off arising from contracts unrelated to the original contract. Accordingly, the former should be “available” even if they were not quantified at the time of notification, while the latter should be “available” only if they were quantified at the time of notification. It was generally felt, however, that it might not be feasible to unify in the context of draft article 19 the various legal regimes governing set-off. After discussion, the Working Group decided to leave the matter to the applicable law. In that connection, the suggestion was made that paragraph (2) should then specify which law would be applicable to set-off. The Working Group generally agreed to defer its discussion on the law applicable to set-off until it had completed its review of draft article 30.

99. In the discussion, the view was expressed that in the context of paragraph (2) an exception should be made to the rule contained in draft article 16, paragraph (3). It was stated that such an exception would result in a notification that did not identify the payee cutting off rights of set-off that might become available to the debtor after notification. It was pointed out that such an approach would reflect current practice and failure to adopt it could hamper such practices and adversely affect the availability and the cost of credit.

100. While some support was expressed for the above suggestion, a number of objections were raised. It was observed that the suggested approach would jeopardize the certainty needed for debtors to the extent that debtors, including consumer-debtors, would inappropriately be required to know that a notification had different effects for the purposes of the various provisions of the draft Convention. In addition, it was pointed out that the suggested approach would not provide the degree of certainty required by assignees (i.e. financiers), since they would normally identify the payee in the notification, along the lines of draft article 16, paragraph (3), as adopted by the Working Group. In response, it was observed that, while it

would be normal practice to identify the payee in the context of certain transactions (e.g. factoring), a notification would not always contain an identification of the payee in the context of other practices, under which notification was merely intended to cut off the debtor’s rights of set-off that might arise after notification based on a source other than the original contract. For that reason, draft article 16, paragraph (3), requiring identification of the payee in the notification would need to be reconsidered. After discussion, the Working Group decided that paragraph (2) should include within square brackets language reflecting the above-mentioned suggestion for consideration at a future session and referred the specific formulation to the drafting group. The decision was made on the understanding that draft article 16, paragraph (3), might need to be reconsidered at a later stage. Subject to that modification and the modification mentioned in paragraph 96 above, the Working Group adopted the substance of paragraph (2).

Paragraph (3)

101. The view was expressed that draft article 12 would only be acceptable if the debtor could raise against the assignee any rights of set-off that might be available to the debtor against the assignor for violation of an anti-assignment clause. The suggestion was thus made that paragraph (3) should be either deleted or revised to reflect that view. The prevailing view, however, was that, in case of an assignment made in breach of an anti-assignment clause, the debtor could claim damages only from the assignor and not from the assignee. Such an approach was generally found to be consistent with the approach followed in draft article 12, according to which any liability existing under the law applicable outside the draft Convention for the violation of an anti-assignment clause by the assignor should not be extended to the assignee, since that could render the assignment of no value to the assignee.

102. As a matter of drafting, it was suggested that the reference to paragraph (2) contained in paragraph (3) should be deleted, since paragraph (3) referred to defences and rights of set-off arising because of a violation of anti-assignment clauses included in the original contract. That suggestion was objected to on the ground that anti-assignment clauses might be agreed upon by the assignor and the debtor in an agreement other than the original contract. After discussion, the Working Group adopted the substance of paragraph (3) unchanged.

Article 20. Agreement not to raise defences or rights of set-off

103. The text of draft article 20 as considered by the Working Group was as follows:

“(1) Without prejudice to [the law governing consumer protection] [public policy requirements] in the State in which the debtor is located, the debtor may agree with the assignor in writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 19. Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.

“(2) The debtor may not agree not to raise:

“(a) defences arising from fraudulent acts on the part of the assignee or the assignor;

“(b) the right to contest the validity of the original contract.

“(3) Such an agreement may only be modified by written agreement. [After notification, such a modification is effective as against the assignee subject to article 21(2).]”

Paragraph (1)

104. Various views were expressed as to whether the opening words of the first sentence should refer to the law governing consumer protection or to public policy requirements. One view was that the reference to public policy requirements should be retained, since it would parallel existing rules under many national laws. A related view was that both references to consumer protection and to public policy requirements should be retained in order to ensure maximum protection of the debtor. The prevailing view, however, was that the reference to public policy should be avoided, since it would inappropriately widen the scope of the exceptions to the provision and create uncertainty as to its contents. Moreover, it was pointed out that the question of public policy was sufficiently addressed in the context of draft articles 32 and 33 dealing with mandatory rules and public policy respectively.

105. As to the reference to consumer-protection legislation, the view was expressed that it should be limited to: statutory law (thus excluding the application of case law, the contents of which might be difficult to ascertain); and to the law applicable to individuals, i.e. natural persons (thus excluding the law applicable to legal persons, although certain associations or small unincorporated businesses might be treated as “consumers” under consumer-protection legislation in certain countries). It was suggested that elements of a definition of “consumer” for the purposes of draft article 20 could be drawn from draft article 4 (a), which dealt with assignments made “for personal, family or household purposes”.

106. It was widely felt, however, that it would be overly ambitious for the draft Convention to attempt to unify notions such as “consumer” or “law governing consumer protection” by way of a substantive law provision. Any attempt to define “consumer” in the context of draft article 20 or more generally for the purposes of the draft Convention would deviate from the approach taken in previous international legal instruments adopted by UNCITRAL. After discussion, the Working Group agreed that it would be preferable for the draft Convention to deal with the matter of consumer protection by way of a conflict-of-laws rule under which the definition of “consumer”, as well as the scope and contents of any “law governing consumer protection”, would be determined by the law of the country in which the debtor was located.

107. As to the second sentence of paragraph (1), while the view was expressed that it merely stated the obvious consequence of the rule contained in the first sentence, it

was generally felt that it should be maintained for the purpose of clarity. After discussion, subject to the above-mentioned deletion of the reference to public policy requirements, the Working Group adopted the substance of paragraph (1) unchanged.

Paragraph (2)

Opening words

108. As a matter of drafting, it was generally agreed that the words “the debtor may not agree not to raise” should be replaced by wording such as “the debtor may not agree to exclude”.

Subparagraph (a)

109. The view was expressed that the reference to defences arising from fraudulent acts on the part of the assignor should be deleted. In support, it was stated that such a reference might introduce uncertainty in a number of financial transactions by requiring the assignee to investigate whether the original contract might be vitiated by fraud on the part of the assignor. It was also stated that, in the context of paragraph (2), it was important to grant protection to the assignee who had acted in good faith. It was generally felt that the reference to “fraudulent acts on the part of the assignee” would sufficiently address the need to cover both cases where fraud had been committed by the assignee alone or by the assignee in collusion with the assignor. After discussion, it was decided that subparagraph (a) should read along the following lines: “defences arising from fraudulent acts on the part of the assignee”.

Subparagraph (b)

110. A concern was expressed that precluding the debtor from agreeing not to raise “the right to contest the validity of the original contract” might run counter to existing practice, which was said to be essential in the context of financing of export transactions and under which debtors would agree not to raise defences arising from the possible invalidity of the original contract. Such practice was consistent with the need to preserve the assignee from having to investigate the validity of the underlying original contract.

111. It was recalled that paragraph (2) had been inspired by article 30, paragraph (1), of the United Nations Convention on International Bills of Exchange and International Promissory Notes (1988)^b, hereinafter referred to as “the United Nations Bills and Notes Convention”; (see A/CN.9/434, para. 211) and was intended to parallel in the context of assignment of receivables the legal regime of negotiable instruments. The discussion focused on the ways in which such a parallel might be established. Various views were expressed in that respect.

^bOfficial Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17), annex I; see also General Assembly resolution 43/165, annex, of 9 December 1988.

112. One view was that the matter might be dealt with by way of a general reference to the law of negotiable instruments. Pursuant to that view, a proposal was made that subparagraph (b) should be rephrased along the following lines: "The debtor may not agree not to raise against the assignee defences or rights of set-off which the debtor would be entitled to raise if the receivable were embodied in a negotiable instrument issued in the State in which the debtor is located". It was stated that, should the proposed wording be retained as stating a general rule, subparagraph (a) as currently drafted could be mentioned as an illustration of that rule. That proposal was supported on the ground that it would accommodate the above-mentioned practice in the financing of export transactions by validating clauses under which debtors would agree not to raise defences arising from the possible invalidity of the original contract. A related proposal was that paragraph (2) might merely refer to article 30, paragraph (1), of the United Nations Bills and Notes Convention, which would thus be incorporated by reference into the draft Convention.

113. However, doubts were expressed as to whether it would be appropriate to regulate the issue by way of a mere reference to the law of negotiable instruments, which might not in all countries be similar to the legal regime established by the United Nations Bills and Notes Convention. Doubts were also expressed as to whether a reference to the law of negotiable instruments was consistent with draft article 4 (b), which excluded the application of the draft Convention to transfers of receivables by endorsement or delivery of a negotiable instrument. In addition, it was stated that referring to the law governing negotiable instruments might run counter to the will of the parties, since their decision not to incorporate their receivables in negotiable instruments might indicate their intent not to make their transaction subject to the law of negotiable instruments. In that context, it was stated that paragraph (2) as currently drafted should be regarded as establishing the minimum level of protection for the debtor. With a view to preserving that minimum level of protection, it was suggested that the words "to the extent that it would contravene the public policy of the State in which the debtor is located" might be added at the end of subparagraph (b).

114. Another view was that paragraph (2) should be replaced by substantive provisions drawn from article 30, paragraph (1) (a) and (c), of the United Nations Bills and Notes Convention. While providing the debtor with a level of protection similar to that currently embodied in paragraph (2), such a substantive provision could avoid any reference to the "validity" of the original contract, a reference which might prove ambiguous in view of the various concepts (e.g. misrepresentation, error and other defences) that might be associated with it in certain legal systems.

115. With a view to reflecting the possible contents of substantive provisions drawn from article 30, paragraph (1), of the United Nations Bills and Notes Convention, the following text was proposed as a substitute for paragraph (2) (b):

"(b) defences based on the debtor's incapacity to incur liability on the original contract;

"(c) where the original contract is in writing, defences based on the fact that the debtor signed the original contract without knowledge that the debtor's signature made the debtor a party to the contract, provided that such lack of knowledge was not due to the debtor's negligence and provided that the debtor was fraudulently induced to sign".

116. It was observed that the proposed new subparagraphs (b) and (c) were based solely on the provisions of article 30, paragraph (1) (c), of the United Nations Bills and Notes Convention. Thus, article 30, paragraph (1) (a), of that Convention, which empowered a party to set up against a holder of a negotiable instrument "defences under paragraph 1 of article 33, article 34, paragraph 1 of article 35, paragraph 3 of article 36, paragraph 1 of article 53, paragraph 1 of article 57, paragraph 1 of article 63 and article 84 of [the Bills and Notes] Convention", was not reflected in the proposal. It was explained by the proponents of the new subparagraphs that the defences listed in article 30, paragraph (1) (a), of the Bills and Notes Convention were either not applicable in the context of assignment transactions or, if applicable, were of the kind that should be subject to waiver by the debtor. While it was widely felt that further deliberation might be needed at a future session regarding the extent to which the draft Convention should parallel the approach taken in article 30, paragraph (1), of the Bills and Notes Convention, the Working Group agreed that the proposed text provided an appropriate basis for continuation of the discussion.

117. Wide support was expressed for new paragraph (2) (b), which was said to dispel uncertainty by avoiding the reference to the notion of the "validity" of the original contract. With respect to the proposed reference to the "incapacity" of the debtor to incur liability, it was generally felt that the text should make it clear that it was also intended to refer to the possible lack of authority of the debtor to incur liability, a concept which might not be encompassed by the notion of "incapacity" in all legal systems. On that assumption, the Working Group adopted the substance of new paragraph (2) (b) and referred it to the drafting group.

118. Support was also expressed in favour of new paragraph (2) (c). The view was expressed, however, that the proposed text might need to be considered more carefully at a future session in the light of the need to ensure an appropriate level of protection of the debtor. In particular, it was stated that imposing upon the debtor the cumulative obligation to prove that it had not been negligent and that it had been fraudulently induced to sign might be excessively burdensome. As a matter of drafting, it was stated that the proposed text of new paragraph (2) (c) placed too much emphasis on form requirements, by referring to the original contract being "in writing" and to the "signature" of the debtor. It was thus suggested that, instead of focusing on how form requirements had been met by the original contract, the provision should focus on how the consent of the debtor had been expressed. With a view to accommodating the above-mentioned views and concerns, it was suggested that the proposed new subparagraph (c) might be redrafted as follows:

“(c) defences based on the fact that the debtor consented to the original contract without knowledge that the debtor’s consent made it a party to the contract, provided that such lack of knowledge was not due to the debtor’s negligence or provided that the debtor was fraudulently induced to consent”.

119. The Working Group took note of the suggested amendment. After discussion, it was decided that the original text of the proposed paragraph (2) (c) referred to in paragraph 115 above should be placed in square brackets for continuation of the discussion at a future session.

Paragraph (3)

120. As a matter of drafting, it was generally felt that the words “such an agreement” should be replaced by the words “an agreement referred to in paragraph (1)”. It was also felt that the drafting group might need to consider whether the text of paragraph (3) might be better placed before paragraph (2).

121. It was generally agreed that there was no need to limit the scope of the provision to the case where a modification of the agreement occurred after notification of the assignment. With a view to covering also the case where a modification occurred before notification, it was decided that the second sentence should be redrafted as follows: “The effect of such a modification is determined by article 21”. After discussion, the Working Group adopted the substance of paragraph (3) as amended.

Article 21. *Modification of the original contract [or of the receivable]*

122. The text of draft article 21 as considered by the Working Group was as follows:

“(1) An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee’s right to payment is effective as against the assignee and the assignee acquires corresponding rights.

“(2) After notification of the assignment, an agreement under paragraph (1) of this article is effective as against the assignee and the assignee acquires corresponding rights,

“Variant A

if it is made in good faith and in accordance with reasonable commercial standards or, in case of a modification relating to a receivable fully earned by performance, it is consented to by the assignee.

“Variant B

if the modification is provided for in the assignment or is later consented to by the assignee.

“[(3) Paragraphs (1) and (2) of this article do not affect any right of the assignee against the assignor for breach of an agreement between the assignor and the assignee that the assignor will not modify the original contract without the assignee’s consent.]

“[(4) In case a receivable is confirmed or determined in a decision of a judicial or other authority, it may be modified only through a decision of that authority.]”

Paragraph (1)

123. While support was expressed in favour of the substance of paragraph (1), a number of suggestions of a drafting nature were made. One suggestion was that reference should be made, instead of to “the assignee’s right to payment”, to the contents or the characteristics of the receivable. That suggestion was broadly supported. Another suggestion was that the last words of paragraph (1) could be usefully clarified by a reference to the person as against which the assignee acquired corresponding rights. It was agreed that those words were generally acceptable to the extent that they were intended to ensure that the assignee acquired the rights arising under the modified contract as against the debtor. It was widely felt, however, that, in order to avoid creating any uncertainty as to the meaning of those words, language should be included in paragraph (3) so as to ensure that any modification of the original contract agreed upon between the assignor and the debtor would not affect the rights of the assignee against the assignor. Subject to the above-mentioned change to paragraph (1) and the modification of paragraph (3) (see para. 132, below), the Working Group adopted the substance of paragraph (1).

Paragraph (2)

124. As a matter of drafting, it was suggested that the *chapeau* of paragraph (2), rather than focusing on the exceptional cases in which a modification after notification was effective as against the assignee, should be reformulated to state the rule that after notification a modification would not be effective as against the assignee. Language along the following lines was suggested: “After notification, an agreement between the assignor and the debtor is ineffective as against the assignee unless”. The suggestion was broadly supported on the understanding that in those exceptional cases in which a modification would be effective as against the assignee even after notification, the assignee would acquire the rights arising under the modified contract as against the debtor.

125. The Working Group considered the question of which of the two variants contained in paragraph (2) was preferable. In favour of variant A, it was stated that it was sufficiently flexible to ensure that, while a modification would need to be consented to by the assignee in case of a fully earned receivable, the assignee’s consent would not be necessary for every minor modification of the original contract if the receivable was not fully earned. It was observed that such flexibility was necessary in particular in project financing where requiring the parties to the original construction contract to obtain the consent of the assignee to every minor modification could be disruptive for the project and burdensome for the assignee. In addition, it was said that the same degree of flexibility was necessary in financial restructuring agreements in which, in return for a change in the interest rate or the date of maturity of debts, receivables were offered as security. In that con-

text, the assignor, who was allowed to manage its business, should not be required to seek the consent of the assignee to every little modification of the restructuring agreement.

126. While the need to preserve flexibility in the above-mentioned cases was generally recognized, the view was widely shared that variant A introduced uncertainty. It was stated that such uncertainty would be caused by the use of the terms “good faith” and “reasonable commercial standards”, which were not universally understood in the same manner. In addition, it was observed that an approach along the lines of variant A might encourage fraud by the assignor. Moreover, it was pointed out that parties to construction or to restructuring agreements did not need the protection provided by variant A, since they would normally address the issue of modifications in their contracts. As to the requirement that the assignee consent to a modification in case of a fully earned receivable, it was stated that it did not adequately protect the assignee, since assignees often extended credit on the basis of unearned or partly earned receivables (e.g. in case of multiple shipments over a long period of time or post-invoice contractual obligations).

127. The Working Group thus focused its attention on variant B. It was widely felt that variant B appropriately reflected the cardinal principle that, after notification of the assignment, a modification of the original contract made without the consent of the assignee could not be effective as against the assignee. However, in order to accommodate the need for some flexibility, a number of suggestions were made. One suggestion was that variant B could be usefully revised to provide that consent by the assignee should not be withheld unreasonably. There was broad support in the Working Group for that suggestion.

128. Another suggestion was that variant B could be restructured so as to list three situations in which a modification would be effective as against the assignee, i.e. if the modification was provided for in the original contract or if it was later consented to by the assignee or if a reasonable assignee would have consented to the modification. While that suggestion received strong support, a number of concerns were expressed. One concern was that such an approach might inadvertently result in assignees having to look at a large number of contracts in order to determine whether a provision was included therein dealing with contract modification. Another concern was that, in order to ensure that the modification would be effective as against the assignee, the debtor would have to determine whether a “reasonable” assignee would have consented to it, a matter that would not always be easy for the debtor to determine.

129. Yet another suggestion was that the consent of the assignee should be required only in case a modification of the original contract resulted in “material adverse effects” on the rights of the assignee. While some support was expressed in favour of that suggestion, it was objected to on the ground that it would inappropriately limit the situations in which the consent of the assignee would be required. The reference to the consent of a “reasonable assignee” was said to be preferable, since it appeared to be less restrictive in that respect.

130. In order to accommodate the views and concerns expressed, language along the following lines was proposed:

“After notification of the assignment, an agreement between the assignor and the debtor that affects the assignee’s rights is ineffective unless:

“(a) the assignee consents to it; or

“(b) the receivable is not fully earned by performance and either modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.”

131. Broad support was expressed in favour of the suggested revision of paragraph (2). In response to a number of questions that were raised, it was observed that: the exact meaning of the word “ineffective” could usefully be clarified in a commentary to the draft Convention; reference should be made to modifications provided for in the original contract, so as to ensure that both the debtor and the assignee would be able to know about the possibility of modifications; and reference should be made to fully earned receivables, on the understanding that such reference indicated the time when an invoice was issued even if the relevant contract had only been partially performed. After discussion, the Working Group adopted the substance of paragraph (2) as amended.

Paragraph (3)

132. The Working Group recalled the decision taken in the context of its discussion of paragraph (1) to revise paragraph (3) so as to ensure that a modification agreed upon between the assignor and the debtor did not affect the assignee’s rights against the assignor (see para. 123, above). It was widely felt that paragraph (3) needed to be expanded so as to cover any right of the assignee as against the assignor for breach of an agreement between them.

133. As to the exact way in which that understanding could be expressed, a number of suggestions were made. One suggestion was that reference should be made, instead of to rights of the assignee for breach of an agreement not to modify the original contract, to paragraphs (1) and (2) being without prejudice to any agreements between the assignor and the assignee. Another suggestion was that the words “that the assignor ... consent” contained in paragraph (3) should be deleted. That suggestion received broad support. It was stated that a modification of the original contract could be a breach of an agreement between the assignor and the assignee, even if that agreement did not include a specific clause precluding the assignor from modifying the original contract. Subject to that change, the Working Group adopted the substance of paragraph (3).

Paragraph (4)

134. It was generally agreed that paragraph (4) should be deleted. It was stated that a judgement creditor and a judgement debtor should be allowed to settle their dispute

by agreement. While the courts might not be bound by such a settlement agreement, the parties thereto were. In addition, it was observed that the paragraph might be misinterpreted as interfering with the judicial process in that it might be read as suggesting that a higher court could not reverse the decision of a lower court. After discussion, the Working Group decided that the paragraph should be deleted. In line with that decision, the Working Group decided that the reference to the original receivable in the title of draft article 21 should be deleted.

New paragraph (4)

135. The view was expressed that, for the same reasons mentioned in the context of the Working Group's discussion of draft article 19 (see paras. 99-100, above), a new paragraph (4) should be inserted within square brackets in draft article 21. The Working Group decided that new paragraph (4), to be included in draft article 21 for consideration at a future session, should read along the following lines: "For the purposes of this article, the notification of the assignment is effective even if it does not identify the person to whom or the account or address to which the debtor is required to make payment."

Article 22. *Recovery of advances*

136. The text of draft article 22 as considered by the Working Group was as follows:

"Without prejudice to [the law governing consumer protection] [public policy requirements] in the country in which the debtor is located and the debtor's rights under article 19, failure of the assignor to perform the original contract [or the decision of a judicial or other authority giving rise to the assigned receivable] does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee."

137. The view was expressed that the title of draft article 22 insufficiently reflected the contents of the provision. It was stated that the reference to "a sum paid by the debtor" was intended to cover not only "advance" payments but more generally any payment made by the debtor to the assignor or the assignee. For example, in the case where the original contract was to be performed in successive instalments, the failure of the assignor to perform an instalment should not entitle the debtor to recover any sum paid upon performance of a previous instalment. After discussion, the Working Group decided that the title of draft article 22 should read "Recovery of payments".

138. With respect to the substance of the draft article, the view was expressed that the words "and the debtor's rights under article 19" should be deleted as superfluous. In support of deletion, it was stated that the debtor's rights to raise defences or rights of set-off would only apply where the debtor wished to reduce or avoid payments that were yet to be made. Such rights were said to be irrelevant in the context of draft article 22, since where a sum had already been paid, defences or rights of set-off of the debtor under draft article 19 could not entitle the debtor to re-

cover any such sum from the assignee. The view was expressed, however, that deleting the reference to draft article 19 might inappropriately weaken the position of the debtor, particularly in case of fraudulent collusion between the assignor and the assignee. After discussion, the Working Group decided to maintain the reference to draft article 19 in draft article 22, subject to further deliberation at a future session.

139. With regard to the reference to public policy, support was expressed in favour of the view that it should be retained. It was stated that dealing with the issues of public policy and other mandatory rules of law only in the context of draft articles 32 and 33 might inappropriately limit the extent to which the draft Convention would defer to the mandatory law applicable outside the draft Convention. It was stated in response that, while draft articles 32 and 33 were placed in chapter VI dealing with conflicts of laws, they were not intended in any way to limit the extent to which the draft Convention would take into account the concerns of States regarding public policy and other mandatory rules. In addition, it was said that those draft articles were intended merely to ensure that public policy and other mandatory rules would apply through the mechanism of conflict-of-laws rules, thus providing the widest recognition of legislation applicable outside the draft Convention. Moreover, it was pointed out that by avoiding multiple references to the notions of "public policy" and "mandatory rules" in the draft Convention, draft articles 32 and 33 were useful in limiting the risk that such notions might receive different interpretations in the context of different articles of the draft Convention. After discussion, it was generally agreed that the text of draft article 22 should mirror the provisions of draft article 20, and that, in line with the decision taken with respect to draft article 20, paragraph (1) (see para. 107, above), the words "[public policy requirements]" should be deleted. Subject to that change, the Working Group adopted the substance of draft article 22.

Chapter V. Subsequent assignments

General remarks

140. After concluding its discussion of section II of chapter IV of the draft Convention, owing to the lack of sufficient time, the Working Group decided to defer consideration of section III to a future session and to have an initial exchange of views on chapter V. It was generally agreed that the purpose of that exchange of views would be to identify the issues to be addressed at a future session.

141. It was generally felt that subsequent assignments (i.e. assignments by the initial or any other assignee to subsequent assignees) should be covered by the draft Convention. It was stated that such assignments were made in a number of practices, including international factoring, securitization, project financing, restructuring of financially troubled businesses and refinancing transactions. Facilitation of such practices, it was observed, should be at the core of a text which was aimed at increasing the availability of lower-cost credit.

142. In the discussion, the view was expressed that the Working Group might consider establishing rules dealing with order of priority among several assignees of the same receivables by the same assignor in the case of an assignment by way of security. It was pointed out that in some legal systems a second assignment of the same receivables was invalid, thus not permitting the use of receivables by the assignor as security for credit obtained from several successive assignees.

Article 25. *Scope*

143. The text of draft article 25 as considered by the Working Group was as follows:

“This Convention applies to:

“(a) assignments of receivables by the initial or any other assignee to subsequent assignees (“subsequent assignments”) that are governed by this Convention under article 1, notwithstanding that the initial or any other previous assignment is not governed by this Convention; and

“(b) any subsequent assignment, provided that the initial assignment is governed by this Convention, as if the subsequent assignee were the initial assignee.”

Subparagraph (a)

144. It was noted that subparagraph (a) was intended to clarify that subsequent assignments that fell within the scope of the draft Convention were governed by the draft Convention, even if the initial assignment fell outside the scope of the draft Convention (e.g. a subsequent assignment in a securitization transaction may be covered even if the initial assignment was a domestic assignment of domestic receivables).

145. A number of observations were made. One observation was that subparagraph (a) appeared to be inconsistent with the principle of *continutio juris* embodied in subparagraph (b). Another observation was that, in order to more accurately reflect the idea that a subsequent assignment falling within the scope of the draft Convention should be covered, even if the initial assignment was not covered, reference should be made to chapter I as a whole.

Subparagraph (b)

146. Support was expressed for the principle of *continutio juris* embodied in subparagraph (b), i.e. that the regime governing the initial assignment should govern any subsequent assignment. However, it was observed that subparagraph (b) could operate well if the initial receivable was international, since any subsequent assignee would be able to predict that the draft Convention would apply to subsequent assignments by virtue of the internationality of the receivable. To the contrary, in case the initial receivable was domestic, the application of subparagraph (b) might not produce satisfactory results, since a subsequent assignee would not be able to predict the application of the draft Convention to a domestic assignment of a domestic receivable. It was thus widely felt that subparagraph (b) needed to be amended in order to avoid a situation in which the draft Convention would

apply to domestic assignments of domestic receivables. In order to achieve the desired result, it was suggested that, at the end of subparagraph (b), language along the following lines should be added: “provided that in cases in which the receivable was a domestic receivable a subsequent assignment in which the assignor and the assignee are located in the same State as the debtor is not governed by this Convention”.

Article 26. *Agreements limiting subsequent assignments*

147. The text of draft article 26 as considered by the Working Group was as follows:

“(1) A receivable assigned by the initial or any subsequent assignee to a subsequent assignee is transferred notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the initial or any subsequent assignor’s right to assign its receivables.

“(2) Nothing in this article affects any obligation or liability for breach of such an agreement, but a person who was not party to such an agreement is not liable for its breach.”

Title

148. It was observed that the title of draft article 26 might need to be aligned with the title of draft article 12.

Paragraph (1)

149. It was noted that, in paragraph (1), a reference had been added to an anti-assignment agreement between “the initial or any subsequent assignor and the debtor or any subsequent assignee” in order to ensure that an anti-assignment clause contained in the original contract or in the assignment or in a subsequent assignment did not invalidate any subsequent assignment. While support was expressed for the substance of paragraph (1), the view was expressed that its exact formulation might have to be considered in particular with a view to determining whether a reference to a subsequent assignee was necessary.

Paragraph (2)

150. It was noted that, under paragraph (2), if any assignee was liable towards the debtor or any assignor under other applicable law outside the draft Convention for further assigning the receivable despite an anti-assignment clause contained in the original contract, in the assignment or in any subsequent assignment, that liability was not extended to any subsequent assignee.

151. The view was expressed that, if paragraph (2) referred to contractual liability, it might be superfluous in that it expressed a general principle of contract law. If, however, paragraph (2) covered tortious liability of the assignee for causing the assignor to violate an anti-assignment agreement, it might not be appropriate.

152. In response, it was pointed out that, if the assignee were to be held liable in any way relating to the breach of

an anti-assignment agreement between the assignor and another party, the assignment would be of no value to the assignee. In addition, subjecting the assignee to such potential liability would inadvertently result in an increase in the cost of credit even if such liability did not actually arise, since assignees, in case of a bulk assignment, would have to examine a large number of contracts in order to determine whether an anti-assignment clause was included therein. Moreover, it would in any case be difficult to distinguish tortious from contractual liability and to cover one but not the other. After discussion, it was agreed that the matter needed to be revisited in the context of draft article 12, in which the issue of liability of the assignee for breach of an anti-assignment clause by the assignor was dealt with.

Article 27. *Debtor's discharge by payment*

153. The text of draft article 27 as considered by the Working Group was as follows:

“Notwithstanding that the invalidity of an assignment renders all subsequent assignments invalid, the debtor is entitled to discharge its obligation by paying in accordance with the payment instructions set forth in the first notification received by the debtor.”

154. It was stated that, in order to avoid repeating the title of draft article 18, the title of draft article 27 might need to be amended so as to read “debtor's discharge by payment in subsequent assignments”.

155. It was widely felt that, in case the debtor received several notifications relating to a number of subsequent assignments, the debtor should be able to discharge its obligation by paying the person identified in the last notification received before payment. It was stated that, in its current formulation, the provision could inadvertently result in the debtor having to determine whether an intermediate assignment was invalid. In response, it was observed that, for the debtor to be able to determine that that rule would apply and not the rule of draft article 18 (3) (which provided that the debtor should discharge its obligation by paying the person identified in the first notification), the notification should indicate the fact that several subsequent assignments had taken place. However, the view was expressed that in practice no problem would arise since normally only the last assignee would need to notify the debtor and thus the first notification would be also the last. It was stated that draft article 28, which was drawn from article 11, paragraph (2), of the Ottawa Convention, had been premised on that understanding.

156. It was noted that in the case of an initial assignment, under draft article 18, paragraph (2), the debtor could discharge its obligation by paying the person identified in the first notification even if the initial assignment was invalid; and that, if in doubt as to the validity of an assignment, the debtor may, under draft article 18, paragraph (4), pay the assignor and be discharged. However, the view was expressed that the reference to the invalidity of a subsequent assignment and the absence of similar language in draft article 18 might raise problems of interpretation.

157. It was agreed that, in line with the decision of the Working Group on draft article 18, paragraph (2) (see para. 78, above), the words “the person or the account or address identified in the first notification” should be substituted for the words “in accordance with the payment instructions set forth in the notification received by the debtor”.

Article 28. *Notification of the debtor*

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

“Notification of a subsequent assignment constitutes notification of [any] [the immediately] preceding assignment.”

159. The view was expressed that notification of a subsequent assignment should constitute notification of any preceding assignment. It was stated that, in view of draft article 16, paragraph (3), such an approach might inadvertently result in requiring that the notification identify all assignees and all payees. In response, it was observed that the content of notification in the context of subsequent assignments would need to be different. It was pointed out that the debtor receiving a notification needed to be able to determine whether a series of subsequent assignments or of several assignments of the same receivables were involved. For lack of sufficient time, the Working Group deferred further consideration of draft article 28 to a future session.

IV. REPORT OF THE DRAFTING GROUP

160. The Working Group requested a drafting group established by the Secretariat to review the provisions of draft articles 14-16 and 18-21, with a view to ensuring consistency between the various language versions.

161. At the close of its deliberations, the Working Group considered the report of the drafting group and adopted the substance of draft articles 14-16, 18, 19 and 21 as revised by the drafting group. The text of those revised articles is reproduced in the annex to the present report.

162. With respect to draft article 20, paragraph (2), the text of subparagraph (b) as revised by the drafting group was as follows:

“(b) defences based on the debtor's incapacity or the lack of authority of the debtor's agent to incur liability on the original contract;”

163. Doubts were expressed as to whether the reference to “the lack of authority of the debtor's agent” appropriately reflected the decision taken by the Working Group to clarify that the text was also intended to refer to a possible lack of authority of the debtor to incur liability (see para. 117, above). It was stated that, while the reference to the debtor's incapacity to incur liability was intended to apply to situations where the debtor was a natural person, the reference to the lack of authority of the debtor was in-

tended to apply mostly to situations where the debtor was a legal person, thus acting through its authorized agents. With a view to expressing more clearly the intent of the Working Group, it was decided that subparagraph (b) should read as follows:

“(b) defences based on the debtor’s incapacity or the lack of authority of the debtor’s agent to incur the debtor’s liability on the original contract;”

164. Subject to that modification, the Working Group adopted the substance of draft article 20 as revised by the drafting group. The adopted text is reproduced in the annex to the present report.

V. FUTURE WORK

165. It was noted that the next session of the Working Group was scheduled to take place at Vienna from 5 to 16 October 1998, those dates being subject to confirmation by the Commission at its thirty-first session, to be held in New York from 1 to 12 June 1998.

ANNEX

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Article 14. *Rights and obligations of the assignor and the assignee*

(1) Subject to the provisions of this Convention, the rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

(3) In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage which in international trade is widely known to, and regularly observed by, parties to the particular receivables financing practice.

Article 15. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the contract of assignment that:

- (a) the assignor has the right to assign the receivable;
- (b) the assignor has not previously assigned the receivable to another assignee; and
- (c) the debtor does not and will not have any defences or rights of set-off.

(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.

Article 16. *Notification of the debtor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment and request that payment be made to the person identified in the notification.

(2) Notification of the assignment or request for payment made by the assignor or the assignee in breach of an agreement referred to in paragraph (1) is effective. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

(3) Notification of the assignment shall be in writing and shall reasonably identify the assigned receivables, the assignee and the person to whom or for whose account or the address to which the debtor is required to make payment.

(4) Notification shall be in any language that is reasonably designed to inform the debtor about the content of the notification. It shall be sufficient if notification is given in the language of the original contract.

(5) Notification of the assignment may relate to receivables arising after notification.

Section II. Debtor

Article 18. *Debtor’s discharge by payment*

(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying the assignor.

(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (5) of this article, it is discharged only by paying the person or to the account or address identified in such notification.

(3) In case the debtor receives notification of more than one assignment of the same receivables made by the same assignor, the debtor is discharged by paying the person or to the account or address identified in the first notification received.

(4) In case the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

(5) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.

Article 19. *Defences and rights of set-off of the debtor*

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences or rights of set-off arising from the original contract [or from a decision of a judicial or other authority giving rise to the assigned receivable] of which the debtor could avail itself if such claim were made by the assignor.

(2) The debtor may raise against the assignee any other right of set-off, provided that it was available to the debtor at the time notification of the assignment was received. [For the purposes of this paragraph, the notification of assignment is effective even if it does not identify the person to whom or for whose account or the address to which the debtor is required to make payment.]

(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 12 against

the assignor for breach of agreements limiting in any way the assignor's right to assign its receivables are not available to the debtor against the assignee.

Article 20. *Agreement not to raise defences or rights of set-off*

(1) Without prejudice to the law governing consumer protection in the State in which the debtor is located, the debtor may agree with the assignor in writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 19. Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.

(2) The debtor may not exclude:

(a) defences arising from fraudulent acts on the part of the assignee;

(b) defences based on the debtor's incapacity or the lack of authority of the debtor's agent to incur the debtor's liability on the original contract;

[(c) where the original contract is in writing, defences based on the fact that the debtor signed the original contract without knowledge that the debtor's signature made the debtor a party to the contract, provided that such lack of knowledge was not due to the debtor's negligence and provided that the debtor was fraudulently induced to sign.]

(3) Such an agreement may only be modified by written agreement. The effect of such a modification as against the assignee is determined by article 21(2).

Article 21. *Modification of the original contract*

(1) An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee's rights is effective as against the assignee and the assignee acquires corresponding rights.

(2) After notification of the assignment, an agreement between the assignor and the debtor that affects the assignee's rights is ineffective as against the assignee unless:

(a) the assignee consents to it; or

(b) the receivable is not fully earned by performance and either modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

(3) Paragraphs (1) and (2) of this article do not affect any right of the assignor or the assignee for breach of an agreement between them.

[(4) For the purposes of this article, the notification of assignment is effective even if it does not identify the person to whom or the account or address to which the debtor is required to make payment.]

D. Working paper submitted to the Working Group on International Contract Practices at its twenty-eighth session: receivables financing: revised articles of draft Convention on Assignment in Receivables Financing: note by the Secretariat (A/CN.9/WG.II/WP.96) [Original: English]

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I. INTRODUCTION

1. At its twenty-eight session, the Working Group on International Contract Practices continued its work, undertaken pursuant to a decision taken by the Commission at its twenty-eighth session (Vienna, 2-26 May 1995), on the preparation of a uniform law on assignment in receivables financing.¹ It was the fifth session devoted to the preparation of that uniform law, tentatively entitled the draft Convention on Assignment in Receivables Financing.

2. The Commission's decision to undertake work on assignment in receivables financing was taken in response to suggestions made to it in particular at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century" (held in New York in conjunction with the twenty-fifth session, 17-21 May 1992). A related suggestion made at the Congress was for the Commission to resume its work on security interests in general, which the Commission at its thirteenth session (New York, 14-25 July 1980) had decided to defer for a later stage.²

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by the Secretariat concerning certain legal problems in the area of assignment of receivables (A/CN.9/378/Add.3, A/CN.9/397 and A/CN.9/412). Having considered those reports, the Commission concluded that it would be both desirable and feasible to prepare a set of uniform rules, the purpose of which would be to remove obstacles to receivables financing arising from the uncertainty existing in vari-

ous legal systems as to the validity of cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) and as to the effects of such assignments on the debtor and other third parties.³

4. At its twenty-fourth session (Vienna, 13-24 November 1995), the Working Group commenced its work by considering a number of preliminary draft uniform rules contained in a report of the Secretary-General entitled "Discussion and preliminary draft of uniform rules" (A/CN.9/412). At that session, the Working Group was urged to strive for a legal text aimed at increasing the availability of lower cost credit (A/CN.9/420, para. 16).

5. At its twenty-fifth to twenty-seventh sessions (New York, 8-19 July 1996, Vienna, 11-22 November 1996 and Vienna, 20-31 October 1997),⁴ the Working Group continued its work by considering different versions of the draft uniform rules contained in notes prepared by the Secretariat (A/CN.9/WG.II/WP.87, A/CN.9/WG.II/WP.89 and A/CN.9/WG.II/WP.93). At those sessions, the Working Group adopted the working assumptions that the text being prepared would take the form of a convention (A/CN.9/432, para. 28) and would include conflict-of-laws provisions (A/CN.9/434, para. 262), dealing in particular with questions of priority (A/CN.9/445, paras. 27 and 31).

³Ibid., *Forty-eighth Session, Supplement No. 17 (A/48/17)*, paras. 297-301; *ibid.*, *Forty-ninth Session, Supplement No. 17 (A/49/17)*, paras. 208-214; and *ibid.*, *Fiftieth Session, Supplement No. 17 (A/50/17)*, paras. 374-381.

⁴The twenty-seventh session, which was originally scheduled to take place in New York from 23 June to 3 July 1997, had to be rescheduled as a result of the decision of the General Assembly to hold its nineteenth special session on Agenda 21 in New York from 23 to 27 June 1997.

¹*Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17)*, paras. 374-381.

²*Ibid.*, *Thirty-fifth Session, Supplement No. 17 (A/35/17)*, paras. 26-28.

6. This note sets forth a revised version of the draft Convention, reflecting the deliberations and decisions of the Working Group thus far. Additions and modifications to the text are indicated by *underlining*. With the exception of draft article 17, the *underlined* text in draft articles 13-22 is not new text but it appears *underlined*, since it has not been discussed at the previous session of the Working Group.

II. DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING

Prior discussion:

A/CN.9/445, paras. 120-122 (Twenty-seventh session, 1997)

A/CN.9/434, para. 14 (Twenty-sixth session, 1996)

Remarks

In order to ensure consistency between the title and the content of the draft Convention, the Working Group may wish to consider the title once it has completed its consideration of the draft Convention as a whole.

Preamble

The Contracting States,

Reaffirming their conviction that international trade on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

[Considering that problems created by the uncertainties as to the legal regime applicable to assignments in international trade constitute an obstacle to transactions in which value, credit or related services is given or promised against value in the form of receivables, including factoring, forfeiting, securitization, project financing and refinancing transactions.]

Being of the opinion that the adoption of uniform rules governing assignments in receivables financing would facilitate the development of international trade and would promote the availability of credit at more affordable rates,

Have agreed as follows:

Prior discussion:

A/CN.9/445, paras. 123-124 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 15-16 (Twenty-sixth session, 1996)

Remarks

Should the Working Group prefer to retain the second paragraph of the preamble, which has been prepared by the Secretariat for the consideration of the Working Group, it may wish to delete draft article 5(d) (definition of receivables financing).

Chapter I. Scope of application

Article 1 [1]⁵. *Scope of application*

(1) This Convention applies to assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the assignment, the assignor is located in a Contracting State.

(2) *[The provisions of articles [...] do not apply] [This Convention does not affect the rights and obligations of the debtor] unless the debtor is located in a Contracting State [or the rules of private international law lead to the application of the law of a Contracting State to the relationship between the assignor and the debtor].*

[(3) The provisions of articles 29 to 33 apply [to assignments of international receivables and to international assignments of receivables as defined in this chapter] independently of paragraphs (1) and (2) of this article.]

(4) *Chapter VII applies in a Contracting State which has made a declaration under article 43. [If a Contracting State makes such a declaration, the provisions of articles 23(1) and 24(1), (2) do not apply in this State.]*

Prior discussion:

A/CN.9/445, paras. 26-27, 31 and 125-145 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 17-25 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 14-18 and 29-32 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 19-25 and 30-31 (Twenty-fourth session, 1995)

Remarks

1. At its previous session, the Working Group decided that, in order to achieve certainty as to the application of the draft Convention and as to the law applicable to priority, the term "place of business" or other similar term should be clearly defined (A/CN.9/445, paras. 164-167). In order to avoid creating interpretation problems with regard to other UNCITRAL texts in which the term "place of business" is referred to, use of that term is being avoided. Reference is made instead to the location of the assignor and the debtor, which is defined in draft article 5. The definition is intended to ensure certainty by identifying as the location of the assignor or the debtor a single place and one that can be determined easily, i.e. the place of registration or, in the case of an individual or a person without a registered office, its habitual residence. Under article 16(3) of the UNCITRAL Model Law on Cross-Border Insolvency (1997)^a, hereinafter referred to as "the UNCITRAL Model Insolvency Law" and article 3(1) of the Convention on Insolvency Proceedings prepared by the European Union, hereinafter referred to as "the European Insolvency Convention", the registered office or, in the case of an individual, its habitual residence, is presumed to be the centre of its main interests, "in the absence of proof to the contrary".

^aOfficial Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17), annex I.

⁵The numbers in square brackets refer to the articles of the previous version of the draft Convention (A/CN.9/WG.II/WP.93).

2. An alternative formulation for paragraph (1) might be: “This Convention applies to international assignments”. In order to cover all assignments presently covered in paragraph (1) internationality would have to be defined along the following lines: “An assignment is international if, at the time of the assignment, any two of the following parties are located in different States: assignor, assignee, debtor” (see articles 1 and 4 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1995)^b; hereinafter referred to as the “United Nations Guarantee and Stand-by Convention”).

3. Under such an approach, both international assignments and assignments of international receivables would be covered. The internationality, however, would be determined at the time of the assignment (under the present formulation of draft article 3, the internationality of a receivable is determined at the time it arises; as a result, in case of an assignment of future receivables, parties may not be able to determine at the time of the assignment whether the draft Convention would apply).

4. At its previous session, the Working Group decided that the reference to the application of the draft Convention by virtue of private international law should be deleted, since it introduced an unacceptable degree of uncertainty in a text that dealt not only with contractual obligations but also with proprietary rights (A/CN.9/445, para. 139). However, the uncertainty referred to cannot be removed by deleting the reference to private international law, since the rules of private international law also apply outside the draft Convention. In addition, as a result of the Working Group’s decision, if by virtue of private international law rules the law of a Contracting State would be applicable, the domestic law of that Contracting State may be applied and not the draft Convention. It is submitted that the uncertainty arising from the application of non-uniform private international law rules and the problem just identified could be satisfactorily addressed by a set of uniform private international law rules along the lines of draft articles 29-33.

5. In paragraph (2), the Working Group may wish to specify the relevant provisions. Paragraph (3) appears in square brackets pending a final decision by the Working Group on the question whether the conflict-of-laws provisions of the draft Convention should be retained and, if so, whether they should apply if the forum is in a Contracting State, irrespective of whether the assignor or the debtor is located in a Contracting State. Paragraph (4) reflects the tentative decision of the Working Group that the substantive law priority provisions of the draft Convention should apply only to States that wish to be bound by them (A/CN.9/445, paras. 26-27). Under the second sentence of paragraph (4), if a State opts into chapter VII, it chooses to apply the substantive law priority provisions contained in chapter VII and not draft articles 23 and 24, which are conflict-of-laws provisions. The Working Group may wish to consider following a different approach by combining the substantive law priority provisions with the conflict-of-laws priority provisions. Under such an approach, the sub-

stantive law priority provisions chosen by a Contracting State would apply if the assignor is located in that State (draft article 1(1)). No inconsistency would arise with draft articles 23 and 24, since those articles provide that priority is governed by the law (i.e. the substantive law) of the State in which the assignor is located, which would be the same State.

Article 2 [2]. *Assignment of receivables*

(1) For the purposes of this Convention, “assignment” means the transfer by agreement from one person (“assignor”) to another person (“assignee”) of its right to payment of a monetary sum (“receivable”) owed by the debtor, *provided that the transfer is made against value, credit or related services given or promised by the assignee to the assignor or a person specified by the assignor.* “Assignment” includes the transfer of receivables and the creation of rights in receivables as security for indebtedness or other obligation.

[(2) “Receivable” includes any right of the assignor to payment of a monetary sum arising under:

[(a) a contract between the assignor and the debtor, whether the contract is for the sale or lease of goods, the provision of services or credit, the licensing of technology, intellectual property or information, or otherwise;

(b) a settlement agreement or a decision of a judicial or other authority;

(c) any policy of insurance or reinsurance;

(d) a deposit agreement between the assignor and a financial institution;

(e) an agreement between the assignor and a financial institution for the management of securities, commodities or other assets;

(f) an agreement for the sale or other transfer, or lending, of securities, instruments or precious metals;

(g) other contracts, the amount of payment under which is indexed or otherwise relates to interest rates, to prices of securities, commodities or other assets, or to the occurrence of other events or circumstances that are independent of the actions of the parties to the contract.]

[(3) “Receivable” also includes any right of the assignor arising under the original contract, if any, including a right arising from a clause for the retention of title or the creation of a right in goods as security for indebtedness or other obligation.]

Prior discussion:

A/CN.9/445, paras. 146-153 and 170-179 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 62-70 and 72-77 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 40-49 and 53-69 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 33-43 and 53-69 (Twenty-fourth session, 1995)

^bGeneral Assembly resolution 50/48, annex, of 11 December 1995.

Remarks

1. The words “provided that the transfer is made” have been inserted in paragraph (1) in order to clarify that the consideration must be given in return for the transfer of a property right in the receivables to be covered by the draft Convention and does not relate to the contract of assignment, for the validity of which no consideration is required under the “abstraction principle” prevailing in some countries. The words “or a person specified by the assignor” have been inserted in order to ensure that a person may assign its receivables so that another person may obtain or be promised “value, credit or related services”.

2. Paragraph (2) appears within square brackets, since the Working Group has made no decision yet as to whether the practices mentioned should be covered. They are included in paragraph (2) with a view to facilitating consultations with representatives of the practices mentioned (A/CN.9/445, para. 178). Subparagraph (b) is intended to cover settled or liquidated tort claims, as well as tax claims. Rights arising under guarantees and stand-by letters of credit are not mentioned in paragraph (2), since their assignment is covered by other international texts, including the Guarantee and Standby Convention. The Working Group may wish to consider whether explicit reference to the assignment of such rights should be made in draft article 4 dealing with exclusions..

3. Paragraph (3), which appears within square brackets, reflects a suggestion made at the previous session of the Working Group (A/CN.9/445, paras. 189, 216 and 234). As a result of paragraph (3), goods returned from the debtor to, or reclaimed by, the assignor would belong to the assignee (see article 7 of the UNIDROIT Convention on International Factoring (Ottawa, 1988); hereinafter referred to as “the Ottawa Convention”).

Article 3 [3]. *Internationality*

A receivable is international if, at the time it arises, the assignor and the debtor are *located* in different States. An assignment is international if, at the time it is made, the assignor and the assignee are *located* in different States.

Prior discussion:

A/CN.9/445, paras.154-163 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 26-33 (Twenty-sixth session, 1996)

A/CN.9/420, paras. 26-29 (Twenty-fourth session, 1995)

Article 4 [4]. *Exclusions*

This Convention does not apply to assignments made:

- (a) for personal, family or household purposes;
- (b) *to the extent made* by endorsement or delivery of a negotiable instrument;
- (c) as part of the sale, or change in the ownership or the legal status, of *the* business out of which the assigned receivables arose.

Prior discussion:

A/CN.9/445, paras. 168-169 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 42-61 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 17 and 62-66 (Twenty-fifth session, 1996)

Remarks

The words added in subparagraph (b) are intended to ensure that, if a receivable is transferred both by way of assignment and by endorsement or delivery of a negotiable instrument, the draft Convention would apply to the assignment but not to the transfer by endorsement or delivery of an instrument.

Chapter II. General provisionsArticle 5 [5]. *Definitions and rules of interpretation*

For the purposes of this Convention:

(a) “Original contract” means the contract, *if any*, between the assignor and the debtor from which the assigned receivable arises [*or by which the assigned receivable is confirmed, determined or modified*];

(b) A receivable is deemed to arise at the time when the original contract is concluded [*or, in the absence of an original contract, at the time when it is confirmed or determined in a decision of a judicial or other authority*];

(c) “Future receivable” means a receivable that arises after the conclusion of the *contract of assignment*;

[*(d) “Receivables financing” means any transaction in which value, credit or related services are provided for value in the form of receivables. “Receivables financing” includes factoring, forfaiting, securitization, project financing and refinancing;*]

(e) “Writing” means any form of communication that is accessible so as to be usable for subsequent reference *and provides identification of the sender and indication of the sender’s approval of the information contained in the communication by generally accepted means or by a procedure agreed upon by the sender and the addressee of the communication*;

(f) “Notification of the assignment” means a *communication* informing the debtor that an assignment has taken place;

(g) “Insolvency administrator” means a person or body, including one appointed on an interim basis, authorized to administer the reorganization or liquidation of the assignor’s assets;

(h) “*Insolvency proceeding*” means a *collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the assignor are subject to control or supervision by a court for the purpose of reorganization or liquidation*;

(i) “Priority” means the right of a party in preference to another party;

(j) A person is located in the State in which it has its registered office, or, if it has no registered office or in the case of an individual, its habitual residence;

[(k) “Time of the assignment” means the time specified in the contract of assignment or other writing, which may not be earlier than the time at which the contract of assignment is actually concluded.]

Prior discussion:

A/CN.9/445, paras. 164-167, 180-190 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 70-72, 75-76, 78-85, 166-194 and 244 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 40-72 (Twenty-fifth session, 1996)

A/CN.9/420, para. 44 (Twenty-fourth session, 1995)

Remarks

1. The underlined wording in subparagraph (a) is intended to cover settlement agreements by which tort, tax or other non-contractual receivables may be confirmed or determined and agreements modifying the original contract. The *underlined* wording in subparagraph (b) is aimed at covering tort, tax or other non-contractual receivables. Under subparagraph (b), a tort receivable arises: if it is confirmed in a settlement agreement (i.e. is converted into a contractual receivable), at the time that agreement is concluded; and if it is confirmed in a decision of a judicial or administrative authority, at the time that decision is issued. Other tort receivables are not covered by the draft Convention because of the uncertainty with which they are associated.

2. As a result of a decision made by the Working Group at its previous session, new wording has been inserted in subparagraph (e) in order to better reflect the notion of “authentication” (A/CN.9/445, para. 186). It has been drawn from article 7 of the (1996) Model Law on Electronic Commerce of the United Nations Commission on International Trade Law^c, hereinafter referred to as “the UNCITRAL Electronic Commerce Model Law”.

3. Subparagraph (h) has been moved to draft article 5 from draft article 24 of the previous version of the draft Convention, since the term “insolvency proceeding” is used in the current draft in several articles (the definitions of “opening of insolvency proceeding” and “attachment”, contained in draft article 24(8) of the previous version of the draft Convention, have been deleted, since they do not appear in the final text of the UNCITRAL Model Insolvency Law, from which they had been drawn, and their definition may be better left to other applicable law).

4. Subparagraph (j) reflects the decision made at the previous session of the Working Group that the draft Convention should provide a clear definition of the term “place of business” or other similar term (A/CN.9/445, para. 164). In order to avoid creating interpretation problems with regard to the meaning of the term “place of business”, which is used in other texts prepared by UNCITRAL, reference is made to the term “location”.

^cOfficial Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

Subparagraph (j) is intended to provide a single place of reference and one that can be determined easily. The place of registration, i.e. incorporation, of a legal person or the habitual residence of a physical person is bound to be a single place (a subsidiary of a major corporation registered in a country other than the country of the head-office is going to be a separate legal entity and financiers would be able to determine this fact easily). On the other hand, such a “registered office” approach may inadvertently result in assignments being governed by a law with which they have no relationship and in the dealings of assignors, i.e. borrowers, being often governed by the law of the country in which assignors have their head-office. It may be argued, however, that both of those results would be acceptable to assignors, as long as the suggested approach provides the certainty and predictability required for assignors to obtain lower-cost credit. Assignors may structure their transactions with assignees in accordance with the law of the country in which assignors have a registered office, which may be the country of the head-office or a subsidiary through which a transaction is closed.

5. By contrast to draft article 11, which deals with the time of the transfer of the receivable as a result of the assignment contract, subparagraph (k) deals with the time of the conclusion of the assignment contract, a term used in draft articles 1, 3, 9, 11, 23, 24, 31, 34, 39 and 40. It has been prepared by the Secretariat in order to address suggestions made at the previous session of the Working Group (A/CN.9/445, para. 225). The first suggestion was that, in order to enhance certainty, the term “time of the assignment” should be clearly defined. The second suggestion was that parties should not be allowed to manipulate the rule by agreeing to backdate their assignment contract.

Article 6 [6]. Party autonomy

(1) As between the assignor and the assignee, articles [...] may be excluded or varied by agreement.

(2) As between the assignor and the debtor, articles [...] may be excluded or varied by agreement.

[(3) Nothing in this Convention invalidates an assignment which is *effective as between the assignor and the assignee* under rules other than the provisions of this Convention].

Prior discussion:

A/CN.9/445, paras. 191-194 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 35-41 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 33-38 (Twenty-fifth session, 1996)

Remarks

The Working Group may wish to specify the draft articles which could be excluded or varied by agreement of the parties. In paragraph (3) the underlined language is intended to clarify that paragraph (3) does not address the issue of the effects of an assignment on the debtor and other third parties. In its present formulation, paragraph (3) would run contrary to draft article 9, if variant A were to be preferred.

Article 7 [7]. *Debtor's protection*

(1) Except as otherwise provided in this Convention, an assignment does not have any effect on the rights and obligations of the debtor.

(2) Nothing in this Convention affects the debtor's right to pay in the currency and in the country specified in the payment terms contained in the original contract [or *in the decision of a judicial or other authority* giving rise to the assigned receivable].

Prior discussion:

A/CN.9/445, paras. 195-198 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 86-94 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 87-92 and 244 (Twenty-fifth session, 1996)

A/CN.9/420, para. 101 (Twenty-fourth session, 1995)

Remarks

Draft article 7 is intended to ensure that the draft Convention provides a debtor-protection framework that meets the minimum threshold required in any jurisdiction. It is supplemented by draft articles 12, 13 and 18 to 22. Where necessary, i.e. in draft articles 20 and 22, the debtor-protection provisions in the draft Convention are made subject to consumer-protection law (for possible exceptions to draft article 12 in case the debtor is a consumer or a State, see remarks to draft article 12). Paragraph (2) is intended to ensure that an assignment under the draft Convention cannot change the currency and the country in which payment is to be made. However, it is left to other law to determine what constitutes payment and whether payment has to be made in the specific place where the assignor or the assignee or the debtor is located, as long as they are located within the country specified in the original contract.

Article 8 [8]. *Principles of interpretation*

(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.

Prior discussion:

A/CN.9/445, paras. 199-200 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 100-101 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 76-81 (Twenty-fifth session, 1996)

A/CN.9/420, para. 190 (Twenty-fourth session, 1995)

Chapter III. Form and effect of assignmentArticle 9 [10]. *Form of assignment*

(1) *Variant A:* An assignment in a form other than in writing is not effective, unless it is effected pursuant to a contract between the assignor and the assignee which is in writing.

Variant B: An assignment is not effective, unless it is evidenced by a writing which describes the receivables to which it relates or, in the absence of a writing, it complies with the rules concerning form of the assignment of the State in which the assignor is located at the time of the assignment.

Variant C: The form of the assignment and the effect of any non-compliance with such form is governed by the law of the State in which the assignor is located at the time of the assignment.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective without a new writing being required for each receivable when it arises.

Prior discussion:

A/CN.9/445, paras. 204-210 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 102-106 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 82-86 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 75-79 (Twenty-fourth session, 1995)

Remarks

Variant A has attracted so far the support of the majority in the Working Group (A/CN.9/434, para. 104 and A/CN.9/445, paras. 205-206). Variants B and C have been prepared at the previous session of the Working Group by an *ad hoc* drafting group in order to address the concerns expressed by a few delegations with regard to written form (A/CN.9/445, paras. 207-209).

Article 10 [11]. *Effect of assignment*

(1) *Subject to articles 22 and 23,*

(a) an assignment of receivables that are specified individually is effective to *assign* the receivables to which it relates;

(b) an assignment of receivables that are not specified individually is effective to *assign* the receivables that can be identified, at the time agreed upon by the assignor and the assignee and, in the absence of such agreement, at the time when the receivables arise, as receivables to which the assignment relates.

(2) An assignment may relate to existing or future, one or more, receivables, and to parts of or undivided interests in receivables.

Prior discussion:

A/CN.9/445, paras. 211-220 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 66-67, 113, 126 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 101-108 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 45-56 (Twenty-fourth session, 1995)

Remarks

The *chapeau* of paragraph (1) is intended to ensure that the rule set forth therein does not prejudice the rights of third parties. In subparagraphs (a) and (b), the words “to assign” have been inserted (which, under draft article 2(1), includes both the transfer of and the creation of security rights in receivables) in order to avoid giving the impression that only transfers of receivables are covered (A/CN.9/445, para. 213).

Article 11 [12]. *Time of transfer of receivables*(1) *Subject to articles 23 and 24,*

(a) a receivable arising up to the time of the assignment is transferred at the time of the assignment; and

(b) a future receivable is deemed to be transferred at the time agreed upon between the assignor and the assignee [which may be no earlier than the time of the assignment]. In the absence of such agreement, a future receivable is deemed to be transferred at the time of the assignment [or, in the case of a receivable arising from a decision of a judicial or other authority, at the time when it [arises] [becomes payable]].

(2) *If a State makes a declaration under article 43, paragraph (1) is subject to the priority rule referred to in the declaration [instead of articles 23 and 24].*

Prior discussion:

A/CN.9/445, paras. 221-226 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 108 and 115-122 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 109-112 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 57-60 (Twenty-fourth session, 1995)

Remarks

The *chapeau* of paragraph (1), as well as paragraph (2), is intended to ensure that the rule on the time of transfer of a receivable contained in paragraph (1) does not interfere with the priority rules set forth in the draft Convention, which may be draft articles 23 and 24 or the substitute priority rules contained in chapter VII. The words appearing within square brackets in the first sentence of paragraph (1)(a) are aimed at ensuring that the parties to the assignment do not agree on a time of transfer that is earlier than the time of the assignment. The Working

Group may wish to consider whether the reference to draft articles 23 and 24 adds to the clarity of paragraph (2) and should be retained. This reference appears within square brackets pending determination of the relationship between draft articles 23 and 24 and the alternative priority rules (see draft article 1(4) and para. 5 of the remarks to draft article 1).

Article 12 [13]. *Contractual limitations to assignment*

(1) A receivable is transferred to the assignee notwithstanding any agreement between the assignor and the debtor limiting in any way the assignor's right to assign its receivables.

(2) Nothing in this article affects any obligation or liability of the assignor to the debtor in respect of an assignment made in breach of an agreement limiting in any way the assignor's right to assign its receivables, but the assignee is not liable to the debtor for such a breach.

Prior discussion:

A/CN.9/445, paras. 227-231 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 128-133 and 135-136 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 113-126 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 61-68 (Twenty-fourth session, 1995)

Remarks

1. The Working Group may wish to consider the revised title of draft article 12. In addition, the Working Group may wish to consider the questions whether: the borrower in a syndicated bank loan may preclude the lenders from assigning the loan to a competitor of the borrower (which would not be a true assignment but a part of a take-over scheme); the assignor may preclude the assignee from assigning the receivables further (a no-assignment clause in the assignment); the assignee may preclude a subsequent assignee from assigning the receivables further (a no-assignment clause in a refinancing contract). Draft article 12 may be considered together with draft article 26 dealing with contractual limitations to assignment in the context of subsequent assignments, in order to clarify whether, e.g. a contractual limitation between the initial assignor and the debtor precludes not only the initial but any subsequent assignment or creates any liability for the assignee or any subsequent assignee for assigning the receivables further.

2. At a previous session of the Working Group, the suggestion was made that in the case of an anti-assignment clause contained in a contract, in which the debtor is a consumer or a governmental entity, the consumer or the governmental entity should be allowed to discharge its obligation by paying in accordance with the payment terms of the original arrangement between the assignor and the debtor, i.e. the assignee could not change the payment terms (A/CN.9/445, para. 229).

3. To the extent that it relates to consumer transactions, such an approach would reflect current practice in which consumer receivables are assigned in bulk, while consumers are not notified. In those practices, consumers keep paying to the same bank account or post office box or other box, and it is for the assignor and the assignee to negotiate about the control of that bank account or post office box or other box. As to the application of that rule in case the debtor is a State, it may be considered that, for public policy reasons, a deviation from the general rule of draft article 12 might be appropriate.

4. On the other hand, it may be argued that the practice mentioned above involving consumers is already sufficiently accommodated in the text of the draft Convention and does not need to be the subject of special treatment. Under draft article 18(1), in the absence of notification, the debtor may discharge its obligation by paying the assignor. In addition, consumer debtors would not need any additional protection, since normally they do not have the power to negotiate anti-assignment clauses with their creditors, and those sophisticated consumers who do have such power may take care of their interests on their own. In addition, both consumer debtors and governmental entities may be protected by law outside the draft Convention, since the draft Convention covers contractual limitations to assignment and not statutory limitations that may exist, e.g. under consumer protection or government contracting legislation.

Article 13 [14]. *Transfer of security rights*

(1) Unless otherwise provided by law or by agreement between the assignor and the assignee, any personal or property rights securing payment of the assigned receivables are transferred to the assignee without a new act of transfer.

(2) *Paragraph (1) of this article applies even if there is an agreement between the assignor and the debtor, or the person granting a right securing payment of the assigned receivables, limiting in any way the assignor's right to assign a receivable or a right securing payment of the receivable.*

(3) *The transfer of a possessory property right under paragraph (1) of this article does not affect any obligations of the assignor to the debtor or the person granting the property right with respect to the property transferred existing under the law governing that property right.*

(4) *Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any rights securing payment of the assigned receivables.*

Prior discussion:

A/CN.9/445, paras. 232-235 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 138-147 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 127-130 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 69-74 (Twenty-fourth session, 1995)

Remarks

1. Paragraphs (2) and (3) have been prepared by the Secretariat in order to address concerns expressed at a previous session of the Working Group (A/CN.9/434, paras. 143-145). They are intended to reflect the decision of the Working Group that: the transfer of security rights should be effective despite agreements between the assignor and the debtor restricting their transferability; and that the transfer of those security rights should not prejudice the rights of the guarantor of an independent guarantee, the issuer of a stand-by letter of credit, or a person granting a possessory right (A/CN.9/434, para. 146).

2. Paragraph (2) does not refer to independent guarantees and stand-by letters of credit, since the rule in paragraph (1) cannot apply to such instruments for the reason that they are not "security rights" and are normally not transferred automatically. Should the Working Group decide to extend the application of the rule in paragraph (1) to independent guarantees and stand-by letters of credit, a reference should be added in paragraph (1), e.g. to "supporting rights", while in paragraph (2) it should be ensured that such a transfer of "supporting rights" does not prejudice the rights of a guarantor/issuer (the term "independent undertaking" could be used and defined, probably along the lines of article 3 of the United Nations Guarantee and Standby Convention).

3. The Working Group may wish to consider whether the words "unless otherwise provided by law" contained in paragraph (1) make paragraph (4) redundant.

Chapter IV. Rights, obligations and defences

Section I. Assignor and assignee

Article 14 [15]. *Rights and obligations of the assignor and the assignee*

(1) Subject to the provisions of this Convention, the rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

(3) *In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage of which they knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to the particular receivables financing practice.*

Prior discussion:

- A/CN.9/434, paras. 148-151 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 131-144 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 73, 81 and 95 (Twenty-fourth session, 1995)

Remarks

The Working Group may wish to merge paragraph (1) into draft article 10(1) and to delete paragraphs (2) and (3). Paragraph (2) may not be necessary, since parties may, in any case, agree to be bound by usages and are normally bound by practices established between themselves. Paragraph (3) may introduce uncertainty since there does not seem to be a distinct body of usages on receivables financing practices.

Article 15 [16]. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents that:

(a) [notwithstanding an agreement between the assignor and the assignee limiting in any way the assignor's rights to assign its receivables,] the assignor has, at the time of assignment, the right to assign the receivable;

(b) the assignor has not previously assigned [, nor will later assign,] the receivable to another assignee; and

(c) the debtor does not have, at the time of assignment, any defences or rights of set-off arising under the original contract or any other agreement with the assignor, other than those specified in the assignment.

(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.

Prior discussion:

- A/CN.9/434, paras. 152-161 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 145-158 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 80-88 (Twenty-fourth session, 1995)

Remarks

1. The Working Group may wish to consider whether the bracketed language in paragraph (1)(a) is necessary, since this result is implied in draft article 12, according to which an assignment made despite an anti-assignment clause is effective. In the context of its discussion on paragraph (1)(b), the Working Group may wish to consider the question whether a representation of the assignor that it will not assign the same receivables again should be retained in a default rule such as draft article 15. Normally, such "negative pledge" types of representations are a matter of negotiation and are undertaken only in the context of specific transactions.

2. Paragraph (1)(c) is intended to limit the representation as to the absence of defences of the debtor to situations involving contractual receivables, since such a representation would not be appropriate in the case of non-contractual receivables. The Working Group may wish to consider whether the representation as to the absence of defences of the debtor should also refer to defences arising after the time of the assignment.

Article 16 [17]. *Notification of the debtor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment and request that payment be made to the assignee.

(2) Notification of the assignment or request for payment made by the assignor or the assignee in breach of an agreement under paragraph (1) is effective. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

(3) Notification shall be in writing and shall reasonably identify the receivables and the person to whom or for whose account or the address to which the debtor is required to make payment.

(4) Notification of the assignment may relate to receivables arising after notification. [Such notification is effective for a period of five years after the date it is received by the debtor, unless:

(a) otherwise agreed between the assignee and the debtor; or

(b) the notification is renewed in writing during the period of its effectiveness [for a period of five years unless otherwise agreed between the assignee and the debtor.]

Prior discussion:

- A/CN.9/434, paras. 162-165 (Twenty-sixth session, 1996)
 A/CN.9/432, paras. 159-164 (Twenty-fifth session, 1996)
 A/CN.9/420, paras. 89-97 (Twenty-fourth session, 1995)

Remarks

1. With the exception of the bracketed language in paragraph (4), draft article 16 is intended to reflect the agreement already reached by the Working Group on the issues addressed in this provision.

2. Under draft article 16 in combination with draft article 18, if notification is given by the assignee, the debtor is entitled to request the assignee to furnish within a reasonable period of time adequate proof (until adequate proof is furnished, the debtor does not need to pay the assignee and does not owe any interest for the delay in payment). In the absence of such adequate proof, the debtor may discharge its obligation by paying the assignor (draft article 18(4)). If the debtor knows that the assignee who notified is not entitled to payment or if the debtor receives notification under other law, the debtor may discharge its obligation by

paying to the person entitled to payment or to a judicial or other authority or to a public deposit fund (draft article 18(5)). Draft article 18(5) is intended to provide the debtor with a right, not an obligation. The debtor does not need to know or to determine the validity of the assignment, but it may discharge its obligation as prescribed in draft article 18(5) if it does have positive knowledge.

3. The bracketed language in paragraph (4) is intended to protect the assignor by limiting the types of future receivables in respect of which notification may be given. While financiers may wish to obtain a right in all future receivables, they usually advance credit only on the basis of future receivables that may arise within a limited period of time. On the other hand, introducing such a time limit would place on the assignee and the debtor the burden of having to keep track of the time of effectiveness of notifications, and might increase uncertainty and the cost of credit. With regard to the debtor, a time limit could create injustice, since, unless the debtor knows that the payment instructions contained in the notification are only effective for five years, it runs the risk of paying without being discharged.

Article 17. *Right of the assignee to payment*

(1) *The assignee is entitled to payment of the assigned receivable. Unless otherwise agreed between the assignor and the assignee, if payment is made to the assignee, the assignee is entitled to retain whatever it receives.*

(2) *Unless otherwise agreed between the assignor and the assignee, if payment is made to the assignor, the assignee has a right in whatever is received by that assignor.*

(3) *If payment is made to another person, including another assignee, a creditor of the assignor or the insolvency administrator, the assignee has a right in whatever is received by that person.*

Prior discussion:

A/CN.9/445, paras. 215-220

Remarks

1. Draft article 17 is intended to codify a rule which is common in most legal systems, namely that the assignee has the right to claim and to retain payment of the assigned receivables (which payment may take various forms, including a funds transfer, a cheque or goods). Under paragraph (1), the assignee may claim and retain payment (the assignee may claim payment even before notification, since the assignment is effective under draft article 10, but, under draft article 18(1), the debtor may choose to pay the assignor). Under paragraphs (2) and (3), the assignee may claim any payment of the assigned receivable made to other persons (the Working Group may wish to specify what constitutes payment of the assigned receivable). However, draft article 17 does not attempt to specify whether that right is a personal or a property right (*in rem* or *ad personam*), since this is a matter on which legal systems differ widely (A/CN.9/445, paras. 215-220).

2. The right to whatever is received upon payment is described, in some legal systems, as a “proceeds” issue. Use of that term is avoided, since it has a specific meaning and finds a specific treatment in certain legal systems, while it is unknown or is treated differently in other legal systems. Should the Working Group decide to attempt to unify the law in those respects, it could consider an approach, under which: the assignment would transfer, or create a security right in, not only the receivable, but also the proceeds of the receivable; priority as to the receivable would constitute priority as to its proceeds; and proceeds of receivables would include assets commingled with other assets, provided that they could be identified or traced as proceeds of receivables. As a matter of drafting, this result could be reached by extending the definition of “receivable” contained in draft article 2 so as to cover proceeds of receivables (e.g. in draft article 2(3) a subparagraph could be inserted that would read along the following lines: “any monetary sum or other property received upon any disposition, collection or distribution on account of an assigned receivable”; the reference to the specific types of payment covered is intended to avoid any uncertainty that may arise as a result of the differences existing among legal systems as to what constitutes payment; “other property” is intended to indicate non-cash proceeds; “any disposition” is intended to indicate, e.g. the sale of or creation of a security right in receivables; collections and distributions refer to cash or dividends collected or distributed on account of securities).

3. Alternatively, this result could be achieved by defining “proceeds” in draft article 5 along the following lines: “‘Proceeds of receivables’ means any monetary sum or other property received upon any disposition, collection or distribution on account of an assigned receivable”; and by introducing in draft article 11 language along the following lines: “Unless otherwise agreed between the assignor and the assignee, the assignment transfers or creates a security right in any proceeds of the assigned receivables, provided that they may be identified or traced as proceeds of the receivables”; and in draft articles 23 and 24 language along the following lines: “Priority as to receivables constitutes priority as to any proceeds, provided that they may be identified or traced as proceeds of the receivables”. Should the Working Group choose to follow this approach, more detailed rules may be needed, in particular for priority as to proceeds in case of insolvency of the assignor.

Section II. Debtor

Article 18 [18]. *Debtor’s discharge by payment*

(1) Until the debtor receives notification of the assignment, it is entitled to discharge its obligation by paying the assignor.

(2) After the debtor receives notification of the assignment, *subject to paragraphs (3) to (5) of this article*, it is discharged *only* by paying *in accordance with the payment instructions set forth in the notification*.

(3) In case the debtor receives notification of more than one assignment of the same receivables made by the same

assignor, the debtor is discharged by paying *in accordance with the payment instructions set forth in the first notification received by the debtor.*

(4) [*In case the debtor receives notification of the assignment from the assignee,*] *the debtor is entitled to request the assignee to furnish within a reasonable period of time adequate proof that the assignment has been made and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, [the writing evidencing assignment or] any [other] writing emanating from the assignor and indicating that the assignment has taken place.*

(5) This article does not *affect* any other ground on which payment by the debtor *to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund* discharges the debtor.

Prior discussion:

A/CN.9/434, paras. 176-191 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 165-172 and 195-204 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 98-115 and 124-131 (Twenty-fourth session, 1995)

Remarks

1. Draft article 18 is intended to set forth the ways in which the debtor may discharge its obligation by payment. It is not meant to establish an obligation of the debtor to pay, which is left to the contract or other legal relationship between the assignor and the debtor and to the law governing that relationship (see A/CN.9/432, paras. 173 and 181). The rule is that, up to notification, the debtor may discharge its obligation by paying the assignor (it may pay the assignee, but, in such a case, the debtor exposes itself to the risk of having to pay twice); after notification, discharge is obtained by payment to the assignee, in case of notification under the draft Convention. Paragraphs (3) to (5) deal with special cases in which the debtor may be discharged other than by paying the assignee (multiple notifications, notification by the assignee, notification under other law).

2. Under paragraph (2), the debtor's obligation to pay the assignee or as instructed by the assignee is triggered by the receipt of the notification by the debtor. The assignee bears the burden of ensuring that the notification is received by the debtor and, if something goes wrong (e.g. the assignor undertakes to notify the debtor but fails to do so), the risk of loss may be allocated by agreement between the assignor and the assignee.

Article 19 [19]. *Defences and rights of set-off of the debtor*

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences *arising from the original contract [or from a decision of a judicial or other authority giving rise to the assigned receivable]* of which the

debtor could avail itself if such claim were made by the assignor.

(2) The debtor may raise against the assignee any right of set-off *arising from contracts between the assignor and the debtor other than the original contract [or from a decision of a judicial or other authority other than that giving rise to the assigned receivable], provided that they were available to the debtor at the time notification of the assignment was received by the debtor.*

(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 12 against the assignor for breach of agreements *limiting in any way the assignor's right to assign its receivables* are not available to the debtor against the assignee.

Prior discussion:

A/CN.9/434, paras. 194-204 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 205-209 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 132-151 (Twenty-fourth session, 1995)

Remarks

The Working Group may wish to address the question whether the debtor may raise against the assignee rights of set-off, the basis for which was created before notification, although they may have not been "available" to the debtor at that time (e.g. a reciprocal and similar claim which becomes payable only after notification).

Article 20 [20]. *Agreement not to raise defences or rights of set-off*

(1) Without prejudice to [*the law governing consumer protection*] [*public policy requirements*] *in the State in which the debtor is located*, the debtor may agree with the assignor in writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 19. *Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.*

(2) The debtor may not agree not to raise:

(a) defences arising from fraudulent acts on the part of the assignee or the assignor;

(b) *the right to contest the validity of the original contract.*

(3) Such an agreement may only be modified by written agreement. [*After notification, such a modification is effective as against the assignee subject to article 21(2).*]

Prior discussion:

A/CN.9/434, paras. 205-212 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 218-238 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 136-144 (Twenty-fourth session, 1995)

Remarks

Paragraph (2) was inspired by article 30(1) of the United Nations Convention on International Bills of Exchange and International Promissory Notes (1980)^d, hereinafter referred to as “the United Nations Bills and Notes Convention” (see A/CN.9/434, para. 211). The second sentence of paragraph (3) is aimed at protecting the assignee from a modification of an agreement not to raise defences or rights of set-off, which may be agreed upon between the assignor and the debtor without the knowledge of the assignee. The words within square brackets are intended to ensure that, after notification, the modification of such an agreement is not effective towards the assignee unless the conditions set forth in draft article 21(2) have been met.

Article 21 [21]. *Modification of the original contract
[or of the receivable]*

(1) *An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee’s right to payment is effective as against the assignee and the assignee acquires corresponding rights.*

(2) *After notification of the assignment, an agreement under paragraph (1) of this article is effective as against the assignee and the assignee acquires corresponding rights,*

Variant A: if it is made in good faith and in accordance with reasonable commercial standards or, in case of a modification relating to a receivable fully earned by performance, it is consented to by the assignee.

Variant B: if the modification is provided for in the assignment or is later consented to by the assignee.

[(3) Paragraphs (1) and (2) of this article do not affect any right of the assignee against the assignor for breach of an agreement between the assignor and the assignee that the assignor will not modify the original contract without the assignee’s consent.]

[(4) In case a receivable is confirmed or determined in a decision of a judicial or other authority, it may be modified only through a decision of that authority.]

Prior discussion:

A/CN.9/434, paras. 198-204 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 210-217 (Twenty-fifth session, 1996)

Remarks

1. The purpose of draft article 21 is twofold: first, to protect the debtor by allowing the debtor to pay under the modified contract; and second, to protect the assignee from such modifications and to ensure that the assignee acquires rights under the modified contract.

^dOfficial Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17), annex I; see also General Assembly resolution 43/165, annex, of 9 December 1988.

2. Paragraphs (1) through (3) cover contractual modifications relating to contractual or non-contractual receivables (e.g. a modification of the time of payment or the amount owed, a modification of an agreement not to raise defences, a modification of a settlement agreement relating to tort or tax receivables).

3. Under paragraph (2), a choice needs to be made. Reference to good faith may create some uncertainty, but avoids putting on the parties the burden of having to obtain the consent of the assignee to every little modification of an unperformed contract, a procedure that might be burdensome for the assignee as well. Paragraph (4) has been inserted in order to address the modification of a non-contractual receivable determined or confirmed in a judicial or administrative decision (e.g. a tort or a tax receivable).

Article 22 [22]. *Recovery of advances*

Without prejudice to [the law governing consumer protection] [public policy requirements] in the country in which the debtor is located and the debtor’s rights under article 19, failure of the assignor to perform the original contract [or the decision of a judicial or other authority giving rise to the assigned receivable] does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

Prior discussion:

A/CN.9/434, paras. 213-215 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 239-244 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 145-148 (Twenty-fourth session, 1995)

Remarks

In line with the principle that the debtor’s position should not be worsened as a result of the assignment, draft article 22 provides that the debtor’s position should not be improved either by granting the debtor the right to recover from the assignee any advance payments made to the assignor or the assignee. Such a right of the debtor to recover from the assignee becomes critical in case the assignor becomes insolvent, otherwise the debtor can recover from the assignor based on their contractual relationship. At the same time, draft article 22 expressly preserves any right that the debtor may have, under domestic consumer-protection or other similar legislation, to recover from the assignee. In addition, draft article 22 protects the right of the debtor to refuse payment based on draft article 19.

Section III. Third parties

Article 23 [23]. *Competing rights of several assignees*

(1) *Priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor is located.*

(2) Notwithstanding paragraph (1), conflicts of priority may be settled by agreement between competing assignees.

Prior discussion:

A/CN.9/445, paras. 18-29 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 238-254 (Twenty-sixth session, 1996)

A/CN.9/432, para. 247-252 (Twenty-fifth session, 1996)

Article 24 [24]. *Competing rights of assignee and insolvency administrator or creditors of the assignor*

(1) *Priority as between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located.*

(2) *Priority as between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located.*

(3) *Nothing in this article requires a court to take any action which is manifestly contrary to the public policy of the State in which the court is located.*

(4) *In case an insolvency proceeding is commenced in a State other than the State in which the assignor is located,*

Variant A: except as provided in this article, this Convention does not affect the rights of the insolvency administrator or the rights of the assignor's creditors.

Variant B: this Convention does not affect:

(a) any right of creditors of the assignor to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer;

(b) any right of the insolvency administrator,

(i) to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer,

(ii) to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment of receivables that have not arisen at the time of the commencement of the insolvency proceeding,

(iii) to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract, or

(iv) to encumber the assigned receivables with the expenses of the insolvency administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee;

(c) [if the assigned receivables constitute security for indebtedness or other obligations,] any insolvency rules or procedures generally governing the insolvency of the assignor:

(i) permitting the insolvency administrator to encumber the assigned receivables;

(ii) providing for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding,

(iii) permitting substitution of the assigned receivables for new receivables of at least equal value,

(iv) providing for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured, or

(v) other rules and procedures of similar effect and of general application in the insolvency of the assignor [specifically described by a Contracting State in a declaration made under article 43].

(5) An assignee asserting rights under this article has no fewer rights than an assignee asserting rights under other law.

Prior discussion:

A/CN.9/445, paras. 30-44 and 57 (Twenty-seventh session, 1997)

A/CN.9/434, paras. 255-258 and 216-237 (Twenty-sixth session, 1996)

A/CN.9/432, para. 253-258 and 260 (Twenty-fifth session, 1996)

Remarks

1. Paragraphs (1) and (2) reflect a decision tentatively reached by the Working Group at its previous session (A/CN.9/445, paras. 39-40). Paragraphs (3) and (4) are intended to address the potential conflict between the draft Convention and the applicable insolvency law. As a result of crafting the scope provisions and the priority provisions on the basis of the registered office of the assignor, the possibility for such a conflict arising has been significantly reduced. If the insolvency proceeding is commenced in the State in which the assignor has its registered office or habitual residence in the case of an individual or a person without a registered office (i.e. a main insolvency proceeding under article 2(b) of the UNCITRAL Model Insolvency Law), no conflict would arise because the law applicable to priority would be from the same jurisdiction as the law governing insolvency.

2. A conflict can only arise if an insolvency proceeding is commenced in another State, i.e. a non-main insolvency proceeding under article 2(c) of the UNCITRAL Model Insolvency Law, which is a Contracting State. If that other State is not a Contracting State, the draft Convention would not apply. This result should not create any prob-

lems, since the secondary insolvency proceeding commenced in that State would generally not have any automatic extraterritorial effects and the assignor would be solvent in the State in which it has its registered office or habitual residence in the case of an individual or a person without a registered office).

3. The purpose of paragraph (3) is twofold: on the one hand, to ensure that the public policy of the State, in which a non-main insolvency proceeding is commenced, is preserved; and on the other hand, to avoid a blanket exclusion of the application of the law applicable under draft article 24 on the pretext of the slightest alleged deviation from public policy considerations. Paragraph (4) is intended to go a step further and to ensure that the draft Convention does not override certain rights of the insolvency administrator that are based on mandatory provisions of the State in which a non-main insolvency proceeding is commenced (which may not reflect public policy considerations).

4. In paragraph (4), a choice needs to be made between a general and a more detailed formulation of the principle. Variant A is based on the assumption that, once the validity of an assignment has been established by the draft Convention, nothing inhibits the insolvency administrator to challenge the assignment on any grounds other than its basic validity. Variant B expressly sets forth the matters that are either left generally to the law of the State in which a non-main insolvency proceeding has been commenced (e.g. the rights of the insolvency administrator with regard to post-insolvency future and unearned receivables, and its rights to assign or encumber the assigned receivables in certain circumstances), or are left to that law only under certain conditions (e.g. if "equal value" is given to the assignee, or if a security assignment is involved). By listing the rights of an insolvency administrator that are not affected by the draft Convention, variant B may enhance certainty and predictability to the extent that an assignment may not be challenged on grounds other than those listed. On the other hand, to the extent that the list may not be exhaustive, such an approach may result in excluding rights of insolvency administrators currently existing under national insolvency law.

Chapter V. Subsequent assignments

Article 25 [25(1) and (2)]. *Scope*

This Convention applies to:

(a) assignments of receivables by the initial or any other assignee to subsequent assignees ("*subsequent assignments*") that are governed by this Convention under article 1, notwithstanding that the initial or any other previous assignment is not governed by this Convention; and

(b) any subsequent assignment, provided that the initial assignment is governed by this Convention as if the subsequent assignee were the initial assignee.

Prior discussion:

A/CN.9/445, paras. 47-48 (Twenty-seventh session, 1997)

A/CN.9/432, paras. 265-266 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 166-173 (Twenty-fourth session, 1996)

Remarks

Subparagraph (a) is intended to clarify that subsequent assignments that meet the criteria set forth in draft article 1 are governed by the draft Convention, even if the initial assignment falls outside the scope of application of the draft Convention (e.g. a subsequent assignment in a securitization transaction may be covered even if the initial assignment is a domestic assignment of domestic receivables). Subparagraph (b), which appears within square brackets, has been inserted pursuant to a suggestion made at the previous session of the Working Group (A/CN.9/445, paras. 161-163). It is aimed at ensuring that the law governing the initial assignment governs any subsequent assignment (*continuatio juris*). As a result, a domestic receivable may be brought under the draft Convention, if assigned internationally. The final words of subparagraph (b) are aimed at ensuring that the subsequent assignee has the same legal position that an assignee has under the draft Convention (see article 11(1)(a) of the Ottawa Convention).

Article 26 [25(3)]. *Agreements limiting subsequent assignments*

(1) A receivable assigned by the initial or any subsequent assignee to a subsequent assignee is transferred notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the initial or any subsequent assignor's right to assign its receivables.

(2) Nothing in this article affects any obligation or liability for breach of such an agreement, but a person who was not party to such an agreement is not liable for its breach.

Prior discussion:

A/CN.9/445, para. 49 (Twenty-seventh session, 1997)

A/CN.9/432, para. 267 (Twenty-fifth session, 1996)

A/CN.9/420, paras. 174-178 (Twenty-fourth session, 1996)

Remarks

In paragraph (1), a reference has been added to an anti-assignment agreement between "the initial or any subsequent assignor and the debtor or any subsequent assignee" in order to ensure that an anti-assignment clause contained in the original contract or in the assignment or in a subsequent assignment does not invalidate any subsequent assignment. Under paragraph (2), if any assignee is liable towards the debtor or any assignor under other applicable law outside the draft Convention for further assigning the receivable despite an anti-assignment clause contained in

the original contract, in the assignment, or in any subsequent assignment, that liability is not extended to any subsequent assignee.

Article 27 [25(4)]. *Debtor's discharge by payment*

Notwithstanding that the invalidity of an assignment renders all subsequent assignments invalid, the debtor is entitled to discharge its obligation by paying in accordance with the payment instructions set forth in the first notification received by the debtor.

Prior discussion:

- A/CN.9/445, para. 51 (Twenty-seventh session, 1997)
- A/CN.9/432, para. 268 (Twenty-fifth session, 1996)
- A/CN.9/420, para. 179 (Twenty-fourth session, 1996)

Remarks

Draft article 27 is intended to protect the debtor from having to determine the validity of all assignments in a chain of assignments, in order to obtain a valid discharge of its obligation. Under draft article 18(2), the debtor may discharge its obligation in this way even if the initial assignment is invalid. If in doubt as to the validity of an assignment, the debtor may, under draft article 18(4), pay the assignor and be discharged.

Article 28. *Notification of the debtor*

Notification of a subsequent assignment constitutes notification of [any] [the immediately] preceding assignment.

Prior discussion:

- A/CN.9/445, para. 46 (Twenty-seventh session, 1997)

Chapter VI. Conflict of laws

Article 29 [26]. *Law applicable to the contract of assignment*

(1) [With the exception of matters which are settled in this Convention,] *the contract of assignment is governed by the law chosen by the assignor and the assignee. [The parties' choice of law must be express or [evident from the parties' conduct and from the clauses of the assignment contract, considered as a whole] [demonstrated with reasonable certainty by the terms of the contract and the circumstances of the case]].*

[(2) *Without prejudice to the validity of the contract of assignment or to the rights of third parties, the assignor and the assignee may agree to subject the contract of assignment to a law other than that which previously governed it as a result of an earlier choice under this article or other provisions of this Convention.*]

(3) *In the absence of a choice of law by the assignor and the assignee, the contract of assignment is governed by the law of the State with which the contract of assignment is most closely connected. In the absence of proof to the*

contrary, the assignment contract is presumed to be most closely connected with the State in which the assignor is located.

Prior discussion:

- A/CN.9/445, paras. 56-64 (Twenty-seventh session, 1997)
- A/CN.9/420, paras. 185-195 (Twenty-fourth session, 1995)

Remarks

The wording inserted in the first sentence of paragraph (1) and in paragraph (3) reflects the decisions made by the Working Group at its previous session (A/CN.9/445, paras. 57-64). According to the understanding of the Working Group so far, draft article 29 subjects both the contractual rights and obligations of the assignor and the assignee and the transfer of the receivables as between the assignor and the assignee to the same law. The language that appears in paragraph (1) within square brackets is based on articles 7 of the Inter-American Convention on the Law Applicable to International Contracts (Mexico City, 1994)^e, hereinafter referred to as "the Inter-American Convention", and 3(1) of the Convention on the Law Applicable to Contractual Obligations (Rome, 1980)^f, hereinafter referred to as "the Rome Convention". Paragraph (2) is drawn from article 3(2) of the Rome Convention.

Article 30 [27]. *Law applicable to the rights and obligations of the assignee and the debtor*

(1) [With the exception of matters which are settled in this Convention,] *the assignability of a receivable, the right of the assignee to request payment, the debtor's obligation to pay as instructed in the notification of the assignment, the discharge of the debtor and the debtor's defences are governed by the law governing the receivable to which the assignment relates.*

[(2) *The law governing the receivable is the law governing the contract [or decision or other act] from which the receivable arises.*

(3) *The law governing the contract from which the receivable arises is the law of the State with which the contract is most closely connected. A severable part of the contract which has a closer connection with another State may be governed by the law of that other State.*

(4) *In the absence of proof to the contrary, the contract is presumed to be most closely connected with the State in which the assignor is located.]*

Prior discussion:

- A/CN.9/445, paras. 65-69 (Twenty-seventh session, 1997)
- A/CN.9/420, paras. 197-201 (Twenty-fourth session, 1995)

^eInternational Legal Materials, vol. XXXIII, No. 3 (Washington, D.C., 1994).

^fUnited Nations, Treaty Series, vol. 1605, No. 28023.

Remarks

Paragraphs (2) to (4), which appear within square brackets for the consideration of the Working Group, are intended to specify the law governing the receivable. They have been inspired by article 4 of the Rome Convention and article 9 of the Inter-American Convention.

[Article 31 [28]. *Law applicable to conflicts of priority*

- (1) The priority among several assignees of the same receivables from the same assignor is governed by the law of the State in which the assignor *is located at the time of the assignment*.
- (2) The priority between an assignee and the insolvency administrator is governed by the law of the State in which the assignor *is located at the time of the assignment*.
- (3) The priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor *is located at the time of the assignment*.]

Prior discussion:

- A/CN.9/445, paras. 70-74 (Twenty-seventh session, 1997)
A/CN.9/420, para. 154 (Twenty-fourth session, 1995)

Remarks

Pending determination by the Working Group of the issue of the purpose of the conflict-of-laws provisions, draft article 31 appears within square brackets. If the Working Group decides that the purpose of the conflict-of-laws provisions should be to fill the substantive-law gaps left in the draft Convention (draft article 8(2)), draft article 31 could be deleted, since the rules of the draft Convention dealing with priority are conflict-of-laws provisions and filling substantive-law gaps should be left to the applicable law. If, however, the Working Group decides to provide an additional layer of harmonization of law in the field of assignment by preparing a so called "mini-Convention" on conflict-of-laws issues on assignment, draft article 31 should be retained. A related purpose of the conflict-of-laws rules, i.e. the facilitation of the application of the draft Convention, is referred to in the remarks to article 1. The Working Group may wish to consider whether a reference to the time at which the location of the assignor will determine the law applicable is necessary.

Article 32. *Mandatory rules*

- (1) *Nothing in this chapter restricts the application of the rules of the law of the forum in a situation where they cannot be derogated from by contract ("mandatory rules") irrespective of the law otherwise applicable.*
- (2) *With regard to matters settled in this chapter, the forum may decide to apply the mandatory rules of the law of another State with which the contract of assignment has a close connection, if and in so far as, under the law of that other State, those rules must be applied whatever the law applicable.*

Article 33. *Public policy*

With regard to matters settled in this chapter, the application of the law specified by this Convention may be refused only if such application is manifestly contrary to the public policy of the forum.

Prior discussion:

A/CN.9/445, para. 57 (Twenty-seventh session, 1997)

Remarks

Draft articles 32 and 33 reflect a suggestion made at the previous session of the Working Group (A/CN.9/445, para. 57). They have been inspired respectively by articles 7 and 16 of the Rome Convention and articles 11 and 18 of the Inter-American Convention. The purpose of draft article 32 is to ensure that: the forum may apply its mandatory rules, even if the law of the forum is not the applicable law; and that the forum may apply mandatory rules of another State's law if that State has a close connection with the contract of assignment, irrespective of whether the law of that State is applicable. Draft article 33 is aimed at preserving the public policy of the forum.

Chapter VII. Alternative priority rules

Section I. Priority rules based on registration

Article 34 [23(3)]. *Priority among several assignees*

As between assignees of the same receivables from the same assignor, priority is determined by the order in which certain information about the assignment is registered under this Convention, regardless of the time of transfer of the receivables. If no assignment is registered, priority is determined on the basis of the time of the assignment.

Prior discussion:

- A/CN.9/445, para. 28 (Twenty-seventh session, 1997)
A/CN.9/434, paras. 238-254 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 247-252 (Twenty-fifth session, 1996)

Article 35 [24(4)]. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to articles 23(3) and (4) and 44,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:

- (a) the receivables [were assigned] [arose] [were earned by performance], and information about the assignment was registered under this Convention, before the commencement of the insolvency proceeding or attachment; or

(b) the assignee has priority on grounds other than the provisions of this Convention.

Prior discussion:

A/CN.9/445, para. 31 (Twenty-seventh session, 1997)
A/CN.9/434, paras. 255-258 and 216-237 (Twenty-sixth session, 1996)

A/CN.9/432, paras. 253-258 and 260 (Twenty-fifth session, 1996)

Remarks

The opening words of draft article 35, as well as of draft article 40, are intended to ensure that the rights of the insolvency administrator referred to in draft articles 24(3) and (4) and 44 are preserved.

Section II. Registration

Article 36 [1 and 2 annex]. *Establishment of a registration system*

A registration system will be established for the registration of data about assignments under this Convention and the regulations to be promulgated by the registrar and the supervising authority. The regulations will prescribe the exact manner in which the registration system will operate, as well as the procedure for resolving disputes relating to registration.

Prior discussion:

A/CN.9/445, paras. 94-103 (Twenty-seventh session, 1997)

Remarks

As chapter VII is optional, it generally provides for the establishment of a registration system. With regard to the way in which a registration system may be established, Contracting States have a number of options, including: to establish their own national registration system; or to cooperate in establishing an international registration system. In either case, States may wish to establish a supervising authority, which, in the former case, will provide assistance to States in linking their own registries to other national registries and, in the latter case, will provide for the operation and maintenance of the registration system. The details of this system will have to be described in the regulations (e.g. whether registration and searching will have to be made at the national level or whether, while registration may be made both at the national and international level, all data will be available at the international registry, the duties of the registry and the dispute resolution procedures). The promulgation of the regulations is left to the supervising authority, which will probably have to be a governmental or intergovernmental entity, and to the operator of the system (the registrar), which may be a private contractor.

Article 37 [3, 4 and 5 of annex]. *Registration*

(1) Any person may register data with regard to an assignment at the registry in accordance with this Conven-

tion and the registration regulations. The data registered shall include the name and address of the assignor and the assignee and a brief description of the assigned receivables.

(2) *A single registration may cover:*

(a) *the assignment by the assignor to the assignee of more than one receivable;*

(b) *an assignment not yet made;*

(c) *the assignment of receivables not existing at the time of registration.*

(3) *Registration, or its amendment, is effective from the time that the data referred to in paragraph (1) are available to searchers. Registration, or its amendment, is effective for the period of time specified by the registering party. In the absence of such a specification, a registration is effective for a period of [five] years. Regulations will specify the manner in which registration may be renewed, amended or discharged.*

(4) Any defect, irregularity, omission or error with regard to the name of the assignor that results in data registered not being found upon a search based on the name of the assignor renders the registration ineffective.

Prior discussion:

A/CN.9/445, paras. 104-111 and 115-117 (Twenty-seventh session, 1997)

Article 38 [6 of annex]. *Registry searches*

(1) Any person may search the records of the registry according to the name of the assignor and obtain a search result in writing.

(2) A search result in writing that purports to be issued from the registry is admissible as evidence and is, in the absence of evidence to the contrary, proof of the data to which the search relates, including:

(a) the date and time of registration; and

(b) the order of registration.

Prior discussion:

A/CN.9/445, paras. 118-119 (Twenty-seventh session, 1997)

Section III. Priority rules based on the time of the contract of assignment

Article 39 [23(1)]. *Priority among several assignees*

(1) *If a receivable is assigned several times, the right thereto is acquired by the assignee whose contract of assignment is of the earliest date.*

(2) *The earliest assignee may not assert priority if it acted in bad faith at the time of the conclusion of the contract of assignment.*

(3) *If a receivable is transferred by operation of law, the beneficiary of that transfer has priority over an assignee asserting a contract of assignment of an earlier date.*

(4) *In the event of a dispute, it is for the assignee asserting a contract of assignment of an earlier date to furnish proof of such an earlier date.*

Prior discussion:

A/CN.9/445, para. 28 (Twenty-seventh session, 1997)
A/CN.9/434, paras. 238-254 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 247-252 (Twenty-fifth session, 1996)

Remarks

1. Reflecting a suggestion made at the previous session of the Working Group (A/CN.9/445, para. 84), chapter VII provides an alternative method of determining priority based on the time of the contract of assignment.

2. Should the Working Group decide to refer to alternative methods, it may wish to consider whether yet another alternative method based on the time of notification should be included, in order to avoid giving the impression that a time-of-assignment rule is the second-best alternative to a registration-based rule (A/CN.9/445, para. 86). On the other hand, the Working Group may wish to limit the alternatives offered in the optional part of the draft Convention to one or to decide to delete the optional part altogether, since offering too many alternatives may cause confusion. In its efforts to reach agreement, the Working Group may wish to take into account that all three alternative rules are applied interchangeably in both civil and common law jurisdictions (e.g. while a time-of-assignment rule is considered to be a civil law rule, it exists in common law jurisdictions and is known as “the American rule”; and while a registration- or notification-based rule is considered to be a common law rule, it exists in civil law jurisdictions).

Article 40 [24(3)]. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to articles 23(3) and (4) and 44,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if:

(a) *the receivables were assigned before the commencement of the insolvency proceeding or attachment; or*

(b) *the assignee has priority on grounds other than the provisions of this Convention.*

Prior discussion:

A/CN.9/445, para. 31 (Twenty-seventh session, 1997)
A/CN.9/434, paras. 255-258 and 216-237 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 253-258 and 260 (Twenty-fifth session, 1996)

Chapter VIII. Final provisions

Remarks

With the exception of draft articles 42 to 44, the final provisions are drawn from the Guarantee and Standby Convention.

Article 41. *Depositary*

The Secretary-General of the United Nations is the depositary of this Convention.

Article 42 [9 and 29]. *Conflicts with international agreements*

(1) *Except as provided in paragraph (2) of this article, this Convention prevails over any international convention [or other multilateral or bilateral agreement] which has been or may be entered into by a Contracting State and which contains provisions concerning the matters governed by this Convention.*

(2) *If a State declares, at [the time of signature, ratification, acceptance, approval or accession] [any time], that the Convention will not prevail over international conventions [or other multilateral or bilateral agreements] listed in the declaration, to which it has or will enter and which contain provisions concerning the matters governed by this Convention, this Convention does not prevail.*

Prior discussion:

A/CN.9/445, paras. 201-203 (Twenty-seventh session, 1997)
A/CN.9/434, paras. 96-99 (Twenty-sixth session, 1996)
A/CN.9/432, paras. 73-75 (Twenty-fifth session, 1996)
A/CN.9/420, para. 23 (Twenty-fourth session, 1995)

Article 43. *Application of chapter VII*

A Contracting State may declare at [the time of signature, ratification, acceptance, approval, or accession] [any time] that it will be bound either by sections I and II or by section III of chapter VII.

Article 44. *Insolvency rules or procedures not affected by this Convention*

A Contracting State may describe at [the time of signature, ratification, acceptance, approval, or accession] [any time] other rules or procedures governing the insolvency of the assignor which this Convention does not affect.

Article 45. *Signature, ratification, acceptance, approval, accession*

(1) *This Convention is open for signature by all States at the Headquarters of the United Nations, New York, until ...*

(2) *This Convention is subject to ratification, acceptance or approval by the signatory States.*

(3) *This Convention is open to accession by all States which are not signatory States as from the date it is open for signature.*

(4) *Instruments of ratification, acceptance, approval and accession are to be deposited with the Secretary-General of the United Nations.*

Article 46. *Application to territorial units*

(1) *If a State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at the time of signature, ratification, acceptance, approval or accession, declare that this Convention is to extend to all its territorial units or only one or more of them, and may at any time substitute another declaration for its earlier declaration.*

(2) *These declarations are to state expressly the territorial units to which the Convention extends.*

(3) *If, by virtue of a declaration under this article, this Convention does not extend to all territorial units of a State and the assignor or the debtor is located in a territorial unit to which the Convention does not extend, this location is considered not to be in a Contracting State.*

(4) *If a State makes no declaration under paragraph (1) of this article, the Convention is to extend to all territorial units of that State.*

Article 47 [31]. *Effect of declaration*

(1) *Declarations made under articles 42-44 and 46 at the time of signature are subject to confirmation upon ratification, acceptance or approval.*

(2) *Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.*

(3) *A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the*

expiration of six months after the date of its receipt by the depositary.

(4) *Any State which makes a declaration under articles 42-44 and 46 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.*

Article 48 [32]. *Reservations*

No reservations may be made to this Convention.

Article 49. *Entry into force*

(1) *This Convention enters into force on the first day of the month following the expiration of one year from the date of the deposit of the [fifth] instrument of ratification, acceptance, approval or accession.*

(2) *For each State which becomes a Contracting State to this Convention after the date of the deposit of the [fifth] instrument of ratification, acceptance, approval or accession, this Convention enters into force on the first day of the month following the expiration of one year after the date of the deposit of the appropriate instrument on behalf of that State.*

(3) *This Convention applies only to assignments made on or after the date when the Convention enters into force in respect of the Contracting State referred to in paragraph (1) of article 1.*

Article 50. *Denunciation*

(1) *A Contracting State may denounce this Convention at any time by means of a notification in writing addressed to the depositary.*

(2) *The denunciation takes effect on the first day of the month following the expiration of one year after the notification is received by the depositary. Where a longer period is specified in the notification, the denunciation takes effect upon the expiration of such longer period after the notification is received by the depositary.*

II. ELECTRONIC COMMERCE

A. Report of the Working Group on Electronic Commerce on the work of its thirty-second session (Vienna, 19-30 January 1998) (A/CN.9/446) [Original: English]

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I. INTRODUCTION

1. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on those topics. It was agreed that work to be carried out by the Working Group at its thirty-first session (New York, 18-28 February 1997) could involve the preparation of draft rules on certain aspects of the above-mentioned topics. The Working Group was requested to provide the Commission with sufficient elements for an informed decision to be made as to the scope of the uniform rules to be prepared. As to a more precise mandate for the Working Group, it was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.¹

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). As to the desirability and feasibility of preparing uniform rules on issues of digital signatures and certification authorities, the Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While it had not made a firm decision as to the form and content of such work, it had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (see A/CN.9/437, paras. 156-157). With respect to the issue of incorporation by reference, the Working Group concluded that no further study by the Secretariat was needed, since the fundamental issues were well known and it was clear that many aspects of battle-of-forms and adhesion contracts would need to be left to applicable national laws for reasons involving, for example, consumer protection and other public-policy considerations. The Working Group was of the opinion that the issue should be dealt with as the first substantive item on its agenda, at the beginning of its next session (A/CN.9/437, para. 155).

3. The Commission expressed its appreciation for the work already accomplished by the Working Group at its thirty-first session, endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of

digital signatures and certification authorities (hereinafter referred to as "the Uniform Rules").

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (1996)^a, hereinafter referred to as "the Model Law". Thus, the Uniform Rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, the Uniform Rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, particularly where cross-border certification was sought.

5. As an additional item to be considered in the context of future work in the area of electronic commerce, it was suggested that the Working Group might need to discuss, at a later stage, the issues of jurisdiction, applicable law and dispute settlement on the Internet.²

6. The Working Group on Electronic Commerce, which was composed of all the States members of the Commission, held its thirty-second session at Vienna from 19 to 30 January 1998. The session was attended by representatives of the following States members of the Working Group: Algeria, Australia, Austria, Brazil, Bulgaria, China, Egypt, Finland, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Mexico, Nigeria, Poland, Russian Federation, Singapore, Slovakia, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

7. The session was attended by observers from the following States: Angola, Belarus, Bosnia and Herzegovina, Canada, Colombia, Costa Rica, Czech Republic, Denmark, Greece, Guatemala, Indonesia, Iraq, Ireland, Kuwait, Lebanon, Malaysia, Morocco, Netherlands, Pakistan, Paraguay, Republic of Korea, Sweden, Switzerland, Turkey and Ukraine.

8. The session was attended by observers from the following international organizations: International Trade Centre UNCTAD/WTO, United Nations Conference on Trade and Development (UNCTAD), United Nations

²Ibid., *Fifty-second Session, Supplement No. 17 (A/52/17)*, paras. 249-251.

^aIbid., *Fifty-first Session, Supplement No. 17 (A/51/17)*, annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

¹*Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17)*, paras. 223-224.

Educational, Scientific and Cultural Organization (UNESCO), United Nations Industrial Development Organization (UNIDO), World Intellectual Property Organization (WIPO), European Commission, Organization for Economic Cooperation and Development (OECD), World Trade Organization (WTO), Cairo Regional Centre for International Commercial Arbitration, *Comité maritime international* (CMI), International Association of Ports and Harbors (IAPH), International Bar Association (IBA), International Chamber of Commerce (ICC), Internet Law and Policy Forum (ILPF) and European Law Students Association (ELSA) International.

9. The Working Group elected the following officers:

- Chairman:* Mr. Mads Bryde ANDERSEN
(Denmark);
- Vice-Chairman:* Mr. PANG Khang Chau
(Singapore);
- Rapporteur:* Mr. Gritsana CHANGGOM
(Thailand).

10. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.IV/WP.72); a note prepared by the Secretariat for the thirty-first session of the Working Group under the title "Planning of future work on electronic commerce: digital signatures, certification authorities and related legal issues" (A/CN.9/WG.IV/WP.71), which summarized previous deliberations by the Working Group on the issue of incorporation by reference; a note reproducing the text of a proposed draft provision on incorporation by reference and explanatory comments by the United Kingdom of Great Britain and Northern Ireland (A/CN.9/WG.IV/WP.74); and a note by the Secretariat containing draft uniform rules on digital signatures, other electronic signatures, certification authorities and related legal issues (A/CN.9/WG.IV/WP.73).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Legal aspects of electronic commerce: incorporation by reference.
4. Legal aspects of electronic commerce: draft uniform rules on digital signatures, other electronic signatures, certification authorities and related legal issues.
5. Other business.
6. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

12. The Working Group discussed the issue of incorporation by reference on the basis of the note prepared by the Secretariat (A/CN.9/WG.IV/WP.71) and the proposal made by the United Kingdom of Great Britain and Northern Ireland (A/CN.9/WG.IV/WP.74). The deliberations and conclusions of the Working Group with respect to that issue are reflected in chapter III, below. After discussion, the text of a draft article on incorporation by reference was adopted

by the Working Group. The Secretariat was requested to prepare, on the basis of the deliberations and decisions of the Working Group, a short guide to assist States in enacting and applying the draft article. It was noted that the draft article, together with the relevant guide to enactment, would be placed before the Commission at its thirty-first session, to be held in New York from 1 to 12 June 1998, for final review and possible insertion in the Model Law and its Guide to Enactment.

13. The Working Group also discussed the issues of digital signatures, other electronic signatures, certification authorities and related legal issues on the basis of the note prepared by the Secretariat (A/CN.9/WG.IV/WP.73). The deliberations and conclusions of the Working Group with respect to those issues are reflected in chapter IV, below. The Secretariat was requested to prepare, on the basis of those deliberations and conclusions, a set of revised provisions, with possible variants, for consideration by the Working Group at a future session.

III. INCORPORATION BY REFERENCE

14. Having recalled its earlier deliberation of the matter of incorporation by reference, and the draft texts proposed as its previous sessions (A/CN.9/WG.IV/WP.71, paras. 77-93), the Working Group was invited to consider the matter of incorporation by reference in an electronic context on the basis of a proposed draft provision (A/CN.9/WG.IV/WP.74, annex), which read as follows:

"(1) This article applies when a data message contains reference to, or its meaning is only fully ascertainable by reference to, information recorded elsewhere ('the further information').

"(2) Subject to paragraph (5), the data message shall have the same effect as if the further information were fully expressed in the data message and any reference to the data message will constitute a reference to that message including all further information, if the conditions in paragraph (3) are satisfied.

"(3) The conditions mentioned in paragraph (2) are that the data message:

"(a) identifies the further information —

"(i) by a collective name or description or code; and

"(ii) by specifying adequately the record, and the parts of that record, containing the further information and, where that record is not publicly available, the place where, and, in cases where the means of access is either not obvious or is restricted in some way, the means by which, it may be found; and

"(b) expressly indicates or carries a clear implication that the data message is intended to have the same effect as if the further information were fully expressed in the data message.

“(4) The identification mentioned in paragraph (3)(a) may be made indirectly, by referring to information recorded elsewhere which contains the necessary identification, provided the conditions in paragraph (3) are satisfied with respect to that reference.

“(5) Nothing in this article affects -

“(a) any rule of law which requires adequate notice to be given of the content of the further information, or of the record or place where, or the means by which such information may be found, or which requires that place or record to be accessible to another person; or

“(b) any rule of law relating to the validity of terms for the purpose of contract formation, including the acceptance of an offer.

“(c) any rule of law prescribing the effectiveness of the further information being incorporated or the validity of the process of incorporation.”

15. It was observed that: the draft provision was intended to apply when a data message used incorporation by reference (para. (1)); the overall principle was that the incorporated information (not referred to as “terms or conditions”, since not all information created an obligation) should have the same effect as if it were fully expressed in a data message (para. (2)); the general conditions for incorporation by reference should be clear and precise identification of the information being incorporated (which was of particular importance for the protection of consumers and other third parties), identification of where and how that information could be accessed and an indication of intent to incorporate (para. (3)); indirect identification of the source of information by reference to another source should be acceptable under the same conditions (para. (4)); and that any existing rules of law applying to incorporation by reference in paper communications should extend to electronic communications (para. (5)).

16. It was generally agreed that the matter had to be dealt with, since incorporation by reference was inherent in the use of electronic communications. It was stated that in electronic communications large amounts of data were by necessity incorporated by reference (e.g. communication records, policy statements, digital signatures in certificates). In addition, it was observed that incorporation by reference in an electronic context could be satisfied by various methods, including, but not limited to, uniform resource locators (URLs), object identifiers (OIDs) or other records reasonably available at a stated address.

17. While it was admitted that incorporation by reference created certain risks, e.g. for consumers, it was argued that, at the same time, such practice allowed consumers to take advantage of opportunities offered only via electronic communication networks. The main goal of a provision on incorporation by reference, it was pointed out, should be to establish a balance among the interested parties. With a view to achieving that goal, the Working Group was invited to consider, in parallel with the

above-mentioned draft provision, a draft provision along the following lines:

“*Variant A* Unless otherwise agreed between the parties, information is regarded as forming part of a data message, if expressly indicated or clearly implied [and if that data message indicates a procedure whereby that information can be accessed in a reasonable and timely manner]. Such information is effective to the extent permitted by law.

“*Variant B* Information shall not be denied legal effect solely on the grounds that it is incorporated by reference in a data message.”

18. With regard to variant A, it was stated that the material factors bearing on whether a term was reasonably accessible included: availability (hours of operation of the repository, ease of access, and acceptable levels of redundancy); cost of access (excluding underlying communications service costs; if there was a cost it should be reasonable and in proportion with the value associated with the contract); format (widely used within the community of interest); integrity (verification of content, authentication of sender, and mechanism for communication error correction); and the extent to which it was subject to later amendment (without a contractual right to do so; notice of updates; notice of policy of amendment). Those factors, it was added, could be set forth in a guide to enactment of the provisions on incorporation by reference (see paras. 23-24, below).

19. The Working Group proceeded with its discussion on the basis of the above-mentioned proposals for alternative provisions. It was observed that the proposed draft provisions had a number of advantages in common. One such advantage was that they were intended to facilitate incorporation by reference in an electronic context by removing the uncertainty prevailing in many jurisdictions as to whether the provisions dealing with traditional incorporation by reference were applicable to incorporation by reference in an electronic environment. In that connection, it was suggested that a different approach might be taken, to the effect that wide use of incorporation by reference would be discouraged in an electronic environment, thus reducing the risk that the difficult situation known as “battle of forms” in traditional paper-based trade might be replicated in electronic commerce. In support of that suggestion, it was observed that, while in a paper-based context incorporation by reference was necessary for time, space and cost reasons, in an electronic context a large amount of data could be reflected in data messages in a simple, timely and inexpensive manner. That suggestion was objected to on the grounds that it would be inappropriate for a uniform law to play the role of a code of conduct, thus discouraging the use of a widespread and important practice, the use of which was inherent in electronic communications.

20. Another advantage of the above-mentioned proposals, it was said, was that they recognized that consumer-protect-

tion or other national or international law of a mandatory nature (e.g. rules protecting weaker parties in the context of contracts of adhesion) should not be interfered with. It was pointed out that: the first proposal was intended to achieve that result by listing rules of law that remained unaffected (para. (5)); and that the second proposal led to the same result, since it referred to information being effective “to the extent permitted by law” (variant A), or did not preclude that information be denied legal effect on grounds other than incorporation by reference (variant B). With a view to making it overly clear that existing law was not affected by any of the proposed wordings, it was suggested that any provision on incorporation by reference should be subjected to language along the lines of the second footnote to article 1 of the Model Law, which stated expressly the principle that the Model Law was not intended to override consumer-protection law.

21. However, the view was expressed that the first proposal and variant A of the second proposal presented a number of disadvantages. One disadvantage was that they ran the risk of upsetting well-established or emerging practices by setting too high a standard. It was stated that in many practices it would be impossible to meet the requirements for an express indication or a clear implication of intention that the information be incorporated by reference or for reasonable accessibility to that information. The example was mentioned of the incorporation by reference of a main charter-party in a bill of lading delivered under a sub-charter-party, a practice that was said would be hampered by requirements for an express indication or a clear implication of intention that the information be incorporated by reference or for reasonable accessibility to that information. Another disadvantage was that those provisions might inadvertently interfere with mandatory rules of law and lead to unfair results. In that connection, it was pointed out that, in addition to the two conditions set forth in the first proposal and in variant A of the second proposal, a third element should be included, namely that incorporation by reference should be subject to acceptance by the parties. In particular in open electronic data interchange (EDI), it was stated, acceptance by the parties was essential.

22. In response, it was observed that paragraph (5) of the first proposal and the second sentence of variant A of the second proposal were intended to address exactly those concerns and to ensure that the provision on incorporation by reference would not interfere with established practices or with mandatory rules of national law. However, it was felt that those provisions might raise questions of interpretation. Variant B, it was observed, did not present that disadvantage, in that it merely expressed the general principle of non-discrimination enshrined in article 5 of the Model Law. It was generally recognized that variant B implied that incorporation by reference would be effective only to the extent permitted by law. On that basis, the Working Group generally agreed that variant B would be preferable.

23. As a matter of drafting, it was suggested that variant B should parallel the language of article 5 of the Model Law and thus refer, not only to legal effect, but also to validity and enforceability. With regard to the location of

the provision on incorporation by reference, it was suggested that, in view of the fact that the issue related to electronic commerce in general and not only to digital signatures, it should be inserted in the Model Law as a new article 5 *bis*. In order to assist users of the Model Law and legislators in the interpretation of the provision on incorporation by reference, it was also suggested that the background and explanatory information with regard to the provision on incorporation by reference should be included in the Guide to Enactment of the Model Law. The suggestion was made that the guide could indicate the factors on the basis of which States might wish to adopt an expanded version of the provision on incorporation by reference. Such factors could be inspired from the text of the first proposal and variant A of the second proposal. That suggestion was found to be generally acceptable. However, a note of caution was struck that such an approach might be inconsistent with the approach taken in article 5 of the Model Law. The view was expressed that the above-mentioned factors should not be set out as alternatives to the provisions of the Model Law. It was generally felt that, in drafting the portion of the Guide to Enactment dealing with incorporation by reference, attention should be given to avoiding inadvertently suggesting that restrictions to incorporation by reference should be introduced with respect to electronic commerce in addition to those that might already apply in paper-based trade.

24. After discussion, the Working Group adopted variant B, decided that it should be presented to the Commission for review and possible insertion as a new article 5 *bis* of the Model Law and requested the Secretariat to prepare an explanatory note to be added to the Guide to Enactment of the Model Law.

IV. CONSIDERATION OF DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

Chapter I. Sphere of application and general provisions

25. The Working Group generally agreed that the relationship between the Uniform Rules and the Model Law (in particular, the question whether the Uniform Rules on digital signatures should constitute a separate legal instrument or whether they should be incorporated in an extended version of the Model Law) would need to be clarified at a later stage. While it was agreed that no decision could be made at this stage, the Working Group confirmed its working assumption that the Uniform Rules should: be prepared as draft legislative provisions; be consistent with the provisions of the Model Law in general; and somehow incorporate provisions along the lines of articles 1 (“Sphere of application”), 2(a),(c) and (e) (“Definitions of ‘data message’, ‘originator’ and ‘addressee’”), 3 (“Interpretation”) and 7 (“Signature”) of the Model Law.

26. With respect to the sphere of application of the Uniform Rules, the view was expressed that it should be limited to digital signatures, to the exclusion of other authentication techniques. It was recalled in response that, in

making its preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules on digital signatures, the Working Group, at its previous session, had also agreed that, alongside digital signatures and certification authorities, work in the area of electronic commerce might need to address issues of technical alternatives to public-key cryptography (see A/CN.9/437, paras. 156-157). It was also recalled that, at the thirtieth session of the Commission, it was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the Model Law (see para. 4, above). After discussion, the Working Group confirmed its decision that, while focusing on the preparation of specific provisions dealing with digital signature techniques, it should also extract from those specific provisions rules of more general application to accommodate alternative authentication techniques.

Chapter II. Electronic signatures

Section I. Secure electronic signatures

Article 1. Definitions

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

“For the purposes of these Rules:

“(a) ‘Signature’ means any symbol used, or any security procedure adopted by [or on behalf of] a person with the intent to identify that person and to indicate that person’s approval of the information to which the signature is appended;

“(b) ‘Electronic signature’ means [a signature][data] in electronic form in, or attached to, or logically associated with, a data message [and used by [or on behalf of] a person with the intent to identify that person and to indicate that person’s approval of the contents of the data message][and used to satisfy the conditions in [article 7 of the UNCITRAL Model Law on Electronic Commerce]];

“(c) ‘Secure electronic signature’ means an electronic signature which

“(i) is a digital signature under article 4 and meets the requirements set forth in article 5; or

“(ii) as of the time it was made, can otherwise be verified to be the signature of a specific person through the application of a security procedure that is: uniquely linked to the person using it; capable of promptly, objectively and automatically identifying that person; created in a manner or using a means under the sole control of the person using it; and linked to the data message to which it relates in a manner such that if the message is altered the electronic signature is invalidated; or

“(iii) [as between parties involved in generating, sending, receiving, storing or otherwise processing data messages in the ordinary course of their business,] is commercially reasonable under the circumstances, previously agreed to, and properly applied, by the parties.”

General remark

28. It was pointed out that the provisions contained in draft article 1 were intended not only as definitions but also as a means of delineating the scope of the Uniform Rules. While it was noted that the same drafting technique had been used in the context of the Model Law, it was generally felt that draft article 1 might need to be revisited by the Working Group during its deliberation of the scope of the Uniform Rules.

Subparagraph (a)

29. It was widely felt that subparagraph (a) should be deleted. While including in the Uniform Rules a definition of “signature” based on article 7 of the Model Law might provide useful guidance in those countries where there currently existed no definition of a “signature”, it was stated that such a definition was not necessary for the purposes of the Uniform Rules. One of the reasons stated for deletion was that including an all-purpose definition of “signature” might jeopardize the acceptability of the instrument in those countries where the provision contained in subparagraph (a) might conflict with existing definitions.

Subparagraph (b)

30. It was widely felt that the wording of subparagraph (b) should mirror the text of article 7 of the Model Law. That result could be achieved either by reproducing that article in full in subparagraph (b) or by way of a reference to “the conditions set forth in article 7 of the Model Law”. After discussion, the Working Group found the latter formulation to be preferable. As a matter of drafting, it was generally agreed that the word “data” should be used instead of the words “a signature”.

Subparagraph (c): general remarks

31. The view was expressed that defining an electronic signature as “secure” might be inappropriate. Whether a given technique was “secure” was not a matter of definition but a question of fact to be determined in relation to the circumstances under which that technique was used. The use of the word “secure” was also criticised on the grounds that it introduced a subjective criterion and that it implied that signatures that did not fall within that category were inherently insecure. In response, it was stated that, while the reference to a “secure” signature might need to be replaced by better wording, it was only used in the Uniform Rules as a means of delimiting a category of electronic signatures of a quality such that specific legal effects could be attached to them. As to whether the use of the word “secure” might establish a subjective criterion, it was stated that authentication techniques did not develop in a vacuum. Standards implemented either through regu-

lation or through voluntary, industry-based practices would be available to assess the degree of security of any given technique. After discussion, the Working Group decided to proceed on the assumption that a category (provisionally labelled “secure”) would be used to address the range of techniques to which the Uniform Rules would attach certain legal effects.

32. The view was expressed that it might be inappropriate to provide that the same legal effect would attach to the use of a wide variety of authentication techniques, which were said to range from inherently secure (e.g. digital signatures) to inherently insecure (e.g. certain authentication techniques that might be agreed upon by the parties). In response, it was stated that subparagraph (c) was precisely aimed at creating a category where the most secure among digital signatures could be placed on an equal footing with other techniques, provided that those techniques met the severe standard set forth in subparagraph (c)(ii). As to subparagraph (c)(iii), consideration might be given to placing it in a separate provision dealing with party autonomy. It was agreed that the discussion on the definitions might need to be reopened after the provisions dealing with the legal effects of those definitions had been considered.

Subparagraph (c)(i)

33. The substance of subparagraph (c)(i) was found to be generally acceptable. However, the view was expressed that the requirements of draft article 5 referred to in subparagraph (c)(i) did not adequately ensure the quality of digital signatures as secure electronic signatures. It was suggested that the question would have to be revisited in the context of draft article 5.

Subparagraph (c)(ii)

34. A concern was expressed that the burden of proof under subparagraph (c)(ii) was so high that the presumptions in draft article 2(1) would be of little meaning in the case where non-digital electronic signatures were used. It was stated in response that subparagraph (c)(ii) and draft article 2 were intended to serve different purposes. It was generally agreed, however, that the relationship between subparagraph (c)(ii) and draft article 2 might need to be clarified in the revised draft of the Uniform Rules to be prepared by the Secretariat.

35. It was generally felt that the substance of subparagraph (c)(ii) was important to guarantee the media-neutrality of the Uniform Rules. The view was expressed that, since the purpose of subparagraph (c)(ii) was to define certain criteria which a given technique should meet to trigger the presumptions set forth in draft article 2, it was irrelevant whether that technique was used with an intent to sign. Accordingly, it was suggested that the words “can otherwise be verified to be the signature of a specific person” should be deleted.

36. Additional suggestions were made as to the specific formulation of subparagraph (c)(ii). One suggestion was that the words “promptly” and “automatically” should be deleted. It was stated that “prompt” and “automatic” identification of a person were not inherent in the use of most

authentication techniques (including certain digital signature techniques) and did not clearly relate to the security of the authentication procedure and the integrity of the data being electronically signed. Another suggestion was that the words “of a security procedure” should be complemented by the words “or combination of security procedures”. After discussion, those suggestions were adopted by the Working Group.

Subparagraph (b)(iii)

37. It was suggested that subparagraph (iii) should be deleted. It was stated that granting the status of a “secure electronic signature” to any procedure which might be agreed upon by the parties would create the risk that any low-security procedure could be used to produce legal effects. In that connection, the view was expressed that, currently, the only “secure” authentication technique was that of a digital signature. In response, it was observed that, as a matter of freedom of contract, parties should be free to agree that, as between themselves, they would rely on an authentication technique that was less secure than the type of electronic signature described in subparagraph (c)(ii), and that they would attach the presumptions set forth in draft article 2 to the use of that authentication technique. It was also observed that the reference to the “commercial reasonableness” of the signature technique was intended to provide a safeguard against the unlimited recognition of possibly insecure authentication techniques through party autonomy. A note of caution was struck, however, about relying on the notion of “commercial reasonableness” to provide such a safeguard. In a number of countries, the mere fact that “commercial” parties had agreed on a procedure would be sufficient to interpret that procedure as “commercially reasonable”. As a matter of drafting, a question was raised as to a possible inconsistency between the use of the words “commercially reasonable” and the wording used in article 7 of the Model Law. While it was recalled that the words “commercially reasonable” had been used in article 5 of the UNCITRAL Model Law on International Credit Transfers,^b the Working Group felt that appropriate redrafting might be needed to avoid the above-mentioned interpretation. It was suggested that a reference to an express stipulation by the parties that the agreed technique would have the effects of a secure electronic signature under draft article 2 might need to be included in subparagraph (c)(iii). It was also suggested that the words “as between parties” should be maintained in subparagraph (c)(iii) without square brackets.

38. A question was raised as to whether subparagraph (c)(iii) might be used by the parties to deviate from mandatory rules of law regarding the form of certain legal acts. It was stated that such an interpretation would be unacceptable in view of the fact that such freedom of contract did not exist in a paper-based environment. While it was generally agreed that, under the law of a number of countries, certain mandatory form requirements could not be deviated from by private agreement, such mandatory form requirements typically applied to a very narrow category of transactions, which could probably be dealt with by

^bOfficial Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17), annex I.

way of express exclusion from the scope of a general provision dealing with party autonomy.

39. The discussion focused on the manner in which party autonomy would be dealt with in the Uniform Rules. It was recalled that the mere reference to article 4 (“Variation by agreement”) of the Model Law might not suffice to provide a satisfactory solution, in view of the fact that article 4 established a distinction between those provisions of the Model Law that might be freely varied by contract and those provisions that should be regarded as mandatory unless variation by agreement was authorized by the law applicable outside the Model Law. With respect to electronic signatures, the practical importance of “closed” networks made it necessary to provide wide recognition of party autonomy. However, public policy restrictions on freedom of contract, including laws protecting consumers from overreaching contracts of adhesion, might also need to be taken into consideration. A suggestion was made that the Uniform Rules should include a provision along the lines of article 4(1) of the Model Law to the effect that, except as otherwise provided by the Uniform Rules or other applicable law, electronic signatures and certificates issued, received or relied upon in accordance with procedures agreed among the parties to a transaction would be given the effect specified in the agreement. In addition, it was suggested that the Working Group might consider establishing a rule of interpretation to the effect that, in determining whether a certificate, an electronic signature or a data message verified with reference to a certificate, was sufficiently reliable for a particular purpose, all relevant agreements involving the parties, any course of conduct among them, and any relevant trade usage should be taken into account.

40. As an alternative, the Working Group was invited to consider a proposed new article that read along the following lines:

“(1) Where the law requires the signature of a person, that requirement is met by an electronic signature if

“(a) use of the electronic signature was agreed among the parties to the transaction, or

“(b) the electronic signature was as reliable as was appropriate for the purpose for which the electronic signature was used.

“(2) In determining whether an electronic signature is appropriately reliable for a particular purpose, any course of conduct among the parties and any relevant trade usage shall be taken into account.”

41. The discussion continued on the basis of the proposed new article. It was stated that the proposed text was intended to build on, and expand, the approach followed in article 7 of the Model Law. In particular it was stated that: paragraph (1)(a) was intended to enable parties to determine the type of electronic signature they wished to use in their business transactions; paragraph (1)(a) was inspired by article 7(1)(b) of the Model Law; and paragraph (2) constituted an effort to explain paragraph (1)(b). The view was expressed that, if the proposed new article were to be included in the Uniform Rules, paragraph (2) of draft article 2 of the Uniform Rules would not be necessary and could be deleted.

42. The proposal was generally objected to on the grounds that it clearly ran counter to article 7 of the Model Law in several ways, including that: it failed to include the elements of identification and approval, thus calling signature something that, in the light of the Model Law, was not a signature; it allowed parties to derogate from mandatory rules of law relating to signatures, thus overriding rules that, under article 7(2) of the Model Law, could establish an obligation for, or legal consequences in the absence of, a signature; and it failed to include a provision along the lines of article 7(3) of the Model Law, which allowed States to exclude the application of article 7 in certain cases (e.g. negotiable instruments).

43. It was widely felt that the main disadvantage of the proposed new article lay in the fact that, unlike article 7 of the Model Law and contrary to rules applicable in a paper-based environment, it allowed parties to derogate from mandatory rules of law. Thus, the proposed new article could inadvertently result in subverting the Model Law and national law relating to signatures and inappropriately affecting rights of third parties. In addition, there was broad support for the view that the proposed new article unnecessarily repeated elements contained in draft article 1 of the Uniform Rules.

44. In order to bring the proposed new article in line with article 7 of the Model Law and to address its above-mentioned deficiencies, a number of suggestions were made. One suggestion was to include a reference to the essential characteristics of a signature, namely those relating to identification of a person and approval of the contents of a message, by inserting at the end of the *chapeau* of paragraph (1) of the proposed new article language along the following lines: “is the signature of that person and”. Another suggestion was to give precedence to applicable law by introducing at the beginning of paragraph (1)(a) language along the following lines: “subject to the relevant law”. Yet another suggestion was that, in line with article 7 of the Model Law, the conjunction between subparagraphs (a) and (b) should be “and”, and not “or”. A further suggestion was that taking into account the conduct of the parties and relevant trade usages, as indicated in paragraph (2) of the new article, should be permitted rather than imposed, a result that could be achieved by replacing the word “shall” with the term “may”. Yet another suggestion was that the essential elements of article 7(2) and (3) of the Model Law should be introduced in the proposed new article.

45. The view was widely shared that, instead of redrafting the proposed new article, the Working Group should attempt to establish basic principles regarding the extent to which party autonomy should be accommodated by the Uniform Rules. It was generally agreed that the Uniform Rules should not normally limit party autonomy as between the parties. It was also agreed that the efforts of the Working Group should be aimed at identifying the types of transactions (and, in the case of digital signatures, the types of certificates) that would imply a high level of security and might thus be subject to mandatory rules under existing law in a number of countries. With respect to the legal form requirements that were likely to interfere with party autonomy, it was widely felt that a useful dis-

inction might be drawn between those requirements for signatures that were aimed at providing evidence (which might be made subject to party autonomy) and those form requirements that were prescribed for validity purposes (which would typically be mandatory).

46. After discussion, the Working Group requested the Secretariat to prepare a revised draft of article 1 taking into account the above deliberations and decisions.

Article 2. Presumptions

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

“(1) With respect to a data message authenticated by means of a secure electronic signature, it is rebuttably presumed that:

“(a) the data message has not been altered since the time the secure electronic signature was affixed to the data message;

“(b) the secure electronic signature is the signature of the person to whom it relates; and

“(c) the secure electronic signature was affixed by that person with the intention of signing the message.

“(2) With respect to a data message authenticated by means of an electronic signature other than a secure electronic signature, nothing in these Rules affects existing legal or evidentiary rules regarding the burden of proving the authenticity and integrity of a data message or an electronic signature.

“(3) The provisions of this article do not apply to the following: [...].

“[(4) The presumptions in paragraph (1) may be rebutted by:

“(a) evidence indicating that a security procedure used to verify an electronic signature is not to be generally recognized as trustworthy, due to advances in technology, the way in which the security procedure was implemented, or other reasons;

“(b) evidence indicating that the security procedure agreed to between the parties under article 1(c)(iii) was not implemented in a trustworthy manner; or

“(c) evidence relating to facts of which the relying party was aware which would suggest that reliance on the security procedure was not reasonable. The commercial reasonableness of a security procedure agreed upon by the parties under article 1(c)(iii) is to be determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agreed to adopt the procedure, including the nature of the transaction, sophistication of the parties, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, cost of alternative procedures, and procedures in general use for similar types of transactions.]”

48. While it was agreed that the principle of media neutrality should be reflected in the Uniform Rules through the recognition of the legal effects that would attach to the use of electronic signatures relying on non-digital tech-

niques, the Working Group decided to defer its consideration of draft article 2 until it had completed its review of the remaining draft articles of the Uniform Rules.

Article 3. Attribution

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

“(1) *Variant A* Subject to [article 13 of the UNCITRAL Model Law on Electronic Commerce], the originator of a data message on which the originator’s secure electronic signature is affixed is [bound by the content] [deemed to be the signer] of the message in the same manner as if the message had existed in a [manually] signed form in accordance with the law applicable to the content of the message.

Variant B As between the holder of a private key and any third party who relies on a digital signature which can be [verified] [authenticated] by using the corresponding certified public key, the digital signature [is presumed to be that of the holder] [satisfies the conditions set forth in [article 7(1) of the UNCITRAL Model Law on Electronic Commerce]].

“(2) Paragraph (1) does not apply if

“(a) the [originator] [holder] can establish that the [secure electronic signature] [private key] was used without authorization and that the [originator] [holder] could not have avoided such use by exercising reasonable care; or

“(b) the relying party knew or should have known, had it sought information from the [originator] [certification authority] or otherwise exercised reasonable care, that the [secure electronic] [digital] signature was not that of the [originator] [holder of the private key].”

General remarks

50. The Working Group first considered the purpose and scope of draft article 3 and its relationship with articles 7 and 13 of the Model Law.

51. Differing views were expressed as to whether the draft article should deal only with the attribution of secure electronic signatures (or digital signatures) or whether it should also address the issue of liability of the purported signer to the relying parties. One view was that draft article 3 should be aimed at linking a signature to the purported signer and at ensuring the integrity of a data message. Another view was that the main purpose of draft article 3 should be to create an incentive for the use of digital signatures by properly allocating liability for the loss caused to the relying party through the failure of the purported signer to exercise reasonable care and avoid the unauthorized use of its signature (see para. 58, below). The prevailing view was that both issues should be dealt with. In that context, a note of caution was struck about dealing with issues of liability, which might be inconsistent with the approach followed in the Model Law, under which contractual matters were left to the law applicable outside the Model Law. In response, it was observed that the Uniform Rules were based on a somehow different approach in that they already dealt, *inter alia*, with liability

of certification authorities. After discussion, the Working Group agreed to consider dealing with both issues, possibly in separate provisions (see paras. 55 and 60, below).

52. With regard to the scope of draft article 3, the view was expressed that it should be limited to digital signatures and draft article 3 should be relocated accordingly. In support of that view, it was stated that digital signatures were so well known and widely used that they deserved to be given priority. In addition, it was stated that the issue of attribution of digital signatures was important enough to be treated separately from the issue of attribution of other types of electronic signatures. Another view was that the rules established under draft article 3 should apply both to digital signatures and to other electronic signatures. The prevailing view was that, to the extent possible, the issues addressed under draft article 3 should be dealt with in a media-neutral manner to cover a broad range of electronic signatures.

53. As to the relationship between draft article 3 and articles 7 and 13 of the Model Law, it was observed that article 7 dealt with requirements for signatures and article 13 with attribution of messages. A concern was expressed that draft article 3 might merely restate the provisions of article 13 of the Model Law. In response, it was stated that draft article 3 dealt with the attribution of an electronic signature as distinct from the attribution of the data message and provided specific protection to the purported signer in cases where its signature was used without authorization and the purported signer could not have avoided such unauthorized use, had it exercised reasonable care.

Paragraph (1)

54. Support was expressed in favour of both variants A and B. In favour of variant A, it was stated that it was based on a media-neutral approach, and thus addressed different types of technologies used in international trade. In that connection, it was pointed out that neutrality should be ensured also as to the way in which a particular technology was being implemented (e.g. a digital signature with or without a certificate). Such implementation neutrality could be obtained, it was observed, through a general rule to the effect that the recipient of the data message who reasonably relied on a secure electronic signature would be entitled to regard that message as being that of the purported signer (see A/CN.9/WG.IV/WP.73, paras. 35-36). In support of variant B, it was said that it appropriately focused on digital signatures which, by contrast to other types of electronic signatures, were sufficiently known and widely used.

55. However, both variants A and B were criticized for inappropriately mixing two different issues, namely the issue of attribution and the issue of liability. In addition, a number of concerns were expressed and observations were made with regard to both variants. As to variant A, it was observed that: the opening words were not sufficiently clear; use of the term "originator" was not appropriate for a number of reasons, including that the signer of a data message did not necessarily have to be its originator; the words "is bound by the content" related to the general law of obligations and not to the mere attribution of electronic signatures to the purported signer; and the reference to the

law applicable should relate to the law applicable to the data message as a whole and not only to its contents.

56. As to variant B, it was observed that: in order to avoid overriding the exceptions set forth in other provisions of the Uniform Rules relating, e.g. to compromised private keys, language should be added at the beginning of variant B along the following lines "subject to the provisions of articles ..."; in line with the approach taken in article 13 of the Model Law, reference should be made to actual verification of the authenticated use of a digital signature, and not merely to the ability of the holder of the private key to verify such use; in order to avoid a situation in which a digital signature could be attributed to the purported signer, even though the certificate had been revoked, language along the following lines should be used "private key contained in a valid certificate"; no reference should be made to article 7 of the Model Law, since that article dealt with the requirement for a signature and not with attribution of a signature.

Paragraph (2)

57. While there was agreement in the Working Group that paragraph (2) was generally acceptable, the concern was expressed that use of the term "reasonable care" might introduce uncertainty. In order to address that concern, a number of suggestions were made. One suggestion was that the signature should be attributed to the purported signer if it failed to establish that the use of the signature was unauthorized. Another suggestion was that the signature should be deemed to be that of the purported signer if, in addition, it failed to establish that it could not have avoided the unauthorized use, without any reference being made to the notion of "reasonable care". Both suggestions were objected to on the ground that they would inappropriately increase the level of responsibility of the purported signer.

Suggestions for a new article 3

58. In order to address the concerns expressed with regard to draft article 3 and on the assumption that the issue of attribution of secure electronic signatures was sufficiently addressed in draft article 2 of the Uniform Rules, the suggestion was made that the focus of draft article 3 should be shifted to the issue of liability of the purported signer and, thus, article 3 should read along the following lines:

"(1) As between the holder of a private key and any person relying on a digital signature, the holder is not bound by the message if he did not sign it.

"(2) If the key holder has not exercised reasonable care to prevent the relying party from relying on the unauthorized use of the digital signature, he is liable to compensate the relying party for harm caused to him. The relying party is only entitled to such compensation if he had sought information from the certification authority or otherwise exercised reasonable care to establish that the digital signature was not that of the holder."

59. While it was generally agreed that the suggested language rightly distinguished between attribution of a signature and accountability (or liability) for harm caused by the unauthorized use of a signature, it was observed that

it did not sufficiently address the concerns expressed with regard to variants A and B. In addition, it was observed that it shifted the burden of proof against the relying party who had to establish that it used reasonable care in order to prove that the signature was that of the purported signer. It was generally agreed that a media-neutral approach would be preferable, and that the issues of attribution and accountability should be dealt with separately.

60. With a view to reflecting that approach, the Working Group was invited to consider an alternative formulation along the following lines:

“Attribution of secure electronic signatures

“As between the purported signer and the relying party, a secure electronic signature is deemed to be that of the purported signer, unless the purported signer can establish that the secure electronic signature was used without authorization.

“Liability for secure electronic signature

“In a case where the secure electronic signature was unauthorized and the purported signer did not exercise reasonable care to prevent the addressee from relying on such a message, the purported signer is liable to pay damages to compensate the relying party for harm caused, unless the relying party did not seek information from an appropriate third party or otherwise knew or should have known that the signature was not that of the purported signer.”

61. After discussion, the Working Group requested the Secretariat to reflect the suggested alternative formulation in a revised draft of the Uniform Rules for further consideration by the Working Group at a future session. A concern was expressed by a number of delegations about possible interference between the suggested formulation and their domestic tort law.

Section II. Digital signatures

Article 4. Definition

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

“For the purposes of these Rules,

“Variant A: ‘digital signature’ means a type of an electronic signature consisting of a transformation of a data message using a message digest function and an asymmetric cryptosystem such that any person having the initial untransformed data message and the signer’s public key can accurately determine:

“(a) whether the transformation was created using the signer’s private key that corresponds to the signer’s public key; and

“(b) whether the initial data message has been altered since the transformation was made.

“Variant B: “(a) ‘digital signature’ means a numerical value, which is affixed to a data message and which, using a known mathematical procedure associated with the originator’s private cryptographic key, makes it pos-

sible to determine that this numerical value has only been obtained with the originator’s private key;

“(b) the mathematical procedures used for generating digital signatures under these Rules are based on public-key encryption. When applied to a data message, those mathematical procedures operate a transformation of the message such that a person having the initial message and the originator’s public key can accurately determine:

“(i) whether the transformation was operated using the private key that corresponds to the originator’s public key; and

“(ii) whether the initial message was altered after the transformation was made.”

63. While some support was expressed in favour of both variants A and B, neither one was adopted by the Working Group.

64. In favour of variant A, it was stated that, to the extent it focused on the creation of a digital signature without referring to any specific technology, it was sufficiently flexible to encompass different types of digital signatures. However, a concern was expressed that variant A failed to recognize the different ways in which a public key infrastructure might be implemented (e.g. with or without reliance on a message digest function), and the different functions that might be fulfilled through the use of a digital signature (e.g. the function of identifying the signer (“secure signatures”), the function of establishing the integrity of the data message (“secure records”), or a combination of both functions). In the context of that discussion, it was suggested that, in order to ensure cross-border recognition of different types of digital signatures and certificates, consideration should be given by the Working Group to the idea of preparing a convention instead of an addition to the Model Law (see para. 212, below).

65. In response to the above-mentioned concern, it was observed that it was a well-established approach to include the elements of identification of the signer and verification of the message integrity in a definition of “digital signature”. In addition, it was pointed out that that approach, which was aimed at identifying a functional equivalent of a signature in a paper-based context, was in line with the approach taken in the Model Law. Moreover, it was stated that an effort to address all types of digital signatures would be overly ambitious and would delay progress in a field which needed urgent regulation so that disharmony of law through the introduction of different approaches in national legislation might be avoided. In that regard, it was observed that variant A, by defining digital signature as a type of electronic signature, would confine that term to those applications of public-key cryptography that were meant to serve as a functional equivalent of a signature in a paper-based context, whereas variant B would be wide enough to cover all manifestations of digital signature technology, including those that were not meant to serve as functional equivalents of signatures.

66. In favour of variant B, it was observed that it introduced more certainty as to the scope of the provision in that it was stated in more technical terms and specifically

referred to public-key encryption, which was said to constitute a widely-used technology. At the same time, the concern was expressed that variant B was too restrictive to the extent that it relied on a certain mathematical procedure for the creation of a digital signature, thus possibly excluding future technical developments that might render currently accepted procedures obsolete. It was suggested that a reference to “state-of-the-art mathematical procedures” might need to be made in the draft provision.

67. Both variants A and B were objected to on the grounds that they inappropriately defined “digital signature” by reference to “a transformation of the data message”. It was explained that it was not the message as a whole, but only its numerical representation that changed as a result of processing the message through the use of an algorithm. In order to address that problem, language along the following lines was proposed:

“Digital signature is a cryptographic transformation (using an asymmetric cryptographic technique) of the numerical representation of a data message, such that any person having the data message and the relevant public key can determine:

“(a) that the transformation was created using the private key corresponding to the relevant public key; and

“(b) that the data message has not been altered since the cryptographic transformation.”

68. In support of the proposed text, it was stated that, by avoiding to refer to the signer’s private key, it addressed the need to ensure that digital signatures used for various purposes, beyond identification of the signer, would be covered by the Uniform Rules. It was also stated that, by avoiding reference to a message digest function, the proposed text would also cover digital signatures created through a different procedure.

69. During the discussion, the suggestion was made that the Working Group should consider, merely for purposes of comparison, the text adopted in 1988 by the International Organization for Standardization (ISO), which read as follows: “Digital signature: data appended to, or a cryptographic transformation of, a data unit that allows a recipient of the data unit to prove the source and integrity of the data unit and protect against forgery, e.g. by the recipient” (ISO 7498-2). Another suggestion was that the ISO definition should be included in the Uniform Rules. While it was agreed that the ISO definition demonstrated a technical approach, there was widely shared scepticism in the Working Group as to whether that definition was suitable for the purposes of the Uniform Rules.

70. After discussion, the Working Group generally agreed that it should reserve its decision as to the definition of “digital signature” until it had completed its review of the substantive provisions of the Uniform Rules and come to a conclusion as to the scope of those provisions. In particular, the definition of “digital signature” might vary depending on whether the Uniform Rules covered only the uses of computer-based techniques which were aimed at replicating in an electronic environment the functions traditionally fulfilled through the use of hand-written

signatures in international trade transactions, or whether the scope of the Uniform Rules was extended to cover additional uses of “digital signatures”. The Secretariat was requested to prepare alternative drafts based on variants A and B, and on the above-mentioned proposal (see para. 67, above), taking into account the comments made, for further consideration of the matter at a future session.

Article 5. Effects

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

“(1) Where all or any portion of a data message is signed with a digital signature, the digital signature is regarded as a secure electronic signature with respect to such portion of the message if:

“(a) the digital signature was created during the operational period of a [valid] certificate and is verified by reference to the public key listed in the certificate; and

“(b) the certificate is considered as accurately binding a public key to a person’s identity because:

“(i) the certificate was issued by a certification authority licensed [accredited] by ... [*the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities*]; or

“(ii) the certificate was otherwise issued by a certification authority in accordance with standards issued by ... [*the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities*].

“(2) Where all or any portion of a data message is signed with a digital signature that does not meet the requirements set forth in paragraph (1), the digital signature is regarded as a secure electronic signature with respect to such portion of the message if sufficient evidence indicates that the certificate accurately binds the public key to the holder’s identity.

“(3) The provisions of this article do not apply to the following: [...].”

General remarks

72. It was widely recognized, at the outset, that the substance of draft article 5 would need to be further discussed by the Working Group in the light of the decisions to be made as to the scope of the Uniform Rules. In particular, draft article 5 was directly dependent upon whether the notion of “secure electronic signature” would eventually be used in the Uniform Rules. The legal effects attached to the use of certificates in the context of digital signatures would also depend upon the definition of “certificate” under draft article 8. Should the Uniform Rules cover only the cases where digital signatures were used for the purposes of international trade transactions with the intent to sign (i.e. to identify the signer and link the signer with the information being signed), it might be acceptable to limit the function of the certificate to linking a key pair with the identity of a person. In such a case, it should be specified that the Uniform Rules were dealing only with a special

kind of certificates (“identity certificates”), particularly since other types of certificates might be used in electronic commerce, e.g. to establish the level of authority of a person (“authority certificates”). A view was expressed that authority certificates should be covered by draft article 5 together with identity certificates. In the context of that discussion, it was suggested that a reference should be made in draft article 5 to the certificate verifying the integrity of the information contained in the data message. In response, it was stated that, while verification of data integrity was an important result of the use of the certificate in the context of a digital signature process, it was not a characteristic element of the certificate itself.

73. After discussion, the Working Group decided to proceed with its consideration of draft article 5. It was generally agreed, however, that the discussion would need to be reopened after the Working Group had completed its review of the substantive provisions of the Uniform Rules.

Title

74. A widely shared view was that the title of draft article 5 was insufficiently descriptive and might be misleading. It was decided that the title should be reworded along the following lines: “Digital signatures supported by certificates”.

Paragraph (1)

Opening words

75. Support was expressed in favour of the view that the reference to the notion of “secure electronic signature” was not necessary in draft article 5 and should be replaced by a reference to the conditions set forth in article 7 of the Model Law. It was stated in response that such a reference to article 7 of the Model Law would inappropriately limit the scope of the draft article 5 by presupposing the existence of legal requirements for a signature, which would need to be met in an electronic environment. The purpose of draft article 5 was broader and directly aimed at creating certainty as to the legal effects of digital signatures, provided that certain technical standards were met, irrespective of whether there existed a specific requirement for a signature.

76. After discussion, the Working Group decided that references to a “secure electronic signature” and to the conditions set forth in article 7 of the Model Law should be kept as alternative wordings for further consideration by the Working Group at a future session. The opening words of draft article 5 should read along the following lines: “In respect of all or any part of a data message, where the originator is identified by a digital signature, the digital signature [is a secure electronic signature][satisfies the conditions in article 7 of the UNCITRAL Model Law on Electronic Commerce] if”.

Subparagraph (a)

77. The substance of subparagraph (a) was found to be generally acceptable. With a view to better reflecting the necessary trustworthiness of the digital signature process, it was decided that the word “securely” should be inserted to qualify both the creation of the digital signature and its

verification by reference to the public key listed in the certificate. It was also decided that the reference to the validity of the certificate should be maintained without square brackets in the draft provision.

Subparagraph (b)

78. With respect to subparagraph (b)(i), it was widely felt that the words “licensed” or “registered” were preferable to the word “accredited” in a provision dealing with the case where States would adopt a regulatory approach to public-key infrastructures. As regards subparagraph (b)(ii), the view was expressed that the provision should be deleted, since the scope of draft article 5 should be limited to the use of certificates issued by certification authorities licensed by the enacting State. The prevailing view, however, was that a reference should be made to industry standards and to mechanisms that might be developed by practitioners to ensure the reliability of such standards. It was generally agreed that such a reference was necessary to reflect the “dual approach” to digital signatures and public-key infrastructures adopted by the Working Group at its previous session (see A/CN.9/437, para. 69). Under that approach, industry-based standards would be recognized alongside government regulation. It was pointed out that, in certain countries, government authorities might wish not to become involved with the establishment of security standards for digital signatures. In that connection, it was stated that draft article 5 should not only mention “security standards” but cover more broadly the various types of standards that might be developed by the industry.

79. With respect to the reference to recognized industry standards, it was suggested that wording might be drawn from article 9(2) of the United Nations Convention on Contracts for the International Sale of Goods,^c which referred to “a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned”. It was widely felt, however, that a reference to “commercially appropriate and internationally recognized standards” would be more appropriate.

80. Taking into account the above-mentioned discussion, it was agreed that subparagraph (b) should be redrafted along the following lines for the purpose of future discussion:

“(b) the certificate binds a public key to a person’s identity by virtue of the fact that:

“(i) the certificate was issued by a certification authority licensed by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities]; or

“(ii) the certificate was issued by a certification authority accredited by a responsible

^cOfficial 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.

accreditation body applying commercially appropriate and internationally recognized standards covering the trustworthiness of the certification authority's technology, practices and other relevant characteristics. A non-exclusive list of bodies or standards that comply with this paragraph may be published by ... [the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities]; or

- “(iii) the certificate was otherwise issued in accordance with commercially appropriate and internationally recognized standards.”

Paragraph (2)

81. A number of concerns were expressed in connection with paragraph (2). One concern was that paragraph (2) might be redundant in the light of draft article 2, which set forth the legal presumptions attached to the status of a “secure electronic signature”. In response, it was stated that paragraph (2) was necessary to establish the link between a digital signature that might be recognized (e.g. by a court of justice) as binding the public key to the holder although it did not formally meet the requirements set forth in paragraph (1), and other provisions of the Uniform Rules (e.g. revised draft article 3 on “liability for secure electronic signature”). In that context, the view was expressed that the words “Notwithstanding the provisions of article 5” might have to be introduced in draft article 3.

82. Another concern was that paragraph (2) established an excessively low standard for the recognition of digital signatures that did not otherwise meet the requirements set forth in paragraph (1). As currently drafted, paragraph (2) might lead to granting a “secure” status to digital signatures which relied on insecure procedures, e.g. for lack of sufficient key length. In response, it was stated that, while additional reference to the trustworthiness of the technical procedures might need to be introduced either in draft article 5 or in the definition of “secure electronic signature”, a provision along the lines of paragraph (2) was necessary to preserve the possibility that parties might be allowed to establish before a court or an arbitral tribunal that the digital signature they used was sufficiently reliable to be granted legal value although it was used outside the context of paragraph (1). However, a concern was expressed that the granting of “secure” status created presumptions and assigned tort liabilities under draft articles 2 and 3. It was stated that such serious consequences should be ascertainable by reference to clear rules and standards before the signature was used, instead of being imposed on an unsuspecting party by a court at a later stage.

83. Various suggestions were made as to how the reference to the general rules of evidence contained in paragraph (2) should be expressed. One view was that paragraph (2) should be broader in scope, to encompass not only the situation where a certificate was used but also any other situation where a digital signature or any other electronic signature was used. Under that view, the reference to “the

certificate” should be deleted from paragraph (2), which should be relocated in the section dealing with electronic signatures in general. Another view was that the scope of paragraph (2) should be narrower and the provision should apply only where the digital signature was created during the validity period of a certificate. Under that view, the rule contained in paragraph (2) should be made part of paragraph (1)(b) along the following lines:

- “(iv) sufficient evidence indicates that the certificate accurately binds the public key to the holder's identity.”

84. After discussion, the Working Group did not reach consensus as to the scope and placement of the provision contained in paragraph (2). The Secretariat was requested to prepare a revised draft provision, with variants reflecting the discussion for consideration by the Working Group at a future session.

Article 6. Signature by legal persons

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

“[A legal person may identify a data message by affixing to that message the public cryptographic key certified for that legal person. The legal person shall only be regarded as [the originator][having approved the sending] of the message if the message is also digitally signed by the natural person authorized to act on behalf of that legal person.]”

86. It was recalled that, at the previous session of the Working Group, it had been widely felt that draft article 6 should be deleted. It had been kept between square brackets as a reminder that the Working Group might need to discuss more fully the extent to which the Uniform Rules should validate the operation of “electronic agents” for the purpose of automatically authenticating data messages (see A/CN.9/437, paras. 115-117). The Working Group decided that the question of “electronic agents” would need to be discussed at a later stage. It was decided, however, that draft article 6 should be deleted, since it might be seen as inappropriately interfering with other bodies of law (e.g. the law of agency, and the provisions of company law dealing with representation of companies by natural persons).

Section III. Other electronic signatures

87. There was general agreement that section III should remain in the Uniform Rules, pending a decision as to whether the principle of non-discrimination embodied in the definitions of “signature” and “secure electronic signatures” (and expressed through the legal status recognized to any authentication technique that would qualify as a “secure” electronic signature) should also be expressed by way of more specific provisions dealing with authentication techniques other than digital signatures.

88. With a view to providing more information to the Working Group as to how digital signatures and various other authentication techniques might operate, a number of

presentations of a technical nature were made. Those presentations are summarized below (paras. 89-105).

89. It was recalled that secure electronic commerce required that parties to a transaction have the ability to authenticate each other. In many instances of electronic interaction (e.g. shopping on the Internet), traditional methods of authentication were either unavailable or unreliable. This need for reliable methods of electronic authentication extended beyond the requirements of commerce into nearly every type of interaction in a digital world.

90. It was pointed out that a wide variety of solutions were currently available to address these needs. These solutions had both a technological and a methodological component. While much of the focus tended to be on the differing technological approaches, the impact of the methodology or business model underlying the electronic authentication solution should not be underestimated. In addition to the many different technological approaches, the market had also provided a rich variety of methodologies implementing these technologies. This diversity of solutions reflected the different types of authentication required by the many different situations presented in a digital environment. As this environment developed, new authentication solutions would be required.

91. Methods of authentication could be categorized by focusing on the characteristic being authenticated. The three basic categories of characteristics were described as: (a) "something you know"; (b) "something you are"; and (c) "something you have". Many solutions used a combination of these three characteristics.

92. The first category ("something you know") was one of the most commonly used characteristics to authenticate individuals. Passwords, pass phrases and personal identification numbers (PINs) fell into this category. Most computer systems provided password options that allowed access to resources to those that had a valid password. For example, automated access to bank account information required users to know the correct PIN associated with the account being queried. Another type of authentication in this category was based upon personal information that only a specific individual was likely to know. For example, in some jurisdictions, it was common for a bank to ask an individual to provide his or her mother's birth surname when setting up a bank account. This information could be used at a later date to authenticate the account holder. While this category of authentication was widely used in current practice, it had a number of weaknesses. First, it usually required that the shared knowledge be either secret or difficult to obtain. Second, it required that the parties have a pre-existing relationship where they could "share" the secret element of knowledge (e.g. password, PIN or mother's birth surname).

93. The second category of authentication methods ("something you are"), was often referred to as biometrics. This approach used innate qualities of the individual for authentication. Some of the innate aspects used in biometrics included: fingerprints, retinas, irises, hand-prints, voice prints, and handwritten signatures. Since all of these characteristics were unique to individuals, they provided

an excellent method for authentication. If information about these characteristics could be made publicly available, then this type of authentication would not require a pre-existing relationship. Additionally, these approaches could often provide strong authentication because manipulating or tricking these systems was very difficult. One down side of these approaches was that they involved a higher cost of implementation since they required some type of hardware to be used to obtain information about the aspect in question. Another concern with some applications in this category was the device used to collect the biometric information. In some cases the devices were considered obtrusive (e.g. the retina scanner required users to place their eye up to an eyepiece where a red light was used to scan the retina). In other cases, information obtained in the authentication scan could divulge personal health information that the individual did not want to make public (e.g. certain health conditions could be diagnosed by irregularities in the iris, therefore, while the iris scan was not as physically obtrusive, it was considered by some to be personally invasive). Finally, some of these devices were not always reliable if the conditions of use were "abnormal" (e.g. fingerprints with a cut on a finger). Nonetheless, biometric solutions were widely considered one of the strongest methods of authentication and were currently being used in practice. Examples were given of a country where the immigration and naturalization services were testing a hand-print technology solution to speed up passport control, and of insurance companies that were using signature biometrics to authenticate individuals in claims processing.

94. The third category of authentication methods ("something you have") was described as one of the most active areas in electronic authentication. The "something" could be physical (e.g. a challenge-response device) or it could be information (e.g. an encryption key). A challenge-response device was similar to the shared secret approach used in the "something you know" category, only it was implemented in hardware. This solution required individuals to be given a device that was unique and was assigned to that individual user only. When the individual attempted to access a service, the host system asked the persons to identify themselves (usually by way of a user name) and then the system generated a numeric challenge based upon the information the system had about the unique device assigned to the individual. The individual then keyed that number into the device, which generated a numeric response. That numeric response could then be keyed into the system to which the holder of the device was trying to gain access. The host system "knew" that there was only one acceptable response to the numeric challenge it presented to the individual and that acceptable response could only be generated by the unique device assigned to the individual. Therefore, if the individual typed in the proper numeric response, then the host system "knew" that the person attempting to gain access was who that person claimed to be. That type of device was commonly used in authenticating individuals that sought remote access to computer systems. It was also being used by a bank in a home banking pilot project referred to as "browser banking" because it allows an individual access to the bank account from any browser on any machine. This application demonstrated one of the strengths of the approach.

For while it did require a hardware component, it did not require a system modification like that required by chip cards.

95. The other subcategory of the third category covered the use of digital signatures. The important aspect of digital signature technology was the use of a private key to generate a digital signature and the use of a public key to authenticate the digital signature. The private key used to generate the digital signatures could be stored on a hard disk or on a smart card and had to be kept very private by the person using it. The public key was disseminated widely. There were several different paradigms for using digital signature technology, each having a different way of providing trust to the recipient of a digital signature.

96. One of the first approaches was to create a directory of individuals and public keys. Under this model, the recipient of a digitally signed document verified the public key of the signer of the document by looking up the public key in a trusted directory. It was reported that a number of applications currently used this model.

97. Another approach, historically developed from the directory-based approach, relied on the use of digital certificates. Digital certificates were electronic documents digitally signed by a trusted entity. When a document was digitally signed, a copy of the digital certificate of the signer was attached. It contained information about the individual and the individual's public key. When the recipient received the message and the digital certificate, the recipient used the public key in the digital certificate to authenticate the message.

98. One common use of digital certificates employed a standard (ISO X.509), which allowed for a hierarchy of trusted entities to be used to authenticate parties. This approach was often referred to as the credit card model, as it reflected the business model underlying the credit card industry. For example, a merchant might not know a consumer, but it was willing to accept a certain card for payment, because the merchant knew that the card was issued to the consumer by a bank (the bank's name was always on the card), which was authorized to issue that card by the credit card company. Even if the merchant did not know the bank that issued the card, it could trust the consumer because it knew that the consumer has been authenticated by the bank and the bank has been authenticated by the credit card company. Similarly, X.509 trust hierarchies allowed digital certificates to be authenticated by a hierarchical chain of trusted entities (called "Certificate Authorities" and otherwise referred to in this report as "certification authorities") that could be verified by the recipient of the certificate. The last certification authority in this trust tree was known as the root. Therefore, digitally signing a document in the X.509 approach, involved sending the signer's digital certificate and all of the supporting digital certificates associated with the trust hierarchy being relied upon. Under that model, the recipient could verify the entire trust tree without having to check an online directory. This approach was described as especially well-suited for enabling trusted communications amongst large numbers of people who might have little or no prior contact with each other. One of the strengths of this approach,

the ability to relate many certificates back to a trusted root, was also one of the weaknesses. If this root was compromised, everything beneath the root became unreliable.

99. Another variant of the use of digital certificates was commonly referred to as the web of trust model. In this model, there were no certification authorities. Digital certificates were generated by individuals. There was no trusted root. Individuals decided who they would trust and how much. This model was designed for small communities of users who had regular contacts, and was difficult to implement on large scales. Nonetheless, this model was currently being used in many environments.

100. It was stated that an important consideration in understanding the use of X.509 digital certificates was the historical bias towards identity. Since the X.509 standard arose out of the X.500 directory, it was naturally focused on associating public keys with the identity of individuals. This predisposition with identity was said to confuse many public policy questions surrounding the use of the digital signatures. While it was clear that certain digital certificates authenticated the identity of a person, it is equally clear that other digital certificates had functions other than authenticating identity. Digital certificates could also be used to authenticate an individual's rights or relationships without making any statement about the individual's identity. In many cases, the individual's identity was unnecessary or even undesirable. There were many special-purpose certificates that could only be used for certain functions just like an individual's credit card could not be used to authenticate the individual's identity and an individual's passport could not be used to purchase goods. The inclination to think in terms of identity, while logical, could severely limit the use of the technology. If every application that used digital signatures needed to fulfil the strict requirements of a general-purpose identity certificate, then the technology would be very difficult and expensive to use. It was important to remember that there would be a broad spectrum of authentication requirements and the technology was sufficiently flexible to meet all of these requirements.

101. When a number of credit card companies decided to develop a secure method for electronic commerce over public networks like the Internet, they identified three primary business objectives: the solution had to be secure; the solution had to be open to any technology supplier interested in developing a product that complied with the defined protocol; and all implementations must be interoperable. For the payment industry, "secure" has the following three components: (1) the privacy of the payment information, including consumer's account number; (2) the integrity of the order information; and (3) authentication of the parties to the transaction. Aimed at providing the required level of "security", the secure electronic transaction (SET) protocol was created. This protocol used digital signatures (based on the X.509 model) to fulfil the data integrity and party authentication function.

102. A brief description of the SET protocol was made. A consumer who decided to engage in secure electronic commerce with SET had first to obtain software that has passed the compliance procedures set forth by the SET

root certification authority. This software generated a key pair and an application that the consumer sent to the entity that issued the payment card intended for use. The software put the public key into the certificate application and prompted the consumer to provide identifying information so the financial institution can verify that the person requesting the certificate was authorized to do so. This application was sent to the financial institution through the Internet. If the application was accepted, the financial institution digitally signed the consumer's certificate and sent it back to the consumer via the Internet. The consumer's software stored this digital certificate on the consumer's computer. This application procedure was only done once to obtain the certificate.

103. The consumer then started to shop online and could initiate secure transactions with merchants using SET-compliant software. In the first stages of the transaction, the consumer's software requested authenticating information from the merchant. The software authenticated the merchant by verifying all of the digital signatures and digital certificates sent by the merchant. If there was a failure at any point in the authentication process, the consumer was warned. The consumer then identified the goods or services to be purchased, selected the payment method and initiated the transaction. The consumer software separated the payment information from the order information. The payment information was encrypted using strong cryptography so that the financial institution of the merchant was the only one that could decrypt the payment information. The order information, which specified what was to be purchased and other details of the transaction, and the encrypted payment information was digitally signed and sent to the merchant. When the merchant received this message, it would separate the encrypted payment information, digitally sign this new message and send it to its financial institution. The financial institution would verify the digital signature of the merchant, decrypt the payment information and then submit the payment information for processing through the existing payment infrastructure. The financial institution digitally signed the authorization response and sent it to the merchant. The merchant then sent a digitally signed response to the consumer. If the transaction was authorized, the merchant fulfilled the order.

104. SET was said to illustrate reliance upon digital signature technology in authenticating messages and parties. However, it was important to note that the SET certificates were not identity certificates. They did not authenticate anyone's identity, nor could they be used for that function, as explicitly provided in the policy statement associated with the certificates. SET certificates merely authenticated the relationship of a public key to an account number. SET used digital signature technology to provide extra security to the transaction, not to identify an individual. Furthermore, SET did not use certificate revocation lists (CRLs) for consumer or merchant certificates. In the context of the SET business model, such lists were not necessary. Transactions were still required to be authorized through the existing payment infrastructure, so the addition of a cardholder CRL would provide no benefit while adding significant costs in the construction and maintenance of the system.

105. SET was said to illustrate: (1) non-identity use of digital signatures and certificates; (2) issuance of certificates by non-licensed, market-based certification authorities; (3) issuance of certificates within a system where parties had defined their rights and responsibilities by agreement; and (4) that in some instances a relying party (the bank who completed the payment based on information digitally signed by the consumer) might be the issuer of the certificate. SET was just one example of an implementation of digital signature technology. It was stated that there would be many other uses in the coming years and they would be based on technologies and business models that had yet to emerge.

106. The Working Group expressed its appreciation for the presentations that were made. It was generally felt that illustrations of the techniques being implemented or considered for implementation were helpful to better understand the legal issues that needed to be addressed in the Uniform Rules. The Working Group expressed the hope that further presentations on developments in digital signature and other authentication techniques could be made in the context of its future sessions.

Chapter III. Certification authorities and related issues

Article 7. Certification authority

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

“(1) For the purposes of these Rules, “certification authority” means:

“(a) any person or entity licensed [accredited] by ... [the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities] to act in pursuance of these Rules; or

“(b) any person who, or entity which, as an ordinary part of its business, engages in issuing certificates in relation to cryptographic keys used for the purposes of digital signatures.

“[(2) A certification authority may offer or facilitate registration and time stamping of the transmission and reception of data messages as well as other functions regarding communications secured by means of digital signatures.]”

Paragraph (1)

108. The view was expressed that paragraph (1) placed too much emphasis on the situation where the function of a certification authority was performed by an independent third party (often referred to as a “trusted third party”), which was not the only conceivable situation. It was pointed out that in digital signature practice, parties relied increasingly on self-certification (or mutual-certification) schemes, involving only the originators and addressees of digitally signed messages. Accordingly, the definition of “certification authority” should be broadened to cover all types of practices. It was suggested that the words “as an ordinary part of its business” in paragraph (1)(b) should be

replaced by the words “in the course of its business”. That suggestion was found to be generally acceptable.

109. Another suggestion was that, alongside the definition of “certification authority”, the Working Group might need to address the definition of “registration authority”. While no support was expressed in favour of that suggestion, it was generally felt that the issue might need to be discussed further at a later stage.

110. Yet another suggestion was that subparagraph (a) should be deleted, since it merely addressed a subset of the category dealt with under subparagraph (b). In support of that suggestion, it was stated that any reference to “licensed certification authorities” in the Uniform Rules might be interpreted as encouraging enacting States to establish licensing schemes, which might run counter to the “dual approach” adopted by the Working Group at its previous session (see A/CN.9/437, para. 69). It was also stated that the deletion of subparagraph (a), while preserving the necessary flexibility, would appropriately focus the Uniform Rules on the use of digital signatures for the purposes of international trade transactions, as opposed to the use of digital signatures for administrative purposes. The prevailing view, however, was that the substance of subparagraph (a) should be retained. It was stated that, in certain contexts, licensed certification authorities might not operate a “business”. Moreover, the distinction between licensed certification authorities and those certification authorities that operated on a purely private basis was justified to reflect the different legal regimes that might affect the two types of certification authorities. As an example of such a difference, it was stated that anti-trust legislation that might apply to privately operated certification authorities might not apply to certification authorities performing public functions. Furthermore, even if the category dealt with under subparagraph (a) were encompassed in the provision contained in subparagraph (b), subparagraph (a) would still serve a useful purpose in that it would accommodate the needs of those States that intended to rely on a licensing scheme, thus preserving the neutrality of the Uniform Rules.

111. Taking into account the above discussion, it was decided that paragraph (1) should be redrafted along the following lines for the purpose of future discussion:

“(1) For the purposes of these Rules, “certification authority” means any person who, or entity which, in the course of its business, engages in issuing certificates in relation to cryptographic keys used for the purposes of digital signatures.

“(2) Paragraph (1) is subject to any applicable law which requires a certification authority to be licensed, to be accredited, or to operate in a manner specified in such law.”

Paragraph (2)

112. Some support was expressed in favour of the retention of paragraph (2). The view was expressed that the various functions listed in paragraph (2) should be complemented by an express reference to other functions, such as the creation, management, suspension and revocation of certificates, to better illustrate the link between the various

ancillary services offered by certification authorities and the operation of a digital signature system, which constituted the main activity of a certification authority. The widely prevailing view, however, was that paragraph (2) should be deleted and that its substance might be considered at a later stage for possible inclusion in a guide to enactment, should the Working Group eventually decide that such a guide should be prepared.

Article 8. Certificate

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

“For the purposes of these Rules, “certificate” means a data message [or other record] which, at least:

“(a) identifies the certification authority issuing it;

“(b) names or identifies its holder or a device or electronic agent under the control of the holder;

“(c) contains a public key which corresponds to a private key under the control of the holder;

“(d) specifies its operational period [and existing restrictions, if any, on the scope of use of the public key]; and

“(e) is [digitally] signed by the certification authority issuing it.”

General remarks

114. It was generally agreed that draft article 8 should be divided into two parts (or into two separate articles), one that would contain a general definition of certificates to be covered in the Uniform Rules and another that would list the minimum contents of such certificates along the lines of subparagraphs (a) to (e). It was pointed out that such an approach could result in properly broadening the scope of the Uniform Rules, which would be more limited if all the elements contained in draft article 8 were part of the definition of “certificate”.

Definition of “certificate”

115. At the outset, it was agreed that use of technical definitions of certificates might not be appropriate, since they were likely to be revised to address changing needs and technologies. The Working Group went on to consider a definition of “certificate”, on the basis of language along the following lines: “For the purposes of these rules, “certificate” means a data message or other record issued by a certification authority for the purpose of identifying a person or entity who holds a private key”.

116. It was pointed out that such a definition covered only identity certificates and left outside the scope of the Uniform Rules a variety of certificates that were widely used and might need to be recognized. In that regard, differing views were expressed. One view was that only identity certificates should be covered in the Uniform Rules. Another view was that other types of certificates (e.g. authority certificates) should be covered as well. While some support was expressed in favour of that view, a concern was expressed that, if other certificates were to be covered, the provisions dealing with the representations made by a certification authority and, as a result, its liabil-

ity, would need to establish different legal regimes to cover the various types of certificates issued, which might result in an overly ambitious task for the Working Group.

117. As a matter of drafting, it was suggested that, in order to cover various types of certificates, a general definition might be prepared to cover all types of certificates, while the specific purpose of each type of certificate would be set forth in subsequent provisions. In order to reflect that approach, language along the following lines was proposed: “For the purposes of these rules, “certificate” means a data message that enables the verification of a data message corresponding to the public key contained in the certificate”. Then, the purpose of each type of certificate would be set forth, e.g. along the following lines: “An identity certificate is intended to provide evidence of identity”. Alternatively, it was suggested that, in order to reflect the idea that certificates might fulfil various functions, the definition would need to be amended to refer to a data message “which purports to verify the identity or other significant characteristic of a person”. It was further suggested that the word “confirm”, “establish”, or other similar term should be substituted for the word “verify”, which might sometimes be given a specific technical meaning.

118. The discussion focused on the latter suggested definition. As to the exact formulation of the definition of “identity certificate”, a number of suggestions were made. One suggestion was that reference to “other records” should be avoided. In support of that suggestion, it was stated that introducing a reference to “records” in the Uniform Rules might create problems of interpretation of article 2(a) of the Model Law. In response, it was observed that such a reference to “records” would help avoid creating any uncertainty as to whether a certificate in a purely paper form would be covered by the Uniform Rules. Another suggestion was that, in order to avoid raising interpretation problems as to the subjective intentions of the parties, the words “for the purpose of identifying” should be replaced by the words “which identifies”.

119. The suggested wording was objected to on the grounds that it might create a situation in which the certification authority would be able to escape liability by not identifying the person to whom the certificate was issued. Accordingly, wording along the following lines should be inserted “which purports to identify”. Yet another suggestion was that “person” should be replaced by the term “subject”, which was a term of art widely used in practice and would appropriately cover the situation in which the subject of the certificate was not a person but a “device or electronic agent”. That suggestion was opposed on the grounds that: if used, the term “subject” would need to be defined by reference to a “person”; a person would, in any case, control any “device or electronic agent”; and the term “subject” would be inconsistent with the terminology used in the Model Law, as well as in other UNCITRAL texts. While reference to a “person” was found to be acceptable, it was stated that it should be made clear that it meant the subject of a certificate and covered “entity” as well. As to the reference to “entity”, it was agreed that it could be retained pending final determination by the Working Group of the question whether a “device or elec-

tronic agent” could be subject of a certificate. Yet another suggestion was that “a key pair” should be substituted for “a private key”.

120. After discussion, the Working Group decided that the definition should be reformulated along the following lines:

“[Identity] certificate

“For the purposes of these rules, [identity] ‘certificate’ means a data message or other record which is issued by a certification authority and which purports to confirm the identity [or other significant characteristic] of a person or entity who holds a particular key pair”.

121. It was agreed that the word “identity” and the words “other significant characteristic” that appeared within square brackets would allow the Working Group to consider at a later stage the question whether types of certificates other than identity certificates should be covered.

Provision on the minimum contents of an identity certificate

122. The Working Group next turned its attention to subparagraphs (a) through (e), focusing on the question whether they accurately described the minimum contents of an identity certificate.

General remarks

123. It was generally agreed that the practical purpose of a provision listing the minimum contents of a certificate was to set the standards that a certification authority would have to meet in order to fulfil its function and to avoid liability for damage caused as a result of the failure of the certification authority to include in the certificate all the necessary elements. It was widely felt that no final decision could be made with regard to the minimum contents of a certificate before the issue of liability of the certification authority and the question of the types of certificates to be covered had been clarified. The Working Group decided to proceed with its consideration of subparagraphs (a) to (e) on the assumption that a preliminary exchange of views might facilitate the resumption of the discussion at a later stage.

124. In the discussion, the question was raised whether a certificate that did not meet the minimum requirements set forth in draft article 8 should be considered as an invalid certificate or whether draft article 8 should function as a default rule with the result that such a certificate could be valid if agreed upon by the parties. In the latter case, it was suggested that a rule along the lines of draft article 5(2) should be inserted in draft article 8.

Chapeau

125. While it was agreed that a certificate could be issued in a purely paper form, the appropriateness of using the term “or other record” was questioned (see above, para. 118).

Subparagraph (a)

126. The substance of subparagraph (a) was found to be generally acceptable.

Subparagraph (b)

127. It was observed that use of the word “holder” raised the question whether the person to whom the certificate was issued or the person holding a copy of the certificate and relying thereon was meant. In addition, it was stated that use of the term “holder” created uncertainty since that term was used in draft article 8 to refer both to the person holding the certificate and to the person holding the relevant key pair. While it was suggested that use of the term “subject” should be preferred, for the reasons mentioned above, the Working Group expressed a general preference in favour of the term “person” (see para. 119, above). However, it was decided that both terms should be retained within square brackets for further consideration of the matter. As to the reference to a “device or electronic agent”, the use of which was said to raise uncertainty, it was decided that they should be placed within square brackets pending further consideration of the matter by the Working Group (see para. 119, above).

Subparagraph (c)

128. The substance of subparagraph (c) was found to be generally acceptable. As to the word “holder”, it was decided that it should be replaced by the words “subject” and “person” within square brackets (see para. 127, above).

Subparagraph (d)

129. It was generally agreed that the operational period was one of the most essential elements of a certificate. With regard to the reference to the scope of a certificate and any existing restriction thereon, it was suggested that it should be deleted or at least amended to specify that the scope and any restriction thereon could be incorporated in the certificate by reference. In support of that suggestion, it was stated that a complete listing of all restrictions might be impossible to include in a certificate. In addition, it was observed that such a reference could inadvertently result in the certification authority being liable for failing to include all possible restrictions in the certificate. That suggestion was opposed on the grounds that the scope and any restriction thereon were critical elements on the basis of which the function and the integrity of a certificate could be assessed. In addition, it was stated that a reference to the scope of the certificate and any restriction thereon could address the need to indicate that certificates might fulfil various functions. It was thus suggested that such a reference should be included in a new subparagraph (f) within square brackets for further consideration of the matter by the Working Group. Subject to that change, the Working Group approved the substance of subparagraph (d).

Subparagraph (e)

130. While it was generally agreed that the signature of the certification authority was one of the essential elements of a certificate, differing views were expressed as to whether that signature needed to be digital. One view was that the signature should be digital in order to ensure integrity of the certificate. Another view was that, if the signature of the certification authority were cryptographic, relying parties might not be able to determine that it was the signature of a certain certification authority which would indicate its intent to be bound by the certificate. In

addition, it was stated that, if the signature of the certification authority were not the result of a transparent procedure, the certificate might not be valid. The Working Group agreed that there was a need to ensure that the signature of the certification authority should be secure and the process should be transparent. Accordingly, it was decided that the word “digitally” should be retained without brackets and the words “or otherwise secured” should be added, in order to address the concerns expressed with regard to the term “digitally”.

New subparagraph (g)

131. It was suggested that the algorithms applied by the certification authority should be listed as one of the minimum elements of a certificate. In support of that suggestion, it was stated that the algorithms were essential for ensuring identification of the signer and integrity of the data message. The suggestion was opposed on the ground that, if a reference to the relevant algorithms were required for the certificate to be valid, the certification authority could escape liability by not including them in the certificate. It was stated that, while it was necessary to ensure data integrity, that result might be better accomplished by including the element of data integrity in the definition of digital signature. A contrary view was the non-inclusion of the applied algorithms in the certificate would make the certification authority liable for failing to issue a valid certificate. After discussion, the Working Group decided to include a reference to the applied algorithms in draft article 8 within square brackets for further consideration of the matter at a future session.

Article 9. Certification practice statement

132. The text of draft article 9 as considered by the Working Group was as follows:

“For the purposes of these Rules, “certification practice statement” means a statement published by a certification authority that specifies the practices that the certification authority employs in issuing and otherwise handling certificates.”

133. The Working Group noted that draft article 9 related to a number of issues dealt with in other provisions of the Uniform Rules, e.g. the issue of representations upon issuance of a certificate (draft article 10) and the issue of liability of a certification authority (draft article 12) and decided to defer its consideration of draft article 9 until it had completed its consideration of the Uniform Rules.

Article 10. Representations upon issuance of certificate

134. The text of draft article 10 as considered by the Working Group was as follows:

Variant A

“(1) By issuing a certificate, a certification authority represents to any person who reasonably relies on the certificate, or on a digital signature verifiable by the public key listed in the certificate, that:

“(a) the certification authority has complied with all applicable requirements of these Rules in issuing the certificate and, if the certification authority has pub-

lished the certificate or otherwise made it available to such a relying person, that the holder listed in the certificate [and rightfully holding the corresponding private key] has accepted it;

“(b) the holder identified in the certificate [rightfully] holds the private key corresponding to the public key listed in the certificate;

“(c) the holder’s public key and private key constitute a functioning key pair;

“(d) all information in the certificate is accurate as of the date it was issued, unless the certification authority has stated in the certificate [or incorporated by reference in the certificate a statement] that the accuracy of specified information is not confirmed; and

“(e) to the certification authority’s knowledge, there are no known, material facts omitted from the certificate which would, if known, adversely affect the reliability of the foregoing representations.

“(2) Subject to paragraph (1), the certification authority which issues a certificate represents to any person who reasonably relies on the certificate, or on a digital signature verifiable by the public key listed in the certificate, that the certification authority has issued the certificate in accordance with any applicable certification practice statement [incorporated by reference in the certificate, or] of which the relying person has notice.

“Variant B

“(1) By issuing a certificate, a certification authority represents to the holder, and to any person who relies on information contained in the certificate[, in good faith and] during its operational period, that:

“(a) the certification authority has [processed] [approved] [issued], and will manage and revoke if necessary, the certificate in accordance with:

“(i) these Rules;

“(ii) any other applicable law governing the issuance of the certificate; and

“(iii) any applicable certification practice statement stated or incorporated by reference in the certificate, or of which such person has notice, if any;

“(b) the certification authority has verified the identity of the holder to the extent stated in the certificate or any applicable certification practice statement, or in the absence of such a certification practice statement, the certification authority has verified the identity of the holder in a [reliable] [trustworthy] manner;

“(c) the certification authority has verified that the person requesting the certificate holds the private key corresponding to the public key listed in the certificate;

“(d) except as set forth in the certificate or any applicable certification practice statement, to the certification authority’s knowledge, all other information in the certificate is accurate as of the date the certificate was issued;

“(e) if the certification authority has published the certificate, the holder identified in the certificate has accepted it.

“[(2) If a certification authority issued the certificate subject to the laws of another jurisdiction, the certification authority also makes all warranties and representations, if any, otherwise applicable under the law governing its issuance.]”

135. It was suggested that the title of the draft article might read along the lines of “process of issuing a certificate”. It was noted, at the outset, that draft article 10, which set a standard against which the liability of the certification authority was to be measured, was closely related to draft article 12, which provided the sanction to that standard. Based on variant A, the discussion focused on whether the representations listed in subparagraphs (a) to (e) of paragraph (1) should be regarded as mandatory requirements (i.e. minimum standards from which the parties could not derogate by agreement) or as “default” rules. As to the meaning of possible “default rules”, at various times in the discussion, “default” rules were characterized either as “gap-filling” rules (i.e. requirements that would only be binding in the absence of a contrary agreement) or as rules to be applied only where no contract whatsoever existed between the parties.

136. In support of making paragraph (1) a default rule, it was stated that: a flexible rule was needed to ensure that the forthcoming changes in technology could be accommodated; imposing a high liability standard on all certification authorities would only result in hampering the development of the industry, while encouraging the less reliable certification authorities to enter the market; imposing minimum standards on relatively low-security certificates could restrict the global use of such certificates in a variety of important contexts; in general the expectations of the holder of the certificate and the relying parties with regard to the content of the certificate should only be determined by reference to what the certification authority had undertaken, in its certification practice statement or otherwise, to represent in the certificate; and adoption of mandatory minimum standards for certificates could leave the Uniform Rules isolated from actual commercial practice in major markets. Accordingly, the liability of the certification authority should only be determined by reference to obligations which the certification authority had accepted to undertake. Such an approach was said to provide the level of flexibility that was necessary to accommodate the wide variety of certificates that were available on the market. The following was suggested as a possible reformulation of draft article 10, which might be merged with draft article 12:

“(1) A certification authority shall state explicitly in the certificate what kind of service it provides. If the obligation of the certification authority is not expressed in the certificate, the certification authority is deemed to have guaranteed the identity of the key holder.

“(2) If a certification authority has failed to perform the services stated in the certificate or has guaranteed the identity of the key holder negligently, it is liable to the relying party for damages.

“(3) A certification authority may limit its liability to pay damages by making explicit disclaimers in the certificate.

“(4) This article is subject to contrary agreement between the certification authority and the relying party.”

137. That proposal was objected to on the grounds that, in certain legal systems, there would be an inconsistency between defining the criteria under which a certificate might be accorded legal status on the one hand, and providing on the other hand that a general disclaimer could be used to disregard these essential criteria. It was also stated that there would typically exist no contractual relationship between the relying party and the certification authority. In that connection, the view was expressed that it might be useful to clarify whether the notion of “relying party” should encompass the holder of the key pair listed in the certificate. The view was also expressed that certificates might be very limited in size, thus making it difficult to include “explicit disclaimers” in the certificates. In response, it was stated that establishing a minimum standard as to the deemed contents of a certificate was in line with the need to reduce the size of the certificate itself.

138. In support of maintaining paragraph (1) of variant A as a minimum standard from which the parties should not be allowed to derogate by private agreement, it was recalled that the Working Group at its previous session had expressly made a decision regarding that point (see A/CN.9/437, paras. 70-71). Moreover, it was stated that establishing minimum requirements, in addition to protecting the holder of the certificate and other relying parties, would also enhance the trustworthiness and the commercial acceptability of digital signature mechanisms, thus benefiting certification authorities as well. In response to an objection that establishing a minimum standard would result in imposing burdensome obligations on certification authorities, it was pointed out that the purpose of draft article 10 was not to impose any obligation on the certification authority but merely to define a specific legal regime for certain certificates which, by meeting certain requirements, would qualify to be granted a specific legal status. A certification authority would remain free to offer lower-quality certificates, although such certificates would not entail the same legal consequences. It was conceded by proponents of the retention of a minimum standard that mechanisms limiting the amount of liability under draft article 12 would appropriately balance the acceptance by certification authorities of mandatory requirements under draft article 10. A parallel was drawn in that respect with the liability regime in the maritime transport industry, where the interplay of unfettered market forces had historically resulted in general uncertainty of a magnitude such that it discouraged parties from entering into maritime transactions, thus creating a need for the earlier international instruments in that field, such as the Hague Rules.

139. It was suggested that limiting the scope of the provision by defining a specific type of certificate (e.g. identity certificates issued for the purposes of high-value transactions) to which draft article 10 would apply might make it more acceptable to formulate draft article 10 in terms of a mandatory standard. Alternatively, it was suggested that adopting a reduced mandatory standard might help to make acceptable the application of draft article 10 to a wider category of certificates. With a view to combining those two suggestions, a proposal was made that only

subparagraphs (a), (d) and (e) of paragraph (1) should be retained as a minimum standard. While general support was expressed in favour of including that proposal in the continuation of the discussion, it was generally felt that further clarification would need to be provided on a number of issues.

140. One issue to be clarified was the exact category of certificates to which such a reduced mandatory standard would apply. One view was that the reduced standard should only apply to a limited category of high-security identity certificates. Support was expressed for the view that a stricter standard would be needed for those certificates to which a high level of legal certainty would attach. In particular, should the certificate be aimed at creating a legally-binding signature, further assurances would need to be provided as to the link between the certificate and the identity of the holder of the key pair. However, support was also expressed for the view that the proposed minimum standard under subparagraphs (a), (d) and (e) was so reduced that it could be made applicable to a broad range of certificates.

141. Another issue to be further clarified was the consistency of the proposed text of paragraph (1) with other provisions of the Uniform Rules dealing with the identification function of the certificate. It was recalled that, for the purposes of digital signatures, the main function of the certificate was to provide identification of the holder of the key pair, a reason why it had earlier been suggested that the Working Group should focus its attention on the notion of “identity” certificates. Should the proposed reduced standard be adopted, the certification authority would no longer make any representation as to the identity of the holder but it would merely guarantee that the process defined by the certification authority itself had been followed. While it was recognized that such a process might indirectly lead to the identification of the holder of the key pair, it was suggested that further consideration might be given to retaining the substance of subparagraphs (b) and (c), dealing with the direct (or “conclusive”) identification of the holder, in the Uniform Rules, possibly as part of draft article 2.

142. Although subparagraphs (a), (d) and (e) were suggested as setting a standard for identity certificates, it was generally agreed after discussion that such a limited standard could more appropriately apply to a wide variety of certificates. It was also agreed that further thought should be given to the manner in which the identification function should be reflected, either in draft article 10 or in an earlier part of the Uniform Rules, as an essential function of a smaller category of certificates, for which a high level of legal reliability was sought. It was agreed that the matter would need to be further discussed at a future session. Pending that discussion, subparagraphs (a), (d) and (c) would be maintained in paragraph (1) and subparagraphs (b) and (e) would be placed within square brackets. A suggestion was made that alternative wording drawn from paragraph (1)(b) of variant B might need to be placed within square brackets in paragraph (1) for consideration by the Working Group at a future session. With respect to subparagraph (d), it was widely felt that the reference to a possible disclaimer by the certification authority as to the

accuracy of the information contained in the certificate would be acceptable only if subparagraphs (b) and (c) were made part of paragraph (1).

143. With respect to paragraph (2), there was general agreement that the principle that a certification authority should abide by the commitments it had made in its certification practice statement should be retained.

144. Aimed at reflecting the above discussion, the following suggestion was made for a revised version of draft article 10:

“When a certificate is issued, it is deemed that:

“(a) the person or entity issuing the certificate has complied with all applicable requirements of the Rules;

“[(b) at the time of issuing the certificate, the private key is that of the holder and it corresponds to the public key listed in the certificate;]

“[(c) the holder’s public key and private key constitute a functioning key pair;]

“(d) all information in the certificate is accurate as of the date it was issued[, unless the certification authority has stated in the certificate that the accuracy of specified information is not confirmed];

“(e) to the certification authority’s knowledge, there are no known, material facts omitted from the certificate which would, if known, adversely affect the reliability of the information in the certificate; and

“[(f) if the certification authority has published a certification practice statement, the certificate has been issued by the certification authority in accordance with that certification practice statement.]”

145. After discussion, the Working Group requested the Secretariat to prepare a revised draft of article 10, with possible variants, to reflect the above discussion.

Article 11. Contractual liability

146. The text of draft article 11 as considered by the Working Group was as follows:

“(1) As between a certification authority issuing a certificate and the holder of that certificate [or any other party having a contractual relationship with the certification authority], the rights and obligations of the parties are determined by their agreement.

“(2) Subject to article 10, a certification authority may, by agreement, exempt itself from liability for any loss due to defects in the information listed in the certificate, technical breakdowns or similar circumstances. However, the clause which limits or excludes the liability of the certification authority may not be invoked if exclusion or limitation of contractual liability would be grossly unfair, having regard to the purpose of the contract.

“(3) The certification authority is not entitled to limit its liability if it is proved that the loss resulted from the act or omission of the certification authority done with intent to cause damage or recklessly and with knowledge that damage would probably result.”

147. It was noted that paragraph (1) restated the principle of party autonomy in connection with the liability regime applicable to the certification authority. In addition, it was noted that paragraph (2) dealt with the issue of exemption clauses, which were generally declared admissible, with two exceptions. The first exception came from a reference to draft article 10, which was intended to set a minimum standard from which certification authorities should not be allowed to derogate. The second exception was inspired by the UNIDROIT Principles on International Commercial Contracts (article 7.1.6), as an attempt to provide a uniform standard for assessing the general acceptability of exemption clauses. Moreover, it was noted that paragraph (3) dealt with the situation where loss or other damage would result from intentional misconduct by the certification authority or its agents (inspired by article 18 of the UNCITRAL Model Law on International Credit Transfers).

148. The Working Group considered first the question whether draft article 11 should be retained as part of the Uniform Rules. In support of deletion, it was stated that it dealt with matters that were better left to the contract and to the applicable law. In particular, it was observed that: paragraph (1) was redundant, since it merely stated the principle of party autonomy, which was covered by article 4 of the Model Law; and paragraphs (2) and (3) were interfering with national law on matters which might not lend themselves to unification. In addition, it was observed that draft article 10 sufficiently covered the matter. While leaving the issues of contractual liability to the contract and to the law applicable outside the Uniform Rules was found to be an acceptable alternative, the prevailing view was that it was worth trying to achieve a degree of unification on this important matter.

149. As to the way in which that result could be achieved, a number of suggestions were made. One suggestion was to retain draft article 11 in its current formulation. In support of that suggestion, it was observed that, while paragraph (1) might appear as stating the obvious, paragraph (2) introduced the very important principle that the core obligations of the contract could not be taken away through exemption clauses. In addition, it was pointed out that paragraph (3) was essential and covered not only contractual but also non-contractual relationships.

150. Another suggestion was to refer in paragraph (1) to the inability of the parties to agree on “grossly unfair” terms and to delete paragraphs (2) and (3). While support was expressed for the deletion of paragraphs (2) and (3), that suggestion was objected to on several grounds, including that: use of the term “grossly unfair” was not appropriate, since it was unknown to many legal systems; the protection of the weaker party aimed at by this term should be left to other law (e.g. consumer protection law); and the deletion of paragraphs (2) and (3) could inadvertently result in allowing parties to nullify the core effect of the contract or to exempt liability for intentional misconduct.

151. A related suggestion was to insert after the word “obligations” in paragraph (1) the words “and any limitation thereon” and at the end the words “subject to applicable law”, and to delete paragraphs (2) and (3). In support

of that suggestion, it was said that such an approach would result in an acceptable general statement based on party autonomy and the applicable law. It was observed, however, that no unification would be achieved if that approach were to be adopted.

152. Yet another suggestion was to replace draft article 11 with a provision stating that the standards up to which the certification authority should be held liable should be those set forth in the certification practice statement. The suggestion was opposed on the ground that it would replace both the contract and the minimum standards set forth in draft article 10 as a point of reference for measuring the certification authority's liability. The view was expressed, however, that that suggestion might provide an appropriate rule for low security certificates to which the minimum standards of draft article 10 would not be applicable.

153. In the discussion, a number of suggestions of a drafting nature were made. With regard to paragraph (1), one suggestion was that the reference within square brackets to "any party" was too broad and vague and should be replaced by a reference to "any relying party". Another suggestion was that paragraph (1) should be amended to make it clear that it was not intended to subject the relationship between the parties exclusively to their agreement, since such an approach would make the exception to the right of the parties to agree on liability exemption clauses contained in paragraphs (2) and (3) meaningless. With regard to paragraph (2), it was suggested that after the word "loss" the words "associated with the certificate" should be added and the remainder of the first sentence of paragraph (2) could be deleted.

154. After discussion, the Working Group failed to reach agreement as to the particular formulation of draft article 11 and requested the Secretariat to prepare alternative drafts reflecting the various views expressed for consideration at a future session.

Article 12. Liability of the certification authority to parties relying on certificates

155. The text of draft article 12 as considered by the Working Group was as follows:

"(1) In the absence of a contrary agreement, a certification authority which issues a certificate is liable to any person who reasonably relies on the certificate for:

"(a) [breach of warranty under article 10] [negligence in misrepresenting the correctness of the information stated in the certificate];

"(b) registering revocation of a certificate promptly upon receipt of notice of revocation of a certificate; and

"(c) [the consequences of not] [negligence in] following:

"(i) any procedure set forth in the certification practice statement published by the certification authority; or

"(ii) any procedure set forth in applicable law.

"(2) Notwithstanding paragraph (1), a certification authority is not liable if it can demonstrate that the certi-

fication authority or its agents have taken all necessary measures to avoid errors in the certificate or that it was impossible for the certification authority or its agents to take such measures.

"(3) Notwithstanding paragraph (1), a certification authority may, in the certificate [or otherwise], limit the purpose for which the certificate may be used. The certification authority shall not be held liable for damages arising from use of the certificate for any other purpose.

"(4) Notwithstanding paragraph (1), a certification authority may, in the certificate [or otherwise], limit the value of transactions for which the certificate is valid. The certification authority shall not be held liable for damages in excess of that value limit."

General remarks

156. Widespread support was expressed in favour of a provision dealing with the issue of liability of certification authorities towards relying parties along the lines of draft article 12. It was widely felt, however, that the scope of such a provision should be limited to cases in which the certification authority guaranteed the identity of the key holder and the integrity of the data messages signed by the key holder. Such an approach could facilitate certain practices in which high security standards were required, without negatively affecting other practices in which such high security and liability standards might not be appropriate.

157. Some doubt was expressed, however, as to whether a specific liability regime could or should be established. It was stated that introducing such a liability regime could hamper certification practices, if it were not accompanied by a reasonable quantification of the risks associated with the provision of certification services, since certification authorities would be exposed to risks for which they would not be able to obtain insurance coverage. In addition, it was observed that such a liability regime might not be necessary, since, in the absence of a specific regime, general principles of tort law would apply. It was pointed out, however, that in some jurisdictions in which the liability of certification authorities had not been regulated specifically, certification authorities would, in principle, not be liable towards relying parties. In addition, it was said that leaving the matter to the applicable law would not be appropriate for a number of reasons, including that: the uncertainty prevailing in many jurisdictions could negatively affect the development of electronic commerce; the absence of any liability could inadvertently result in business parties being unable to take advantage of the services offered by certification authorities; and the determination of the applicable law raised very difficult questions. As to the form of the work product, the view was expressed that a uniform liability regime could be implemented more effectively by way of a convention than through a model law (see para. 212, below).

158. After discussion, the Working Group decided that every effort should be made to address the issue of liability of certification authorities towards relying parties in the Uniform Rules and went on to consider draft article 12 in detail. It was suggested that the Working Group might wish to include in the future discussion of draft article 12

a consideration of the nature and foreseeability of damages incurred by the relying party.

Paragraph (1)

Chapeau

159. Differing views were expressed as to whether the opening words of the *chapeau* should be retained. One view was that, if draft article 10 set minimum standards that the certification authority had to meet, the opening words should be deleted. Another view was that the opening words were useful and should be retained, to the extent that they allowed parties to negotiate their liability. It was stated in response that parties could not negotiate, since draft article 12 dealt with tortious liability in cases in which, typically, there was no agreement. It was observed, however, that relying parties in closed communication systems would normally have some type of agreement with the certification authority. In addition, it was observed that liability terms negotiated between certification authorities and key holders might be incorporated in contracts between key holders and relying parties.

160. The prevailing view was that the cases mentioned were exceptional and should not be allowed to defeat the main purpose of draft article 12 which was to regulate tortious liability of certification authorities towards third parties. It was thus suggested that the residual need to address contrary agreements between certification authorities and their clients or relying parties, whenever such agreements existed, could be addressed by including appropriate wording at the end of draft article 12.

Subparagraphs (a) to (c)

161. It was observed that the second set of bracketed language in subparagraphs (a) and (c) appeared to reflect the principle of strict liability and should be deleted. The concern was expressed that use of the notion of “misrepresentation” might create uncertainty, since it had a specific meaning in some legal systems but was unknown in other legal systems. “Mis-statements” was suggested as an alternative expression.

Paragraph (2)

162. Differing views were expressed as to whether the burden of proof of negligence should be on the certification authority or on the relying party. One view was that the burden of proof should be on the relying party. In support, it was stated that the relying party could prove negligence, since the evidence as to whether the certification authority had met the standard of care set forth in draft article 10 would be readily available to the relying party. In addition, it was pointed out that shifting the burden of proof to the certification authority would be appropriate only if the Working Group had adopted the principle of strict liability. Another view was that, while liability should be based on negligence, the burden of proof should be placed on the certification authority, since any relevant evidence would be under the control of the certification authority. It was observed that that would be the case, in particular, if the certificate referred not to the identity of the key holder but to the procedure followed by the certification authority to determine the identity of the key holder.

Paragraphs (3) and (4)

163. Support was expressed in favour of the principle of limitation of the liability of the certification authority embodied in paragraphs (3) and (4). However, the view was expressed that limits of liability would be appropriate only in case of a regime based on strict liability of the certification authority, as opposed to a liability regime based on negligence.

164. As to the types of limits that could be introduced, it was stated that a monetary limit per transaction did not adequately protect certification authorities, particularly in the context of identity certificates, since, irrespective of the liability limit, they could be used several times within a very short period of time, without there being a way to determine whether the liability limit had been exceeded. It was, therefore, suggested that a provision introducing an aggregate liability limit should be included in draft article 12 that could read along the following lines: “A certification authority may, in the certificate or otherwise, provide a limit of liability for the lifetime of the certificate for all incidents of reliance in the amount of an aggregate value of the certificate. The certification authority shall not be held liable for damages in excess of that aggregate limit regardless of the number of claims made against that certificate”. The view was expressed, however, that aggregate liability limits could not function since a relying party would have no way of knowing, under existing technology applications, whether a certain limit had been reached.

Proposals for new draft article 12

165. In order to address the concerns expressed above, a number of proposals for an alternative formulation of draft article 12 were made. One proposal was that draft article 12 should read along the following lines:

“(1) Where a certification authority issues a certificate, it is liable to any person who reasonably relies on the certificate, if it is negligent by:

“(a) providing incorrect information in the certificate;

“(b) failing to [notify or] publish the revocation [or suspension] of the certificate promptly upon becoming aware of the need to revoke [or suspend] it[; or

“(c) failing to follow a procedure in a certification practice statement which has been published by the certification authority and of which the relying person has had notice].

“(2) A certification authority may state in the certificate [or elsewhere] a restriction on the purpose or purposes for which the certificate may be used and the certification authority shall not be liable for damage arising from use of the certificate for any other purpose.

“(3) A certification authority may state in the certificate [or elsewhere] a limit on the value of transactions for which the certificate is valid and the certification authority shall not be liable for damages in excess of that limit.

“[(4) Paragraph (1) of this article does not apply if, and to the extent that, there are contrary terms in an agreement between the certification authority and the person who relies on the certificate.]”

166. Another proposal was that draft article 12 should be amended to read as follows:

“(1) Unless a certification authority proves that it or its agents have taken all reasonable measures to avoid errors in the certificate, it is liable to any person who reasonably relies on a certificate issued by that certification authority for:

“[insert subparagraphs (a) to (c)]

“(2) Notwithstanding paragraph (1), reliance on a certificate is not reasonable to the extent that it is contrary to the information contained in the certificate.”

167. While the first proposal was met with some interest, the Working Group focused its discussion on the second proposal. It was stated that paragraph (1) was intended to establish liability for errors in the certificate subject to the principle of reasonable reliance, avoiding any reference to representations and negligence. In addition, it was observed that paragraph (2) was aimed at allowing the certification authority to set forth in the certificate the standards against which the reasonableness of the reliance on the certificate would be tested. It was explained that paragraph (2) was not intended to provide an exhaustive list of all situations in which reliance on the certificate would not be reasonable. While paragraphs (1) and (2) were generally felt to be acceptable as a basis for future discussion, a number of concerns were expressed and suggestions made.

New paragraph (1)

168. One concern was that, in practice, it would be almost impossible for certification authorities to take “all reasonable measures” in a cost- and time-effective manner. In order to address that concern, a number of suggestions were made. One suggestion was that the word “commercially” should be substituted for the word “all”. In support of that suggestion, it was stated that a reference to “commercially reasonable measures” would reflect what was practicable under the particular circumstances. In addition, it was observed that such a reference would be in line with terminology used in other UNCITRAL texts (e.g. article 5(2)(a) of the UNCITRAL Model Law on International Credit Transfers). The suggestion was opposed on the ground that it would introduce uncertainty, in view of the fact that there existed no universal understanding of what was “commercially reasonable”. Another suggestion was that the term “all” should be simply deleted. That suggestion too was opposed on the ground that it might inadvertently result in inappropriately lowering the standard of care to be met by certification authorities. Yet another suggestion was that language used in article 7(1)(b) of the Model Law should be used in new paragraph (1).

169. Another concern was that new paragraph (1) failed to address errors made by the certification authority in issuing a certificate. In order to address that concern, it was suggested that the words “or issuing it” be added after “certificate” in new paragraph (1). It was stated that information contained in a certificate revocation list (CRL) or similar list should also be covered in new paragraph (2).

170. It was agreed that, pending determination of the question of the function of certification practice state-

ments, subparagraph (c) should be placed within square brackets.

New paragraph (2)

171. As a matter of drafting, it was suggested that the opening words should be deleted and the words “subject to paragraph (2)” should be inserted at the beginning of new paragraph (1). The concern was expressed that new paragraph (2) could have the unintended result of excessively limiting the grounds on which the reasonableness of the reliance on the certificate could be questioned. Another concern was that new paragraph (2) might not cover a situation in which the certificate might be relied upon in a transaction of an excessive value, since value might not be covered by the term “information”. In order to address those concerns, it was suggested that paragraphs (3) and (4) of draft article 12 should be listed as examples of situations in which reliance on the certificate would not be reasonable. In the same vein, it was suggested that other similar examples might be given relating, e.g. to situations in which the certification authority might state in the certificate which designated parties or types of parties might rely on that certificate. In addition, it was suggested that the certification authority should not be able to rely on limits of liability if the loss resulted from intentional or reckless behaviour of the certification authority.

172. Another concern was that, by referring to the information “contained” in the certificate, new paragraph (2) might inadvertently result in inappropriately increasing the amount of information that would need to be included in a certificate. In order to address that concern, the suggestion was made that incorporation of that information in the certificate by reference should be allowed. That suggestion was opposed on the ground that it would be unfair to subject the rights of third parties to terms incorporated in an agreement between the certification authority and the key holder, since those terms might not even be readily available to third parties.

173. After discussion, the Working Group decided that draft article 12 should be reformulated along the following lines:

“(1) Subject to paragraph (2), unless a certification authority proves that it or its agents have taken [all reasonable] [commercially reasonable] measures [that were appropriate for the purpose for which the certificate was issued, in the light of all circumstances] to avoid errors in the certificate [or in issuing it], it is liable to any person who reasonably relies on a certificate issued by that certification authority for:

“(a) errors in the certificate; [or]

“(b) registering revocation of a certificate promptly upon receipt of notice of revocation of a certificate [; or

“(c) the consequences of not following:

“(i) any procedure set forth in the certification practice statement published by the certification authority; or

“(ii) any procedure set forth in applicable law].

“(2) Reliance on a certificate is not reasonable to the extent that it is contrary to the information contained [or incorporated by reference] in the certificate [or in a revocation list] [or in the revocation information]. [Reliance is not reasonable, in particular, if:

“(a) it is contrary to the purpose for which the certificate was issued;

“(b) it exceeds the value for which the certificate is valid; or

“(c) [...]”

The view was expressed that draft article 12 should apply only to certification authorities issuing identity certificates.

Articles 13-16

174. For lack of sufficient time, the Working Group postponed its consideration of draft articles 13-16 to a future session. The view was expressed that these draft articles should apply only to certification authorities issuing identity certificates. Another view was that the Working Group should consider whether the Uniform Rules should apply only to identity certificates or to any other kind of certificate.

Chapter IV. Recognition of foreign electronic signatures

Article 17. Foreign certification authorities offering services under these Rules

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

“*Variant A:* (1) Foreign [persons] [entities] may become locally established as certification authorities or may provide certification services from another country without a local establishment if they meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities.

(2) “*Variant X:* The rule stated in paragraph (1) does not apply to the following: [...]”

“*Variant Y:* Exceptions to the rule stated in paragraph (1) may be made to the extent required by national security.

“*Variant B:* The ... [the enacting State specifies the organ or authority competent to establish rules in connection with the approval of foreign certificates] is authorized to approve foreign certificates and to lay down specific rules for such approval.”

General remarks

176. With regard to the title of chapter IV, it was said that the reference therein to recognition of foreign electronic signatures was not appropriate, since the chapter dealt with the provision of services by foreign certification authorities (i.e. draft article 17), the endorsement of for-

eign certificates by domestic certification authorities (i.e. draft article 18) and the recognition of foreign certificates (i.e. draft article 19). The Working Group considered briefly a number of suggestions that were made so as to reflect more clearly in the chapter heading the subject matter dealt with therein (e.g. “cross-border recognition of certificates”, “recognition of electronic signatures and certificates”, “recognition of foreign certification authorities and certificates”). However, it was generally agreed that the consideration of an appropriate heading for chapter IV should be postponed until the Working Group had discussed in more detail the legal effects of certificates.

177. With regard to the two variants proposed in draft article 17, it was generally felt that variant B, which left for a specified organ of the enacting State to lay down rules for the approval of foreign certificates, did not provide an appropriate basis for the development of uniform rules. It was agreed that variant B should be deleted and that the Working Group should focus its deliberations on variant A.

Scope of draft article 17

178. It was pointed out that the objectives of draft article 17 were twofold: firstly, it recognized the right of a foreign certification authority to become locally established, under the conditions set forth therein; and secondly, it gave the foreign certification authorities the right to provide services in the enacting State without having a local establishment. As such, draft article 17 touched upon matters of trade policy, namely the extent to which the enacting State would waive restrictions against the establishment of foreign certification authorities and the provision of services by foreign certification authorities. It was suggested, instead, that the Working Group should attempt to focus its work on the development of model provisions on the legal effects of foreign certificates and the relationship between certificate holders and certification authorities. Various interventions were made in support of that view. It was felt that matters of trade policy fell within the province of other forums, and that it would not be advisable to address them in the Uniform Rules.

179. In response to those views it was noted that, by allowing foreign entities to become established as certification authorities, draft article 17 merely stated the principle that foreign entities should not be discriminated against, provided that they met the standards set forth for domestic certification authorities. That principle was found to be of particular relevance with respect to certification authorities, since they might be expected to operate without necessarily having a physical establishment or other place of business in the country in which they operated. It was further stated that the Model Law itself dealt with a number of cross-border matters which might be seen as raising issues of trade policy.

180. Having heard the various views expressed, and for the purpose of advancing its consideration of the Uniform Rules, the Working Group proceeded to discuss a number of amendments to draft article 17, without prejudice to the reservations that had been expressed in connection with the substance of draft article 17.

Paragraph (1)

181. The question was asked whether paragraph (1) contemplated only the recognition of certification authorities that operated pursuant to an approval issued by an organ or governmental agency of the foreign State. In response to that question it was observed that, as currently drafted, paragraph (1) did not touch upon the question of whether a certification authority required a governmental approval in the foreign State. However, the view was also expressed that a provision such as draft article 17 had to be based on a licensing regime pursuant to legislative requirements.

182. The view was expressed that some of the difficulties that had been raised by paragraph (1) stemmed from the fact that the provision seemed to place excessive emphasis on the recognition of the certification authority itself, rather than on the certification authority's ability to issue certificates that would be used in the enacting State. Furthermore, the phrase "meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities", might pose an obstacle to the use of new technologies, since the provision could be interpreted as providing grounds for barring the recognition of foreign certification authorities that followed procedures that were technologically more advanced than those in use in the enacting State. Instead of the current formulation, it was suggested that it would be preferable to make reference to "objective requirements" that had to be met by certification authorities in the enacting State. Alternatively, the words "and follow the same procedures" should be placed within square brackets.

183. In connection with the conditions to be met by a foreign certification authority, it was observed that the purpose of draft paragraph (1) was to ensure that those conditions would be essentially the same as those applying to national certification authorities. It was therefore proposed to redraft paragraph (1) to the effect that the recognition of foreign certification authorities should be subject to the laws of the enacting State. Questions relating to the definition of the standards that had to be met by the foreign certification authority could be considered by the Working Group at a later stage. In addition, such an amendment would make it clear that the recognition was also subject to any exclusions obtaining in the enacting State, thus obviating the need for either of the variants of paragraph (2). The proposed text was as follows:

"Subject to the laws of the enacting State, a foreign [person][entity] may:

"(a) become locally established as a certification authority; or

"(b) provide certification services without being established locally if it meets the same objective standards and follows the same procedures as domestic entities and persons that may become certification authorities."

184. In response to that proposal it was stated that the reference to domestic law was not a satisfactory solution since the laws of the enacting State might contain discriminatory provisions that might undermine the spirit of draft

article 17. Furthermore, the proposed amendment gave rise to questions as to who in the enacting State would make a determination that the foreign certification authority met the same objective standards and followed the same procedures as domestic entities and persons and by what means such a determination would be made.

185. The view was expressed that, in its present formulation, paragraph (1) seemed to imply that foreign certification authorities needed not only to be approved under their own law, but needed to comply in addition with the requirements of the enacting State. It was considered that such a rule might have undesirable restrictive effects and would not contribute to promoting electronic commerce. In connection with the latter observation it was suggested that the meaning of paragraph (1) might be clarified by recasting it as a non-discrimination rule along the following lines:

"(1) Foreign [persons] [entities] may not be denied the right to become locally established or to provide certification services solely on the grounds that they are foreign if they meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities."

186. That proposal was objected to on the ground that the proposed rule of non-discrimination raised the same type of general concerns that had been raised in the general remarks concerning the scope of draft article 17 (see paras. 178-180, above).

187. Having considered the various proposals, and taking into account the differing views that had been expressed, the Working Group felt that more time for consultations was needed on the matters dealt with in paragraph (1). The Secretariat was requested to propose a revised version of paragraph (1), with possible variants reflecting the above discussion, for consideration by the Working Group at a later stage.

Paragraph (2)

188. In connection with the two variants of exclusions offered under paragraph (2), the view was expressed that variant X should be deleted since it might provide an open-ended mechanism for limiting the scope of paragraph (1). Pursuant to that view, if any exclusion was to be allowed, it should only be on grounds of national security, as provided under variant Y. However, general preference was expressed for retaining variant X, pursuant to which it would be for the enacting State to formulate the exceptions to the general rule of paragraph (1). While variant Y had the merit of limiting the possible exclusions to those that related to national security, it was felt that States might wish to include in their legislation other possible grounds for exclusions based on public policy. After discussion, it was decided that both variants X and Y should be retained in square brackets for future consideration.

Article 18. Endorsement of foreign certificates by domestic certification authorities

189. The text of draft article 18 as considered by the Working Group was as follows:

“Certificates issued by foreign certification authorities may be used for digital signatures on the same terms as certificates subject to these Rules if they are recognized by a certification authority operating under ... [*the law of the enacting State*], and that certification authority guarantees, to the same extent as its own certificates, the correctness of the details of the certificate as well as the certificate being valid and in force.”

190. As a general remark, it was stated that the inclusion of provisions dealing with issues of cross-border recognition represented a significant step towards enhancing the trustworthiness of certificates. It was said that commercial practice was increasingly making use of certificates and that confidence in this new technology might be fostered through adherence to international standards. The Working Group was invited to consider international mechanisms for the accreditation of certification authorities that operated pursuant to international standards. Support was expressed to including the proposed topic among the matters to be discussed by the Working Group at a later stage. It was noted, however, that the proposed topic did not relate only to the matters raised in draft article 18 and that it might, for instance, be taken up by the Working Group when it resumed consideration of the issue of registration of certificates.

191. With regard to draft article 18, it was noted that the purpose of the rule contained therein was merely to enable a domestic certification authority to guarantee, to the same extent as its own certificates, the correctness of the details of the foreign certificate, and to guarantee that the foreign certificate was valid and in force. By virtue of draft article 18, the liability in the event that the foreign certificate was found to be defective was allocated to the domestic certification authority that provided such a guarantee. However, the existence of a guarantee pursuant to draft article 18 was not a necessary condition for the recognition of a certificate issued by foreign certification authorities that otherwise met the conditions set forth in draft article 19. To the extent that the provision of a guarantee under draft article 18 was merely voluntary, it was suggested that draft article 18 was not necessary and might be deleted. It was further suggested that the Uniform Rules should leave it for the enacting State to decide whether and under what conditions domestic certification authorities could provide such a guarantee in connection with certificates issued by foreign certification authorities. Reference to the issuance of guarantees of the type contemplated in draft article 18 might be made in a guide to enactment or in accompanying explanatory notes, depending on the nature of the instrument that was ultimately adopted.

192. The Working Group was reminded of its earlier discussions, during its thirty-first session, of the different levels of trustworthiness that could be provided by a domestic certification authority with respect to a foreign one. It was noted that those levels ranged from the highest level, in which the domestic certification authority, upon request of the party relying on a foreign certificate, guaranteed the contents of that certificate on the basis of its declared knowledge of the procedures that had led to the issuance of the certificate, thus assuming full liability for any errors or other defects in the certificate, to the lowest

level of trustworthiness, where the domestic certification authority would merely guarantee the identity of the foreign certification authority, based on a verification of its public key and digital signature (see A/CN.9/437, paras. 81-82). It was suggested that those different levels of trustworthiness were not adequately reflected in draft article 18 and that, if the provision was retained, it should be made clear that it did not exclude arrangements other than a full guarantee of the correctness and validity of a certificate issued by a foreign certification authority.

193. In response to those observations it was stated that draft article 18 served a useful purpose, since it allowed the circulation and cross-border use of certificates without calling for bilateral or multilateral international agreements on the recognition of certificates which some States might consider to be required in order to grant recognition under draft article 19. Furthermore, in view of the decision made by the Working Group to deal in the Uniform Rules not only with certification authorities licensed by public entities but also with certification authorities that operated outside a governmental licensing scheme (see A/CN.9/437, paras. 48-50), draft article 18 had the additional advantage of allowing a commercial solution for situations in which recognition under draft article 19 would not be available automatically. In that connection, it was suggested that the scope of draft article 18 could be clarified by redrafting along the following lines:

“Certificates issued by foreign certification authorities may be used for digital signatures on the same terms as certificates subject to these Rules on the basis of an appropriate guarantee provided by a certification authority operating under ... [*the law of the enacting State*].”

194. Support was expressed in favour of retaining in the Uniform Rules a provision that authorized a domestic certification authority to provide guarantees in connection with certificates issued by foreign certification authorities. Such a provision might be based on draft article 18, taking into account the proposals made in the Working Group. However, it was suggested that the current location of draft article 18 in chapter IV was inadequate, since the provision did not deal with recognition of certificates issued abroad.

195. After deliberation, the Working Group agreed to retain draft article 18 within square brackets, with the proposed amendments, and requested the Secretariat to prepare alternative versions of that provision, taking into account the views that had been expressed, for future consideration by the Working Group.

Article 19. Recognition of foreign certificates

196. The text of draft article 19 as considered by the Working Group was as follows:

“(1) Certificates issued by a foreign certification authority are recognized as legally equivalent to certificates issued by certification authorities operating under ... [*the law of the enacting State*] if the practices of the foreign certification authority provide a level of reliability at least equivalent to that required of certification

authorities under these Rules. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

“(2) Signatures and records complying with the laws of another State relating to digital or other electronic signatures are recognized as legally equivalent to signatures and records complying with these Rules if the laws of the other State require a level of reliability at least equivalent to that required for such records and signatures under ... [*the Law of the enacting State*]. [Such recognition may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

“(3) Digital signatures that are verified by reference to a certificate issued by a foreign certification authority shall be given effect [by courts and other finders of fact] if the certificate is as reliable as is appropriate for the purpose for which the certificate was issued, in light of all the circumstances.

“(4) Notwithstanding the preceding paragraph, Government agencies may specify [by publication] that a particular certification authority, class of certification authorities or class of certificates must be used in connection with messages or signatures submitted to those agencies.”

Paragraphs (1) and (2)

197. It was observed that paragraphs (1) and (2) dealt with the ways in which the reliability of foreign certificates and signatures might be established in advance of any transaction being made (and any dispute arising as to the level of reliability of a signature). For that purpose, paragraphs (1) and (2) set forth the tests that might be applied in the enacting State in order to recognize the certificates issued by foreign certification authorities, as well as signatures and records complying with the laws of another State.

198. Various questions were raised concerning the scope of the recognition under paragraphs (1) and (2). With regard to paragraph (1), the view was expressed that the notion of legal equivalence between certificates issued by foreign certification authorities and certificates issued by certification authorities operating under the rules of the enacting State was not sufficiently clear. It was pointed out that the term “recognition”, as commonly used in private international law, entailed the granting of legal effects to acts performed in another jurisdiction. However, that notion could not be applied in the context of paragraph (1), since a certificate was an instrument that contained statements of fact which merely fulfilled a declaratory function. Furthermore, both paragraph (1) and paragraph (2) implied that the enacting State should apply its own laws to ascertain the reliability of certificates issued by foreign certification authorities as well as signatures and records complying with the laws of another State. Therefore, it was said that paragraphs (1) and (2) were not in line with general principles of private international law pursuant to which the validity of acts performed abroad was to be settled in accordance with the applicable law of the jurisdiction where they had been accomplished.

In addition, it was pointed out that article 13 of the Model Law and draft articles 3 and 5 of the Uniform Rules already provided rules for the attribution of data messages and for ascertaining the reliability of an electronic signature.

199. In response to those observations, it was pointed out that paragraphs (1) and (2) served a useful purpose in connection with national regulatory regimes that required the use of specified classes of certificates providing a high level of reliability for the performance of certain transactions. In enacting States that had such regulatory regimes, paragraph (1) provided minimum standards for the recognition of certificates issued by foreign certification authorities that were used in connection with transactions other than those for which a specified class of certificates was required. By the same token, paragraph (2) provided those enacting States with a default rule that created a presumption of validity for signatures and records complying with the laws of another State which were found to provide a reasonable level of security for all those situations where no higher requirements were imposed under the laws of the enacting State. The Working Group was urged not to leave the issue of the minimum standards that applied to a foreign certificate to be settled entirely pursuant to the conflict-of-laws rules of the enacting State.

200. The Working Group discussed possible amendments to paragraphs (1) and (2) with a view to addressing the concerns that had been voiced. In particular, it was suggested that paragraphs (1) and (2) could be combined and reformulated as a non-discrimination rule along the following lines:

“Certificates issued by foreign certification authorities shall not be precluded from having the same recognition as certificates issued by domestic certification authorities on the ground that they have been issued by foreign certification authorities.”

201. However, objections were raised to the proposed negative formulation, since it did not provide the standards on the basis of which the recognition should be granted. Furthermore, it was observed that the proposed non-discrimination rule might give rise to the same reservations that had been voiced in connection with draft article 17 (see paras. 185-186, above).

202. After deliberation, it was generally felt that it would be desirable to formulate a substantive rule that provided a method for establishing the reliability of foreign certificates and signatures in advance of any transaction being made. The Secretariat was requested to prepare a revised version of paragraphs (1) and (2), including one that combined the two paragraphs, with possible variants taking into account the views that had been expressed.

Paragraph (3)

203. It was observed that paragraph (3) was intended to establish the standard against which foreign signatures and certificates might be assessed in the absence of any prior determination of their reliability. However, it was suggested that, as currently formulated, the provision might not be needed, since it merely restated the principle that,

in the event that a dispute arose concerning the authenticity of a signature and the reliability of a certificate issued by a foreign certification authority, the courts of the enacting State had to give to such signature or certificate the evidentiary weight that was found to be appropriate in the circumstances.

204. In response to those observations it was noted that paragraph (3), which was inspired by article 7 of the Model Law, provided useful guidance for the courts of the enacting State in assessing the reliability of a foreign certificate. It was desirable to restate that important principle in the Uniform Rules in view of the fact that a State adopting the Uniform Rules might not necessarily have incorporated article 7 of the Model law in its domestic legislation. In order to state more clearly its purpose, it was proposed that paragraph (3) might be redrafted along the following lines:

“Digital signatures that are verified by reference to a certificate issued by a foreign certification authority shall not be precluded from being given effect [by courts and other finders of fact] if the certificate is as reliable as is appropriate for the purpose for which the certificate was issued, in light of all the circumstances.”

205. After deliberation, the Working Group decided that the substance of paragraph (3) should be retained for further consideration by the Working Group at a later stage.

Paragraph (4)

206. Questions were raised concerning the need for a provision such as paragraph (4), which preserved the right of Government agencies to determine the procedures to be used in communicating electronically with them. On the one hand, the concern was expressed that paragraph (4) might have undesirable restrictive implications and might be interpreted to the effect that persons or entities other than Government agencies did not have the right to choose the particular certification authority, class of certification authorities or class of certificates that they wished to use in connection with messages or signatures they received. Such a situation was considered to be inconsistent with the principle of party autonomy enshrined in various provisions of the Model Law. On the other hand, if the purpose of paragraph (4) was to establish a special prerogative for Government agencies, the provision might need further refinement, since it might be construed to the effect that, in the absence of a clear indication by a Government agency of the particular certification authority, class of certification authorities or class of certificates that they wished to use in connection with messages or signatures submitted to them, the Government agency was under an obligation to accept any class of certification authority or certificate.

207. It was generally felt that parties to commercial and other transactions, and not only Government agencies, should be accorded the right to choose the particular certification authority, class of certification authorities or class of certificates that they wished to use in connection with messages or signatures they received. The Working Group requested the Secretariat to reformulate paragraph

(4) so as to reflect that understanding and decided to consider the appropriate location for the revised provision at a later stage.

V. COORDINATION OF WORK

208. The Working Group heard statements regarding work undertaken by UNESCO and UNCTAD in the field of electronic commerce.

209. It was stated that, at its 29th general conference, UNESCO had received the mandate to undertake the preparation of an international legal instrument relating to the use of cyberspace. In that connection, the view was expressed that there was a need for UNESCO and UNCITRAL to join their efforts in the field of electronic commerce. It was observed that those efforts should be guided by the need to promote electronic commerce in a manner that would benefit both developed and developing countries and that would, at the same time, guarantee the fundamental human rights, including the right to privacy. It was emphasized that issues of attribution of data messages to their originator, integrity of data messages and accountability of parties involved in electronic commerce should be at the core of the efforts of the Working Group on digital and other electronic signatures.

210. In a statement regarding the work of UNCTAD, it was observed that a global trade point network had been established, with the aim of assisting developing countries in their efforts to benefit from developments in the field of electronic communications. In addition, it was announced that UNCTAD was organizing an exhibition of manufacturers of equipment, producers of software and providers of services in electronic commerce (Lyon, 8-13 November 1998). The exhibition, it was observed, would include a series of presentations on a wide range of issues relating to electronic commerce.

211. The Working Group took note of the statements and welcomed the participation of interested organizations in its work. The Secretariat was requested to continue monitoring developments with respect to the legal issues of electronic commerce, as dealt with by other international organizations, and to report to the Working Group on those developments.

VI. FUTURE WORK

212. At the close of the session, the proposal was made that the Working Group might wish to give preliminary consideration to undertaking the preparation of an international convention based on provisions of the Model Law and of the Uniform Rules. It was agreed that the topic might need to be taken up as an agenda item at the next session of the Working Group on the basis of more detailed proposals possibly to be made by interested delegations. However, the preliminary conclusion of the Working Group was that the preparation of a convention should in any event be regarded as a project separate from both the preparation of the Uniform Rules and any other

possible addition to the Model Law. Pending a final decision as to the form of the Uniform Rules, the suggestion to prepare a convention at a later stage should not distract the Working Group from its current task, which was to focus on the preparation of draft uniform rules on digital and other electronic signatures, and from its current working assumption that the Uniform Rules would be in the form of draft legislative provisions. It was generally understood that the possible preparation of a draft conven-

tion should not be used as a means of reopening the issues settled in the Model Law, which might negatively affect the increased use of that already successful instrument.

213. It was noted that the next session of the Working Group was scheduled to be held in New York from 29 June to 10 July 1998, those dates being subject to confirmation by the Commission at its thirty-first session (New York, 1-12 June 1998).

**B. Working paper submitted to the Working Group on Electronic Commerce at its thirty-second session: draft uniform rules on electronic signatures: note by the Secretariat
(A/CN.9/WG.IV/WP.73) [Original: English]**

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I. INTRODUCTION

1. The Commission, at its twenty-ninth session (1996), decided to place the issues of digital signatures and certification authorities on its agenda. The Working Group on Electronic Commerce was requested to examine the desirability and feasibility of preparing uniform rules on those topics. It was agreed that work to be carried out by the Working Group at its thirty-first session could involve the preparation of draft rules on certain aspects of the above-mentioned topics. The Working Group was requested to provide the Commission with sufficient elements for an informed decision to be made as to the scope of the uniform rules to be prepared. As to a more precise mandate for the Working Group, it was agreed that the uniform rules to be prepared should deal with such issues as: the legal basis supporting certification processes, including emerging digital authentication and certification technology; the applicability of the certification process; the allocation of risk and liabilities of users, providers and third parties in the context of the use of certification techniques; the specific issues of certification through the use of registries; and incorporation by reference.¹

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). As to the desirability and feasibility of preparing uniform rules on issues of digital signatures and certification authorities, the Working Group indicated to the Commission that it had reached consensus as to the importance of, and the need for, working towards harmonization of law in that area. While it had not made a firm decision as to the form and content of such work, it had come to the preliminary conclusion that it was feasible to undertake the preparation of draft uniform rules at least on issues of digital signatures and certification authorities, and possibly on related matters. The Working Group recalled that, alongside digital signatures and certification authorities, future work in the area of electronic commerce might also need to address: issues of technical alternatives to public-key cryptography; general issues of functions performed by third-party service providers; and electronic contracting (A/CN.9/437, paras 156-157). With respect to the issue of incorporation by reference, the Working Group concluded that no further study by the Secretariat was needed, since the fundamental issues were well known and it was clear that many aspects of battle-of-forms and adhesion contracts would need to be left to applicable national laws for reasons involving, for

example, consumer protection and other public-policy considerations. The Working Group was of the opinion that the issue should be dealt with as the first substantive item on its agenda, at the beginning of its next session (A/CN.9/437, para. 155).

3. The Commission expressed its appreciation for the work already accomplished by the Working Group at its thirty-first session, endorsed the conclusions reached by the Working Group, and entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities (hereinafter referred to as “the Uniform Rules”).

4. With respect to the exact scope and form of the Uniform Rules, the Commission generally agreed that no decision could be made at this early stage of the process. It was felt that, while the Working Group might appropriately focus its attention on the issues of digital signatures in view of the apparently predominant role played by public-key cryptography in the emerging electronic-commerce practice, the Uniform Rules should be consistent with the media-neutral approach taken in the Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (1996)^a, hereinafter referred to as “the Model Law”. Thus, the Uniform Rules should not discourage the use of other authentication techniques. Moreover, in dealing with public-key cryptography, the Uniform Rules might need to accommodate various levels of security and to recognize the various legal effects and levels of liability corresponding to the various types of services being provided in the context of digital signatures. With respect to certification authorities, while the value of market-driven standards was recognized by the Commission, it was widely felt that the Working Group might appropriately envisage the establishment of a minimum set of standards to be met by certification authorities, particularly where cross-border certification was sought.

5. As an additional item to be considered in the context of future work in the area of electronic commerce, it was suggested that the Working Group might need to discuss, at a later stage, the issues of jurisdiction, applicable law and dispute settlement on the Internet. The Commission was informed that a colloquium on the issues of jurisdiction and applicable law on the Internet would take place in June 1997 under the auspices of the Hague Conference on Private International Law. The Commission was also

¹Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), paras. 223-224.

^aIbid., annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

informed that an international conference convened by the Organization for Economic Cooperation and Development in November 1997 would attempt to develop a coordinated approach to the issues of electronic commerce among interested Governments, intergovernmental organizations, non-governmental organizations and private sector groups. The Commission expressed the hope that those two events could be attended and reported upon by the Secretariat.²

6. This note contains revised draft provisions to be considered for possible inclusion in the Uniform Rules. These provisions deal with digital signatures, other electronic signatures, certification authorities and related legal issues. They were prepared pursuant to the deliberations and decisions of the Working Group at its thirty-first session, as reflected in the report of that session (A/CN.9/437) and also pursuant to the deliberations and decisions of the Commission at its thirtieth session, as reproduced above. In particular, the draft provisions are based on the working assumption adopted by the Working Group that its work in the area of digital signatures would take the form of draft statutory provisions (A/CN.9/437, para. 27). They are also intended to reflect the decision made by the Working Group at its previous session that possible uniform rules in the area of digital signatures should be derived from article 7 of the Model Law and should be considered as setting out a manner in which a reliable method could be used "to identify a person" and "to indicate that person's approval" of the information contained in a data message. More generally, pending a final decision as to the relationship between the Model Law, the Uniform Rules and possible rules on incorporation by reference (see A/CN.9/437, paras. 151-155), the draft provisions are intended to be consistent with the principles expressed, and the terminology used, in the Model Law (A/CN.9/437, para. 26).

7. This note does not deal with the issues of jurisdiction, applicable law and dispute settlement on the Internet, the formation and performance of contracts in an electronic environment, or with any other issue that may need to be considered by the Working Group at a future session. An oral report will be presented to the Working Group regarding the colloquium on the issues of jurisdiction and applicable law on the Internet, which was held in June 1997 under the auspices of the Hague Conference on Private International Law and the international conference convened by the OECD in November 1997 (see para. 5, above).

8. In the preparation of this note, the Secretariat was assisted by a group of experts, comprising both experts invited by the Secretariat and experts designated by interested governments and international organizations.

II. GENERAL REMARKS

9. The purpose of the Uniform Rules, as reflected in the draft provisions set forth in part II of this note, is to facilitate the increased use of electronic signatures in international business transactions. Drawing on the many legisla-

²Ibid., *Fifty-second Session, Supplement No. 17 (A/52/17)*, paras. 249-251.

tive instruments already in force or currently being prepared in a number of countries, these draft provisions aim at preventing disharmony in the legal rules applicable to electronic commerce by providing a set of standards on the basis of which the legal effect of digital signatures and other electronic signatures may become recognized, with the possible assistance of certification authorities, for which a number of basic rules are also provided.

10. Focused on the private-law aspects of commercial transactions, the Uniform Rules do not attempt to solve all the questions that may arise in the context of the increased use of electronic signatures. In particular, the Uniform Rules do not deal with aspects of public policy, administrative law, consumer law or criminal law that may need to be taken into account by national legislators when establishing a comprehensive legal framework for electronic signatures.

11. Based on the Model Law, the Uniform Rules are intended to reflect in particular: the principle of media-neutrality; an approach under which functional equivalents of traditional paper-based concepts and practices should not be discriminated against; and extensive reliance on party autonomy. They are intended for use both as minimum standards in an "open" environment (i.e. where parties communicate electronically without prior agreement) and as default rules in a "closed" environment (i.e. where parties are bound by pre-existing contractual rules and procedures to be followed in communicating by electronic means).

III. DRAFT PROVISIONS ON DIGITAL SIGNATURES, OTHER ELECTRONIC SIGNATURES, CERTIFICATION AUTHORITIES AND RELATED LEGAL ISSUES

Chapter I. Sphere of application and general provisions

12. In considering the draft provisions proposed for inclusion in the Uniform Rules, the Working Group may wish to consider more generally the relationship between the Uniform Rules and the Model Law. In particular, the Working Group might wish to make proposals to the Commission as to whether uniform rules on digital signatures should constitute a separate legal instrument or whether they should be incorporated in an extended version of the Model Law, for example as a new part III of the Model Law.

13. If the Uniform Rules are prepared as a separate instrument or as an addition to the Model Law, it is submitted that they will need to incorporate provisions along the lines of articles 1 ("Sphere of application"), 2(a), (c) and (e) ("Definitions of 'data message', 'originator' and 'addressee'"), 3 ("Interpretation"), 7 ("Signature") and 13 ("Attribution of data messages") of the Model Law. While those articles are not reproduced in this note, it should be noted that the draft provisions of the Uniform Rules have been prepared by the Secretariat based on the assumption

that such provisions would form part of the Uniform Rules. With respect to the sphere of application of the Uniform Rules, it should be borne in mind that under article 1 of the Model Law, transactions involving consumers, while not the focus of the Uniform Rules, would not be excluded from their sphere of application unless the law applicable to consumer transactions in the enacting State conflicted with the Uniform Rules (see A/CN.9/WG.IV/WP.71, paras. 49-50).

14. As to the question of party autonomy, the mere reference to article 4 (Variation by agreement) of the Model Law may not suffice to provide a satisfactory solution, in view of the fact that article 4 establishes a distinction between those provisions of the Model Law that may be freely varied by contract and those provisions that should be regarded as mandatory unless variation by agreement is authorized by the law applicable outside the Model Law. With respect to electronic signatures, the practical importance of “closed” networks makes it necessary to provide wide recognition of party autonomy. However, public policy restrictions on freedom of contract, including laws protecting consumers from overreaching contracts of adhesion, may also need to be taken into consideration. The Working Group may thus wish to include in the Uniform Rules a provision along the lines of article 4(1) of the Model Law to the effect that, except as otherwise provided by the Uniform Rules or other applicable law, electronic signatures and certificates issued, received or relied upon in accordance with procedures agreed among the parties to a transaction are given the effect specified in the agreement. In addition, the Working Group might consider establishing a rule of interpretation to the effect that, in determining whether a certificate, an electronic signature or a data message verified with reference to a certificate, is sufficiently reliable for a particular purpose, all relevant agreements involving the parties, any course of conduct among them, and any relevant trade usage should be taken into account.

15. In addition to the above-mentioned provisions, the Working Group may wish to consider whether a preamble should clarify the purpose of the Uniform Rules, namely to promote the efficient utilization of digital communication by establishing a security framework and by giving written and digital messages equal status as regards their legal effect (see A/CN.9/WG.IV/WP.71, para. 51).

Chapter II. Electronic signatures

Section I. Secure electronic signatures

Article 1. Definitions

For the purposes of these Rules:

(a) “Signature” means any symbol used, or any security procedure adopted by [or on behalf of] a person with the intent to identify that person and to indicate that person’s approval of the information to which the signature is appended;

(b) “Electronic signature” means [a signature] [data] in electronic form in, or attached to, or logically

associated with, a data message [and used by [or on behalf of] a person with the intent to identify that person and to indicate that person’s approval of the contents of the data message] [and used to satisfy the conditions in [article 7 of the UNCITRAL Model Law on Electronic Commerce]];

(c) “Secure electronic signature” means an electronic signature which

- (i) is a digital signature under article 4 and meets the requirements set forth in article 5; or
- (ii) as of the time it was made, can otherwise be verified to be the signature of a specific person through the application of a security procedure that is: uniquely linked to the person using it; capable of promptly, objectively and automatically identifying that person; created in a manner or using a means under the sole control of the person using it; and linked to the data message to which it relates in a manner such that if the message is altered the electronic signature is invalidated; or
- (iii) [as between parties involved in generating, sending, receiving, storing or otherwise processing data messages in the ordinary course of their business,] is commercially reasonable under the circumstances, previously agreed to, and properly applied, by the parties.

References

A/CN.9/437, paras. 29-50 and 90-113 (draft articles A, B and C)
A/CN.9/WG.IV/WP.71, paras. 52-60

Remarks

16. Draft article 1 is intended to reflect the decision reached by the Working Group at its thirtieth session that, consistent with media neutrality in the Model Law, the Uniform Rules should not discourage the use of any technique that would provide a “method as reliable as appropriate” as an alternative to handwritten and other paper-based signatures in compliance with article 7 of the Model Law. While the Uniform Rules may focus on issues of digital signatures, a more general approach should also be taken, and issues relevant to other electronic signature techniques could also be considered (see A/CN.9/437, para. 22).

17. Through a definition of “signature” and “electronic signature” in subparagraphs (a) and (b), the scope of the Uniform Rules is thus delineated in broad terms to cover all techniques that might be applied to provide the functional equivalent of a handwritten signature, as understood in article 7 of the Model Law. It should be noted that the definition of “signature”, which merely restates article 7(1)(a) of the Model Law in the form of a definition, is not intended to replace or otherwise affect any definition of “signature” or “handwritten signature” that might exist

outside the Uniform Rules (e.g. in domestic legislation or case law). That definition is intended mostly to serve as a basis for the subsequent definitions of “electronic signature” and “secure electronic signature”. It may also serve as a useful reference in countries where no definition of “signature” currently exists.

18. The three levels of definition set forth in draft article 1 (i.e. “signature”, “electronic signature” and “secure electronic signature”) are intended to provide the Working Group with an analytic tool, and to reflect a distinction which has become familiar in draft legislation in a number of countries. However, depending on the contents of the Uniform Rules, not all three definitions may be necessary. Should the Working Group decide to focus on one legal effect of electronic signatures (i.e. recognition as a functional equivalent to handwritten signatures), only one category of “electronic signatures” might need to be considered. The notions currently defined as “electronic signature” and “secure electronic signature” could thus be merged into one legal category, irrespective of the number and variety of techniques that would be considered under that legal category.

19. The main definition to be relied upon for the purposes of delineating the scope of the Uniform Rules is that currently embodied in subparagraph (c) under the heading “secure electronic signature”. As a matter of drafting, it may be noted that the word “secure” is not intended to indicate that any given technique may, in fact or in law, provide absolute security. It is merely intended to qualify a higher level of trustworthiness of an electronic signature by reference to a set of criteria which, once met, would entail certain legal effects.

20. Aimed at providing a basis for the legal effects to be derived from the use of electronic signatures, subparagraph (c) is also intended to reflect the “dual approach” adopted by the Working Group at its previous session. The “dual approach” stemmed from the two alternatives under debate, namely the establishment of criteria for a governmental authorization of certification authorities and the recognition of operation criteria for certification authorities functioning outside a governmentally-implemented public-key infrastructure. The Working Group came to the conclusion that those two alternatives might not be mutually exclusive. The difference between the two situations might reside in the modalities under which legal effect might be given to digital signatures in one or the other case. In the case of governmentally-authorized (or “licensed”) certification authorities, the fulfilment of the applicable operation criteria by a certification authority would constitute a prerequisite for the authorization of that certification authority, which, in turn, would be a condition for the recognition of the legal effectiveness of the certificates issued by that certification authority. In the second situation, a certification authority would not need to demonstrate that the operation criteria were met prior to beginning to function. However, if the certificates it issued were to be challenged (e.g. in a judicial dispute or arbitration), the adjudicating body would need to assess the trustworthiness of the certificate by determining whether it had been issued by a certification authority meeting those criteria (see A/CN.9/437, para. 48).

21. In addition to allowing for the operation of both licensed and non-licensed certification authorities, subparagraph (c) further opens the sphere of application of the Uniform Rules to cover authentication devices that would operate without requiring reliance on any kind of certification authority or other “trusted third party”. The reference to the “secure” status thus allows to introduce both licensing schemes through which enacting States might establish the quality and reliability of digital signatures, and market-driven practices that might rely on other forms of electronic signatures.

22. Under subparagraph (c)(i), the secure status would be presumed under the Uniform Rules if a digital signature was applied in conformity with a public-key infrastructure established by the enacting State. In the absence of, or in addition to, such a public-key infrastructure, any kind of electronic signature (i.e. digital and other electronic signatures applied with or without the intervention of certification authorities or other trusted third parties) could be granted secure status, provided that minimum requirements were met. With a view to providing a basic standard against which the quality of such electronic signatures might be assessed, subparagraph (c)(ii) lists four criteria: uniqueness, identification, reliability, and linkage with the information being signed.

23. The requirement that a secure electronic signature be “uniquely linked” to the person applying it is intended to ensure that there is no reasonable likelihood that more than one person would produce the same signature absent fraud or other improper conduct. The requirement of uniqueness could also presumably be satisfied by a biometric-based signature that would incorporate certain attributes unique to the signer, such as a fingerprint or a retinal scan. This requirement would also be satisfied with respect to a digital signature where the key pair used by the signer was randomly generated and of sufficient key length, so that the likelihood of anyone else generating the same key pair would be extremely remote.

24. A secure signature should be such that it can be used to identify the signer. This does not mean that the signature itself must consist of or include the signer’s name. Identification by reference to other sources of information would be sufficient. Thus, for example, a digital signature may identify the signer by reference to a certificate issued by a certification authority. The main requirement is that the identification process must be relatively prompt, objective, and automatic. Thus, for example, while a handwritten signature is presumably capable of identifying the signer, such identification cannot normally be made promptly or automatically, and is frequently not an objective determination. In many cases, the signature itself is not readable. Even where it is readable, that signature may ultimately be capable of identifying the signer, but the timing and certainty of the identification process may not always satisfy the requirements of electronic commerce. Thus, a handwritten signature may not always be reliably identified as the signature of a particular individual (in the absence of an admission of that fact or a witness to the signing) without the testimony of an expert in handwriting analysis who has compared admitted signatures of the purported signer with the signature in question. In such a

case, the result is unlikely to be prompt or automatic, and the conclusion of the expert is in many respects subjective rather than objective. By contrast, the use of a personal identification number (PIN) in an automatic teller machine provides the bank with an automatic, objective, and prompt identification of a specific person that is tied to a specific address and a specific account number when the funds are withdrawn. Such a person is not in a position to deny that the request for funds contains his or her signature (although that person may deny having signed the request; that is the subject of the reliability requirement).

25. In addition to identifying a person as the signer of a message, the procedure used to sign the message must provide a reasonably reliable assurance that the person identified as the signer is in fact the person who signed the message. A security procedure that requires the use of a manner or means that is under the sole control of the person creating the signature may satisfy such a reliability requirement. The use of a trusted third party may also provide the requisite level of reliability. There may also exist other means by which this requirement can be met. The Working Group may wish to discuss other approaches through which an acceptable level of reliability can be assured.

26. A secure signature must be linked to the data message being signed, in such a manner that if the message is changed the signature is invalidated. Such a linkage may be regarded as a crucial requirement for a secure signature, since otherwise the signature could be simply excised from one data message and pasted on to another.

27. Subparagraphs (c)(i) and (ii) are intended to apply in the absence of a pre-existing contractual arrangement regarding electronic signatures between the originator and the addressee of the data message being signed. However, consistent with the approach taken in the Model Law, the Uniform Rules may need to reaffirm the validity of contractual schemes with respect to authentication of data messages. Subparagraph (c)(iii) thus validates closed-system agreements. The Working Group may wish to discuss whether the wording between square brackets (“as between parties involved in generating, sending, receiving, storing or otherwise processing data messages in the ordinary course of their business,”), which mirrors wording used in the Model Law, is needed to limit the effect of party autonomy to business uses of electronic signatures, to the exclusion of transactions involving consumers (see A/CN.9/437, para. 24).

Article 2. Presumptions

(1) With respect to a data message authenticated by means of a secure electronic signature, it is rebuttably presumed that:

(a) the data message has not been altered since the time the secure electronic signature was affixed to the data message;

(b) the secure electronic signature is the signature of the person to whom it relates; and

(c) the secure electronic signature was affixed by that person with the intention of signing the message.

(2) With respect to a data message authenticated by means of an electronic signature other than a secure electronic signature, nothing in these Rules affects existing legal or evidentiary rules regarding the burden of proving the authenticity and integrity of a data message or an electronic signature.

(3) The provisions of this article do not apply to the following: [...].

[(4) The presumptions in paragraph (1) may be rebutted by:

(a) evidence indicating that a security procedure used to verify an electronic signature is not to be generally recognized as trustworthy, due to advances in technology, the way in which the security procedure was implemented, or other reasons;

(b) evidence indicating that the security procedure agreed to between the parties under article 1(c)(iii) was not implemented in a trustworthy manner; or

(c) evidence relating to facts of which the relying party was aware which would suggest that reliance on the security procedure was not reasonable. The commercial reasonableness of a security procedure agreed upon by the parties under article 1(c)(iii) is to be determined in light of the purposes of the procedure and the commercial circumstances at the time the parties agreed to adopt the procedure, including the nature of the transaction, sophistication of the parties, volume of similar transactions engaged in by either or both of the parties, availability of alternatives offered to but rejected by the party, cost of alternative procedures, and procedures in general use for similar types of transactions.]

References

A/CN.9/437, paras. 43, 48 and 92

Remarks

28. Draft article 2 focuses on the legal effects flowing from recognition of the “secure electronic signature” status. At its previous session, the Working Group discussed the possibility that certain issues of electronic signatures (e.g. liability of certification authorities, and attribution of digitally signed messages) might be dealt with by way of presumptions (see A/CN.9/437, paras. 58, 70 and 120-121).

29. The concept of a secure electronic signature, and the rebuttable presumptions that flow from that status may be regarded as critical to enabling a viable system of electronic commerce. With paper-based transactions, a number of indicators can be used by a relying party to determine whether the document is authentic and the signature genuine. These include the use of paper (sometimes with water-marks, coloured backgrounds, or other indicators of reliability) to which the message is affixed, the use of letterhead, handwritten signatures, or delivery in sealed envelopes via a trusted third party (such as postal services). With electronic communications, however, none of these factors of reliability are present. All that can be communicated is a set of electronic impulses that are in all respects identical, and can easily be copied or modified. Thus, in many cases it is important for the addressee and

for any other party relying on an electronic communication to know, at the time of receipt or reliance, whether the message is authentic, whether the integrity of its contents has been preserved, and whether it will be able to establish both of those facts in the event of a subsequent dispute (e.g. to establish in court the non-repudiation of a data message). To that end, the existence of rebuttable presumptions with respect to secure signatures may provide such assurances to relying parties thereby enabling them to engage in commercial activities with confidence that their transactions will be easier to enforce if that should become necessary.

30. The effect of the presumptions in draft article 2 should be distinguished from the effect of attribution under draft article 3. The presumptions in draft article 2 are designed to ease the burden of proving the source of an electronic message when the recipient has verified the apparent source of the message by use of a secure electronic signature. The person to whom the signature relates is thus required to prove that, notwithstanding the addressee's verification of the secure electronic signature and reliance on the security procedure, the signature was not that of that person. As a justification for establishing such a presumption, it may be noted that the evidence necessary to prove who actually sent the message is normally in the possession of the person to whom the signature relates. For example, in the case of a digital signature, the person to whom the signature relates is ordinarily in a better position than any other relying party to prove that the private key was stolen, copied, compromised, or used without authority by a third person. In a typical situation, the recipient of the message will have no evidence other than the security procedure used with which to prove that the person to whom the signature relates did, in fact, send the message. However, under draft article 3, even if the party to whom the signature relates can establish that it did not send the message in question, it may nevertheless be liable for losses caused to the recipient who reasonably relied if the requirements of draft article 3 are met.

31. Consistent with the approach taken in article 7 of the Model Law, paragraph (1) does not create a presumption that the data message bearing a secure electronic signature constitutes a legally binding obligation. Paragraph (1) merely presumes that the secure electronic signature was affixed by the purported signer with the intention of signing the message. If there is evidence that the person whose signature was affixed was the victim of mistake, misrepresentation, duress, or other invalidating cause, the message may be denied legal effect, but the burden of raising these issues rests with the person denying the legal effect of the data message.

32. Paragraph (2) makes it clear that, in the absence of a secure electronic signature, nothing in the Uniform Rules changes the ordinary rules of evidence about the burden of proving the source of a message. Paragraph (3) is modelled on similar provisions in the Model Law. It is intended to facilitate the exclusion of certain situations from the benefit of draft article 2 in cases where a legitimate interest would require such an exclusion by the enacting State. For example, enacting States may decide that the presumptions established in draft article 2 do not apply in

the area of criminal law. Paragraph (4) lists a number of ways in which the presumption established in paragraph (1) may be rebutted. The Working Group may wish to discuss whether such an illustrative provision is needed in the text of the Uniform Rules or whether it should be considered in the context of a guide or commentary.

Article 3. Attribution

(1) *Variant A:* Subject to [article 13 of the UNCITRAL Model Law on Electronic Commerce], the originator of a data message on which the originator's secure electronic signature is affixed is [bound by the content] [deemed to be the signer] of the message in the same manner as if the message had existed in a [manually] signed form in accordance with the law applicable to the content of the message.

Variant B: As between the holder of a private key and any third party who relies on a digital signature which can be [verified][authenticated] by using the corresponding certified public key, the digital signature [is presumed to be that of the holder] [satisfies the conditions set forth in [article 7(1) of the UNCITRAL Model Law on Electronic Commerce]].

(2) Paragraph (1) does not apply if

(a) the [originator] [holder] can establish that the [secure electronic signature] [private key] was used without authorization and that the [originator] [holder] could not have avoided such use by exercising reasonable care; or

(b) the relying party knew or should have known, had it sought information from the [originator] [certification authority] or otherwise exercised reasonable care, that the [secure electronic] [digital] signature was not that of the [originator] [holder of the private key].

References

A/CN.9/437, paras. 118-124 (draft article E)
A/CN.9/WG.IV/WP.71, paras. 64-65

Remarks

33. At its previous session, the Working Group generally felt that no attempt should be made to restate in the context of the Uniform Rules the principles set forth in article 13 of the Model Law (see A/CN.9/437, paras. 119-120). However, it was also felt that the relationship between the Uniform Rules and articles 7 and 13 of the Model Law needed to be clarified. To that effect, variant A of paragraph (1), which reflects a principle that was found generally acceptable by the Working Group at its previous session (see A/CN.9/437, para. 120), is worded in broad terms to encompass both digital signatures and alternative techniques that may be used for producing a secure digital signature.

34. Variant B creates a presumption that a digital signature fulfils the requirements for a “reliable method” under article 7 of the Model Law. The Working Group may wish to consider whether such a presumption should be extended to cover not only digital signatures but also other instances where a secure electronic signature is used. Should the Working Group wish to limit the scope of the provision to digital signatures, draft article 3 would need to be relocated accordingly.

35. The Working Group may wish to discuss whether draft article 3 might be used to deal more precisely with the question of when a person can be held accountable for the content of a data message where that message was not in fact sent by that person, and the message is communicated in an open environment (i.e. without a prior agreement being made directly between the originator and the recipient of the message (or in the context of “system rules”) as to the procedure to be applied for determining the attribution of the data message). While article 13(3)(a) of the Model Law deals with that issue where “a procedure previously agreed to by the originator” is used, the Model Law does not deal expressly with the open environment. Given the high level of security inherent in secure electronic signatures, the Working Group may wish to consider whether a general rule might be established to the effect that the recipient of a data message who reasonably relies on a secure electronic signature is entitled to regard that message as being that of the originator.

36. As an example of a provision to that effect, the Working Group may wish to consider the following wording:

Except as provided by other applicable law, a secure electronic signature is attributable to the person to whom it appears to relate, whether or not authorized by that person, if:

(a) the electronic signature resulted from acts of a person that obtained the access numbers, codes, computer programs, or other information necessary to create the signature from a source under the control of the purported signer, creating the appearance that it came from that person;

(b) the access occurred under circumstances resulting from a failure to exercise reasonable care by the purported signer; and

(c) the recipient relied in good faith to its detriment on the apparent source of the data message.

The effect of such wording is to allocate the risk of loss between the two interested parties, i.e. the purported originator who did not actually sign the message in question, and the recipient who relied on the message in good faith pursuant to a commercially reasonable security procedure. The risk of loss is put on the purported originator only in the situation where the message bears the signature of the purported originator as a result of the purported originator’s fault. Such a situation may occur where the signature was created by a person who obtained the necessary information from a source under the control of the purported originator and where such access occurred under circumstances resulting from a failure to exercise reasonable care

by the purported originator. In such a case, if the recipient reasonably relies on the message, the purported originator will be bound. In all other cases, the risk of loss will fall on the recipient notwithstanding any reasonable reliance. The reference to “other applicable law” in the opening words may be necessary to exclude consumer transactions from the scope of the suggested rule.

Section II. Digital signatures

Article 4. Definition

For the purposes of these Rules,

Variant A: “digital signature” means a type of an electronic signature consisting of a transformation of a data message using a message digest function and an asymmetric cryptosystem such that any person having the initial untransformed data message and the signer’s public key can accurately determine:

(a) whether the transformation was created using the signer’s private key that corresponds to the signer’s public key; and

(b) whether the initial data message has been altered since the transformation was made.

Variant B: (a) “digital signature” means a numerical value, which is affixed to a data message and which, using a known mathematical procedure associated with the originator’s private cryptographic key, makes it possible to determine that this numerical value has only been obtained with the originator’s private key;

(b) the mathematical procedures used for generating digital signatures under these Rules are based on public-key encryption. When applied to a data message, those mathematical procedures operate a transformation of the message such that a person having the initial message and the originator’s public key can accurately determine:

(i) whether the transformation was operated using the private key that corresponds to the originator’s public key; and

(ii) whether the initial message was altered after the transformation was made.

References

A/CN.9/437, paras. 30-38 (draft article A)
A/CN.9/WG.IV/WP.71, paras. 18-45 and 55-56

Remarks

37. The differences between variants A and B are mostly of a drafting nature. While variant B reflects the conclusions reached by the Working Group at its previous session (see A/CN.9/437, para. 32), variant A provides simpler wording,

building upon the definition of “electronic signature”. In both variants, “digital signature” is defined without reference to “certification authorities” or “certificates”.

38. No attempt has been made to provide definitions of “private key”, “public key”, “key pair” or other concepts relating to public-key cryptography. While suggestions for additional definitions were made at the previous session of the Working Group, a note of caution was struck about introducing a large number of definitions in uniform rules of a statutory nature, which might be contrary to the legislative tradition in many countries. The Working Group may wish to discuss the extent to which additional definitions might be necessary (see A/CN.9/437, para. 29).

Article 5. *Effects*

(1) Where all or any portion of a data message is signed with a digital signature, the digital signature is regarded as a secure electronic signature with respect to such portion of the message if:

(a) the digital signature was created during the operational period of a [valid] certificate and is verified by reference to the public key listed in the certificate; and

(b) the certificate is considered as accurately binding a public key to a person’s identity because:

(i) the certificate was issued by a certification authority licensed [accredited] by ... [*the enacting State specifies the organ or authority competent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities*]; or

(ii) the certificate was otherwise issued by a certification authority in accordance with standards issued by ... [*the enacting State specifies the organ or authority competent to issue recognized standards for the operation of licensed certification authorities*].

(2) Where all or any portion of a data message is signed with a digital signature that does not meet the requirements set forth in paragraph (1), the digital signature is regarded as a secure electronic signature with respect to such portion of the message if sufficient evidence indicates that the certificate accurately binds the public key to the holder’s identity.

(3) The provisions of this article do not apply to the following: [...].

References

A/CN.9/437, paras. 43, 48 and 92

Remarks

39. Digital signatures, if properly implemented, should constitute secure electronic signatures. However, a question is to determine when the implementation of a digital signature has been done in a manner such that it is entitled to secure status. Not all digital signatures verifiable with reference to a certificate are secure, especially where there

is uncertainty as to whether the identification or authentication of the holder or the public key is accurate. The primary factors that determine whether a digital signature is secure include: (1) whether the certification authority has properly identified the holder; (2) whether the certification authority has properly authenticated the holder’s public key; (3) whether the holder’s private key has been compromised; and (4) whether the process is trustworthy (e.g. whether the public key algorithm and the key length used are appropriate).

40. Paragraph (1) sets forth two basic criteria for determining when a digital signature qualifies as a secure electronic signature. The first criterion requires that the signature be created during the operational period of a valid certificate and be verified by reference to the public key listed in the certificate. The operational period of a certificate normally begins at the time it is issued and ends upon the earlier of expiration, revocation or suspension.

41. The second step involves providing assurance that the certificate itself accurately identifies a person as the holder of the private key corresponding to the public key specified in the certificate. The trustworthiness of the certificate may be assessed by reference to standards, procedures, and other requirements specified by authorities recognized in the enacting State. Such standards may be established through accreditation of certification authorities by third parties, the voluntary licensing of certification authorities, or otherwise require compliance with rules adopted by the enacting State.

42. Alternatively, under paragraph (2), if a court or other trier of fact determines, as a matter of evidence, that the information stated in the certificate is in fact true, then the trustworthiness of the certificate is obvious. At this stage, however, the trier of fact is required to determine on a case-by-case basis whether the certificate was issued by a certification authority that properly identified the holder and authenticated the holder’s public key.

43. Consistent with the “dual approach” taken by the Working Group, draft article 5 is intended to provide as much latitude as possible for making a determination as to the trustworthiness of a certificate issued by a certificate authority. This flexibility is particularly important in light of the fact that the use of digital signatures is new and the models for its use as well as its regulation have not yet fully developed. Thus, it is important to facilitate the increased use of digital signatures in electronic commerce, while at the same time establishing the standards necessary to make a presumptive determination as to the reliability of a digitally signed message.

44. It is also important to note that while one of the options set forth in draft article 5 includes a judicial determination of the accuracy of a certificate, the other option presumes the accuracy of a certificate if it was issued by a certification authority accredited by the enacting State or if it otherwise meets certain standards established by the enacting State. In such a case, a judicial finding of accuracy is not required in order to qualify for a secure electronic signature status. The second option may be helpful to persons engaging in electronic commerce, who would know in advance of acting in reliance on a communication

whether such action can be enforced. However, the presumption of accuracy may be rebutted by showing that a certificate issued by such an accredited certification authority is, in fact, not accurate or reliable.

[Article 6. Signature by legal persons

A legal person may identify a data message by affixing to that message the public cryptographic key certified for that legal person. The legal person shall only be regarded as [the originator][having approved the sending] of the message if the message is also digitally signed by the natural person authorized to act on behalf of that legal person.]

References

A/CN.9/437, paras. 114-117 (draft article D)
A/CN.9/WG.IV/WP.71, paras. 61-63

Remarks

45. At the previous session, it was widely felt that draft article 6 should be deleted. After discussion, however, the Working Group decided that it should be placed between square brackets, for further consideration at a later session (A/CN.9/437, paras. 115 and 117). While a provision along the lines of draft article 6 may be seen as inappropriately interfering with other bodies of law (e.g. the law of agency, and the provisions of company law dealing with representation of companies by natural persons), it may also be useful at the current stage of development of the Uniform Rules, as a reminder that the Working Group may need to discuss more fully the extent to which the Uniform Rules should validate the operation of “electronic agents” for the purpose of automatically authenticating data messages.

Section III. Other electronic signatures

46. Since no information was communicated to the Secretariat as to how authentication techniques other than digital signatures might be dealt with under the Uniform Rules, no specific provision has been prepared for inclusion in this section. The Working Group may wish to discuss whether such authentication techniques should be dealt with in more detail in the Uniform Rules. Should the Working Group come to the conclusion that such techniques should not be addressed more specifically, the Uniform Rules would still favour the increased use of alternatives to digital signatures, through the principle of non-discrimination embodied in the definitions of “signature” and “secure electronic signatures”, and through the legal status recognized to any authentication technique that would qualify as a “secure electronic signature”.

Chapter III. Certification authorities and related issues

Article 7. Certification authority

(1) For the purposes of these Rules, “certification authority” means:

(a) any person or entity licensed [accredited] by ...
[the enacting State specifies the organ or authority com-

petent to license certification authorities and to promulgate regulations for the operation of licensed certification authorities] to act in pursuance of these Rules; or

(b) any person who, or entity which, as an ordinary part of its business, engages in issuing certificates in relation to cryptographic keys used for the purposes of digital signatures.

[(2) A certification authority may offer or facilitate registration and time stamping of the transmission and reception of data messages as well as other functions regarding communications secured by means of digital signatures.]

References

A/CN.9/437, paras. 39-50 and 90-97 (draft article B)
A/CN.9/WG.IV/WP.71, paras. 18-45 and 57-58

Remarks

47. As indicated in the context of draft article 1, the Uniform Rules should provide legal recognition for both the situation where an enacting State wishes to regulate the operation of certification authorities through a public-key infrastructure or other licensing scheme, and the situation where unlicensed certification authorities may operate freely under market-driven practice standards (see paras. 17-18, above).

48. In dealing with licensed certification authorities, paragraph (1) does not attempt to define criteria to be used by enacting States in implementing a public-key infrastructure or other licensing scheme for certification authorities. A reason for not dealing with those criteria may be the strong public policy component of such public-key infrastructures, which may not easily lend themselves to international harmonization by way of model legislative provisions. Should the Working Group engage in more detailed consideration of the criteria to be used in the context of a licensing scheme, it may wish to consider the following factors, to be taken into account when assessing the trustworthiness of a certification authority: (a) independence (i.e. absence of financial or other interest in underlying transactions); (b) financial resources and financial ability to bear the risk of being held liable for loss; (c) competence of the personnel at the managerial level, expertise in public-key technology and familiarity with proper security procedures; (d) longevity (certification authorities may be required to produce evidence of certification or decryption keys many years after the underlying transaction has been completed, in the context of a lawsuit or property claim); (e) approval of hardware and software; (f) maintenance of an audit trail, and audit by an independent entity; (g) existence of a contingency plan (e.g. “disaster recovery” software or key escrow); (h) personnel selection and management; (i) protection arrangements for the certification authority’s own private key; (j) internal security; (k) arrangements for termination of operations, including notice to users; (l) warranties and representations (given or excluded); (m) limitation of liability; (n) insurance; (o) inter-operability with other certification authorities; (p) revocation procedures (in cases where cryptographic keys might be lost or compromised); (q) isolation of the certifying function from any other

business that the certification authority might pursue (see A/CN.9/WG.IV/WP.71, para. 44 and A/CN.9/437, para. 45).

49. Paragraph (1)(b) defines “certification authority” without any mention of governmental authorization, by reference to its function as the issuer of certificates. Such a provision, in combination with paragraph (2), is also intended to reflect the fact that, while certification authorities may perform other functions and offer services in addition to issuing certificates, such functions and services are outside the sphere of application of the Uniform Rules and should not be taken into account when dealing with the legal effects of electronic signatures. The Working Group may wish to discuss whether a provision along the lines of paragraph (2), which is mainly descriptive in nature should form part of the Uniform Rules or whether it should rather be expressed in a guide or commentary.

Article 8. Certificate

For the purposes of these Rules, “certificate” means a data message [or other record] which, at least:

- (a) identifies the certification authority issuing it;
- (b) names or identifies its holder or a device or electronic agent under the control of the holder;
- (c) contains a public key which corresponds to a private key under the control of the holder;
- (d) specifies its operational period [and existing restrictions, if any, on the scope of use of the public key]; and
- (e) is [digitally] signed by the certification authority issuing it.

References

A/CN.9/437, paras. 98-113 (draft article C)
A/CN.9/WG.IV/WP.71, paras. 18-45 and 59-60

Remarks

50. While a certificate may be used for performing a variety of functions and conveying additional information outside the scope of the Uniform Rules, the only function of a certificate addressed by the Uniform Rules is that of linking a public key to a given holder. Such a linkage may be done directly, by naming the holder of the public key in the certificate. It can also be done indirectly by describing certain attributes about the holder (e.g. a purchasing agent with authority to contract for purchases up to a given amount), or by describing a machine, device, or software agent under the control of the holder. Thus, for example, a certificate may be issued to an employee of a corporation specifying only the limits of such employee’s purchasing authorization. It might then be used in purchase transactions with trading partners where the identity of the individual employee is not important, but rather the main issues are whether that employee has authority to act on behalf of an identified person (i.e. the employer), and the limit of the employee’s purchasing authority. In all cases, however, there is a person, known as the “holder” who controls the private key that corresponds to the public key identified in the certificate and who is the person to whom

digitally signed messages verified by reference to the certificate are to be attributed. If no such person is identified, then the certificate cannot be used to verify that a digital signature is that of a specified person.

51. Draft article 8 is intended to reflect the elements regarded by the Working Group as the basic components of a certificate, namely, that a certificate should: be a data message; identify the certification authority; contain the public key of the holder; identify the holder; and be digitally signed by the certification authority (see A/CN.9/437, para. 101). As to whether a certificate should necessarily be in the form of a data message, the Working Group may wish to discuss whether the Uniform Rules should also cover paper-based certificates.

52. At the previous session, the Working Group decided that it might need to consider whether establishing a mandatory rule regarding the minimum information to be provided in a certificate might run counter to applicable law on data protection. It is submitted that, in view of the nature of the elements listed in draft article 8, such potential conflict is avoided.

53. The definition of “certificate” does not distinguish between different levels of security that may be provided commercially under the heading of a “certificate”. However, in preparing the Uniform Rules, the Working Group may bear in mind that certification authorities typically offer various classes of certificates. At the previous session of the Working Group, various suggestions were made for reflecting in the Uniform Rules the various levels of security that might result from the use of such certificates (see A/CN.9/437, paras. 20, 56, 138 and 145). As an example of such variety, the three classes of “certificates” listed below are reported as being available on the market.

54. Class I certificates confirm that a user’s name and electronic-mail address form an unambiguous subject name within the register, or “repository” maintained by the certification authority. They are typically used primarily for browsing on the Internet and for personal electronic mail, with the purpose of modestly enhancing the security of these environments. Class I certificates are not intended to authenticate the identity of the holder. Rather, they represent a simple check of the non-ambiguity of the subject name within the repository, and a limited verification of the electronic mail address. The holder’s name contained in a class I certificate is considered as non-verified information. These certificates provide a very low level of security. They are not intended for commercial use where proof of identity is required and should not be relied upon for such uses.

55. Class II certificates confirm that the information provided by the holder when applying for the certificate does not conflict with the information accessible in widely recognized consumer databases. Class II certificates are typically used for: (a) inter-organizational electronic mail; (b) low-value, low-risk transactions; (c) personal electronic mail; (d) password replacement; (e) software validation; and (f) on-line subscription services. Class II certificates provide a certain level of assurance as to the holder’s identity, based on an automated, on-line process.

56. Class III certificates provide important assurances as to the identity of the holder, for example by requiring personal (physical) appearance of the holder before an agent of the certification authority, or verification of its identity through appropriate identity documents. The private key corresponding to the public key contained in a class III certificate must be generated and stored in a trustworthy manner according to the requirements set forth by the certification authority. Class III certificates are used in practice for certain electronic commerce applications such as electronic banking, electronic data interchange (EDI), and membership-based on-line services. Class III certificate processes utilize various procedures to obtain probative evidence of the identity of individual subscribers. These validation procedures provide stronger assurances of an applicant's identity than class II certificates.

57. In the preceding examples, it is clear that only class III certificates would fall within the current scope of the Uniform Rules. The Working Group may wish to discuss whether the scope of the Uniform Rules should be expanded to cover also lower classes of certificates, in which case a decision would need to be made as to the various legal effects that would be attached to the various classes of certificates, in particular with respect to the level of liability that would be imposed on certification authorities with respect to the issuance of low-class certificates. Alternatively, the definition of "certificate" in the Uniform Rules might need to be amended to make it clear that lower-level certificates would not be covered by the Uniform Rules.

Article 9. Certification practice statement

For the purposes of these Rules, "certification practice statement" means a statement published by a certification authority that specifies the practices that the certification authority employs in issuing and otherwise handling certificates.

References

A/CN.9/437, paras. 60-62, 70, 110-111 and 149 (draft article J)
A/CN.9/WG.IV/WP.71, para. 89

Remarks

58. The degree to which any party relying on a certificate can trust the link between a person and a public key, as evidenced by a certificate, depends on several factors. Those factors include the practices and procedures followed by the certification authority in authenticating the holder of the key pair, and the certification authority's operating policy, procedures, and security controls. Certification practice statements are often presented by existing certification authorities as one of the main elements through which they promote reliance in the trustworthiness of the certificates they issue and, more generally, as the standard of quality and liability that should govern the relationship between certification authorities and their clients.

59. A certification practice statement is a statement by the certification authority of the policies it follows or the details of the practices, procedures, and systems that it

employs in its operations and in support of the issuance, management, and revocation of a certificate. Topics covered in a certification practice statement might include: (a) procedures used to authenticate the identity of the applicant for a certificate (prior to issuing the certificate); (b) the physical, procedural, and personnel controls used by the certification authority to perform securely the functions of key generation, certificate issuance, certificate revocation, audit, and archiving; (c) the security measures taken by the certification authority to protect its cryptographic keys; and (d) any related information. These issues are of importance both to the holder who is obtaining the certificate and to the relying parties who will use the certificate issued by the certification authority as the basis for entering into transactions with the holder.

60. The certification practice statement can take various forms, such as a contract involving all interested parties, or public notice to all interested parties. The main element, however, is notice to relying parties. The certification practice statement should constitute notice from the certification authority to all relying parties (including holders) of the practices employed by the certification authority in issuing, managing and revoking certificates.

Article 10. Representations upon issuance of certificate

Variant A

(1) By issuing a certificate, a certification authority represents to any person who reasonably relies on the certificate, or on a digital signature verifiable by the public key listed in the certificate, that:

(a) the certification authority has complied with all applicable requirements of these Rules in issuing the certificate and, if the certification authority has published the certificate or otherwise made it available to such a relying person, that the holder listed in the certificate [and rightfully holding the corresponding private key] has accepted it;

(b) the holder identified in the certificate [rightfully] holds the private key corresponding to the public key listed in the certificate;

(c) the holder's public key and private key constitute a functioning key pair;

(d) all information in the certificate is accurate as of the date it was issued, unless the certification authority has stated in the certificate [or incorporated by reference in the certificate a statement] that the accuracy of specified information is not confirmed; and

(e) to the certification authority's knowledge, there are no known, material facts omitted from the certificate which would, if known, adversely affect the reliability of the foregoing representations.

(2) Subject to paragraph (1), the certification authority which issues a certificate represents to any person who reasonably relies on the certificate, or on a digital signature verifiable by the public key listed in the certificate, that the certification authority has issued the certificate in accordance with any applicable certification practice statement [incorporated by reference in the certificate, or] of which the relying person has notice.

Variant B

(1) By issuing a certificate, a certification authority represents to the holder, and to any person who relies on information contained in the certificate[, in good faith and] during its operational period, that:

(a) the certification authority has [processed] [approved] [issued], and will manage and revoke if necessary, the certificate in accordance with:

- (i) these Rules;
- (ii) any other applicable law governing the issuance of the certificate; and
- (iii) any applicable certification practice statement stated or incorporated by reference in the certificate, or of which such person has notice, if any;

(b) the certification authority has verified the identity of the holder to the extent stated in the certificate or any applicable certification practice statement, or in the absence of such a certification practice statement, the certification authority has verified the identity of the holder in a [reliable] [trustworthy] manner;

(c) the certification authority has verified that the person requesting the certificate holds the private key corresponding to the public key listed in the certificate;

(d) except as set forth in the certificate or any applicable certification practice statement, to the certification authority's knowledge, all other information in the certificate is accurate as of the date the certificate was issued;

(e) if the certification authority has published the certificate, the holder identified in the certificate has accepted it.

[(2) If a certification authority issued the certificate subject to the laws of another jurisdiction, the certification authority also makes all warranties and representations, if any, otherwise applicable under the law governing its issuance.]

References:

A/CN.9/437, paras. 51-73 (draft article H)
A/CN.9/WG.IV/WP.71, paras. 70-72

Remarks

61. Draft article 10 is intended to reflect the decision made by the Working Group that, in principle, the draft Uniform Rules should contain provisions regarding the liability incurred by certification authorities in the context of their participation in digital signature schemes (A/CN.9/437, para. 55). The minimum standard of liability set forth in draft article 10 is intended to apply only to the issuance of certificates for the purposes of digital signatures, as defined in draft article 4. The draft Uniform Rules do not attempt to deal with other activities or services that might be performed by certification authorities. Such activities and services may be subject to contractual arrangement between certification authorities and their customers, and to any other applicable law (A/CN.9/437, para. 71).

62. At its thirty-first session, the Working Group generally agreed that wording along the lines of paragraph (1) of variant A was, for the most part, acceptable in substance as the basis for future discussions. Although it does not expressly establish a rule on liability, paragraph (1) sets a minimum standard from which the parties should not be allowed to derogate by private agreement. In particular, no clause limiting the liability of a certification authority should be considered within the scope of any protection or benefit provided by the Uniform Rules if it conflicts with the above-mentioned requirements. Where the liability of a certification authority is alleged, the certification authority is presumed to be liable for the consequences of issuing a certificate, unless it can prove that it meets the requirements listed in paragraph (1). However, should a certification authority wish to undertake obligations stricter than the representations listed in paragraph (1), it should be allowed to do so, by way of clauses included in a certification practice statement or otherwise (A/CN.9/437, para. 70). Paragraph (2) is intended to address situations where certification practice statements would contain such stricter standards.

63. Variant B, while inspired by variant A, places stronger emphasis on self-regulation by certification authorities. In particular in subparagraph (b), the certification authority does not warrant that the holder rightfully holds the private key. Instead, the certification authority warrants that, for the purpose of establishing the link between the holder and the private key, it followed at least the procedures set forth in its certification practice statement or used "reliable" or "trustworthy" methods for identifying the holder. Paragraph (2) of variant B makes it clear that paragraph (1)(a)(ii) also applies where the certificate is issued under the laws of another jurisdiction. The Working Group may wish to decide whether such clarification should be expressed in the Uniform Rules or in a guide or commentary.

Article 11. Contractual liability

(1) As between a certification authority issuing a certificate and the holder of that certificate [or any other party having a contractual relationship with the certification authority], the rights and obligations of the parties are determined by their agreement.

(2) Subject to article 10, a certification authority may, by agreement, exempt itself from liability for any loss due to defects in the information listed in the certificate, technical breakdowns or similar circumstances. However, the clause which limits or excludes the liability of the certification authority may not be invoked if exclusion or limitation of contractual liability would be grossly unfair, having regard to the purpose of the contract.

(3) The certification authority is not entitled to limit its liability if it is proved that the loss resulted from the act or omission of the certification authority done with intent to cause damage or recklessly and with knowledge that damage would probably result.

References

A/CN.9/437, paras. 51-73 (draft article H)
A/CN.9/WG.IV/WP.71, paras. 70-72

Remarks

64. Paragraph (1) restates the principle of party autonomy in connection with the liability regime applicable to the certification authority. Paragraph (2) deals with the issue of exemption clauses, which are generally declared admissible, with two exceptions. The first exception comes from a reference to draft article 10, which is intended to set a minimum standard from which certification authorities should not be allowed to derogate (see para. 58, above). The second exception is inspired by the UNIDROIT Principles on International Commercial Contracts (article 7.1.6), as an attempt to provide a uniform standard for assessing the general acceptability of exemption clauses. It may be noted that the reference to the limitation or exemption of liability being “grossly unfair” suggests a flexible approach to exemption clauses. That approach may lead to broader recognition of limitation and exemption clauses than would otherwise be the case if the Uniform Rules were to refer merely to the law applicable outside the Uniform Rules.

65. Paragraph (3) deals with the situation where loss or other damage would result from intentional misconduct by the certification authority or its agents. The substance of the suggested rule is inspired by similar wording used in many international transport conventions, and recently used in article 18 of the UNCITRAL Model Law on International Credit Transfers (1992).^b

Article 12. Liability of the certification authority to parties relying on certificates

(1) In the absence of a contrary agreement, a certification authority which issues a certificate is liable to any person who reasonably relies on the certificate for:

(a) [breach of warranty under article 10] [negligence in misrepresenting the correctness of the information stated in the certificate];

(b) registering revocation of a certificate promptly upon receipt of notice of revocation of a certificate; and

(c) [the consequences of not] [negligence in] following:

(i) any procedure set forth in the certification practice statement published by the certification authority; or

(ii) any procedure set forth in applicable law.

(2) Notwithstanding paragraph (1), a certification authority is not liable if it can demonstrate that the certification authority or its agents have taken all necessary measures to avoid errors in the certificate or that it was impossible for the certification authority or its agents to take such measures.

(3) Notwithstanding paragraph (1), a certification authority may, in the certificate [or otherwise], limit the purpose for which the certificate may be used. The certification authority shall not be held liable for damages arising from use of the certificate for any other purpose.

(4) Notwithstanding paragraph (1), a certification authority may, in the certificate [or otherwise], limit the

value of transactions for which the certificate is valid. The certification authority shall not be held liable for damages in excess of that value limit.

References:

A/CN.9/437, paras. 51-73 (draft article H)
A/CN.9/WG.IV/WP.71, paras. 70-72

Remarks

66. Draft article 12 is intended to reflect the view expressed at the previous session that the Uniform Rules should contain a rule establishing a rebuttable presumption of liability. Under such a rule, for example, in the event of erroneous identification of a person or erroneous attribution of a public key to a person, the certification authority would be held liable for the loss sustained by any injured party, unless the certification authority could demonstrate that it had done its best efforts to avoid the error. Such a liability scheme is intended to provide additional protection to any person using the service of a certification authority, without however imposing strict liability on the certification authority (see A/CN.9/437, para. 58).

67. In the context of the discussion regarding draft articles 10-12, the Working Group may wish to consider the question whether the liability of certification authorities should be subject to limits and how such limits could be established (see A/CN.9/437, paras. 63-67). At its previous session, various suggestions were discussed by the Working Group with regard to the possible methods for limiting the amount of the liability incurred by certification authorities. One possible approach would be to determine a fixed amount. Other suggested approaches would rely on a limitation of the liability by reference to a multiplier of the fee paid by the subscriber, a percentage of the transaction value or a percentage of the actual loss sustained by the injured party. It was pointed out, however, that the damage that might result from the acts of a certification authority was not easily quantifiable, so as to serve as an objective criterion for arriving at a fixed amount of liability. Also, the service rendered by a certification authority, and the fees it charged, often bore no relationship to the value of the transactions to which they related or to the damage that might be sustained by the parties (A/CN.9/437, para. 66). As to the suggested comparison between the situation of a certification authority and that of a carrier under international conventions applicable to the transport of goods and the transport of passengers (A/CN.9/437, para. 67), a preliminary review of those texts suggests that limits of liability are generally established by reference to a fixed amount (e.g. in the case of the transport of passengers), possibly in combination with a reference to the value of the goods being transported. That issue may need to be considered by the Working Group at a future session on the basis of further study by the Secretariat.

Article 13. Revocation of a certificate

(1) During the operational period of a certificate, the certification authority that issued the certificate must revoke the certificate in accordance with the policies and procedures governing revocation specified in the applica-

^bOfficial Records of the General Assembly, Forty-seventh Session, Supplement No. 17 (A/47/17), annex I.

ble certification practice statement or, in the absence of such policies and procedures, promptly upon:

(a) receiving a request for revocation by the holder identified in the certificate, and confirmation that the person requesting revocation is the [rightful] holder, or is an agent of the holder with authority to request the revocation;

(b) receiving reliable evidence of the holder's death if the holder is a natural person; or

(c) receiving reliable evidence that the holder has been dissolved or has ceased to exist, if the holder is a corporate entity.

(2) The holder of a certified key pair is under an obligation to revoke the corresponding certificate where the holder learns that the private key has been lost, compromised or is in danger of being misused in other respects. If the holder fails to revoke the certificate in such a situation, the holder is liable for any loss sustained by third parties having relied on the content of messages as a result of the holder's failure to undertake such revocation.

(3) Regardless of whether the holder listed in the certificate consents to the revocation, the certification authority that issued a certificate must revoke the certificate promptly upon acquiring knowledge that:

(a) a material fact represented in the certificate is false;

(b) the certification authority's private key or information system was compromised in a manner affecting the reliability of the certificate; or

(c) the holder's private key or information system was compromised.

(3) Upon effecting the revocation of a certificate under paragraph (3), the certification authority must notify the holder and relying parties in accordance with the policies and procedures governing notice of revocation specified in the applicable certification practice statement, or in the absence of such policies and procedures, promptly notify the holder and promptly publish notice of the revocation if the certificate was published, and otherwise disclose the fact of revocation upon inquiry by a relying party.

(4) [As between the holder and the certification authority,] the revocation is effective from the time when it is [received] [registered] by the certification authority.

[(5) As between the certification authority and any other relying party, the revocation is effective from the time it is [registered] [published] by the certification authority.]

References

A/CN.9/437, paras.125-139 (draft article F)

A/CN.9/WG.IV/WP.71, paras. 66-67

Remarks

68. Draft article 13 is intended to reflect the various views expressed at the previous session of the Working Group by setting forth a default standard governing revocation of certificates. At all times, however, a certification

authority can avoid the default standard by establishing procedures governing revocation in its certification practice statement, and following those procedures. As regards the time of effectiveness of a revocation, the Working Group may wish to decide whether a distinction should be drawn between the situation of the holder and that of any other relying party (see A/CN.9/437, para. 130).

Article 14. Suspension of a certificate

During the operational period of a certificate, the certification authority that issued the certificate must suspend the certificate in accordance with the policies and procedures governing suspension specified in the applicable certification practice statement or, in the absence of such policies and procedures, promptly upon receiving a request to that effect by a person whom the certification authority reasonably believes to be the holder listed in the certificate or a person authorized to act on behalf of that holder.

References

A/CN.9/437, paras. 133-135 (draft article F)

Remarks

69. At its previous session, the Working Group decided that the Uniform Rules should contain a provision on suspension of certificates (see A/CN.9/437, paras. 133-134). As regards the time of effectiveness of a suspension, the Working Group may wish to decide whether provisions should be added along the lines of paragraphs (4) and (5) of draft article 13.

Article 15. Register of certificates

(1) Certification authorities shall keep a publicly accessible electronic register of certificates issued, indicating the time when any individual certificate expires or when it was suspended or revoked.

(2) The register shall be maintained by the certification authority

Variant A: for at least [30] [10] [5] years

Variant B: for ... [the enacting State specifies the period during which the relevant information should be maintained in the register]

after the date of revocation or expiry of the operational period of any certificate issued by that certification authority.

Variant C: in accordance with the policies and procedures specified by the certification authority in the applicable certification practice statement.

References

A/CN.9/437, paras. 140-148 (draft article G)

A/CN.9/WG.IV/WP.71, paras. 68-69

Remarks

70. At the previous session, no objection of principle was raised to including in the Uniform Rules a provision on registration of certificates (see A/CN.9/437, para. 142).

The proper maintenance of a widely accessible register (sometimes referred to as a “repository”) featuring, in particular, a certificate revocation list (CRL) may be regarded as an important element in establishing the trustworthiness of digital signatures. When dealing with the ways in which such registers and CRLs should be maintained by certification authorities, the Working Group may wish to consider whether relying parties should be under an obligation to verify the status of the certificate by consulting the relevant register or CRL before they could rely on the validity of the certificate.

71. More generally, the Working Group may wish to discuss whether the Uniform Rules, in establishing minimum standards for the operation of certification authorities, should also deal with the rights and obligations of parties relying on certificates.

Article 16. Relations between parties relying on certificates and certification authorities

[(1) A certification authority is only allowed to request such information as is necessary to identify the user.

(2) Upon request, the certification authority shall deliver information about the following:

(a) the conditions under which the certificate may be used;

(b) the conditions associated with the use of digital signatures;

(c) the costs of using the services of the certification authority;

(d) the policy or practices of the certification authority with respect to the use, storage and communication of personal information;

(e) the technical requirements of the certification authority with respect to the communication equipment to be used by parties relying on certificates;

(f) the conditions under which warnings are given to parties relying on certificates by the certification authority in case of irregularities or faults in the functioning of the communication equipment;

(g) any limitation of the liability of the certification authority;

(h) any restrictions imposed by the certification authority on the use of the certificate;

(i) the conditions under which the holder is entitled to place restrictions on the use of the certificate.

(3) The information listed in paragraph (1) shall be delivered to the user before a final agreement of certification is concluded. That information may be delivered by the certification authority by way of a certification practice statement.

(4) Subject to a [one-month] notice, the user may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received by the certification authority.

(5) Subject to a [three-month] notice, the certification authority may terminate the agreement for connection to the certification authority. Such notice of termination takes effect when received.]

References

A/CN.9/437, paras. 149-150 (draft article J)
A/CN.9/WG.IV/WP.71, para. 76

Remarks

72. At its previous session, the Working Group noted that the various elements listed in draft article 16 should be placed in square brackets, to be considered by the Working Group at a later stage (see A/CN.9/437, para. 150).

Chapter IV. Recognition of foreign electronic signatures

Article 17. Foreign certification authorities offering services under these Rules

Variant A: (1) Foreign [persons] [entities] may become locally established as certification authorities or may provide certification services from another country without a local establishment if they meet the same objective standards and follow the same procedures as domestic entities and persons that may become certification authorities.

(2) *Variant X:* The rule stated in paragraph (1) does not apply to the following: [...].

Variant Y: Exceptions to the rule stated in paragraph (1) may be made to the extent required by national security.

Variant B: The ... [the enacting State specifies the organ or authority competent to establish rules in connection with the approval of foreign certificates] is authorized to approve foreign certificates and to lay down specific rules for such approval.

References

A/CN.9/437, paras. 74-89 (draft article I)
A/CN.9/WG.IV/WP.71, paras. 73-75

Remarks

73. By allowing foreign entities to become established as certification authorities, draft article 17 merely states the principle that foreign entities should not be discriminated against, provided that they meet the standards set forth for domestic certification authorities. While that principle may be generally accepted, it may be of particular relevance to express it with respect to certification authorities, since certification authorities might be expected to operate without necessarily having a physical establishment or other place of business in the country in which they operate.

Article 18. Endorsement of foreign certificates by domestic certification authorities

Certificates issued by foreign certification authorities may be used for digital signatures on the same terms as certificates subject to these Rules if they are recognized by

a certification authority operating under ... [*the law of the enacting State*], and that certification authority guarantees, to the same extent as its own certificates, the correctness of the details of the certificate as well as the certificate being valid and in force.

References

A/CN.9/437, paras. 74-89 (draft article I)
A/CN.9/WG.IV/WP.71, paras. 73-75

Remarks

74. Draft article 18 enables a domestic certification authority to guarantee, to the same extent as its own certificates, the correctness of the details of the foreign certificate, and to guarantee that the foreign certificate is valid and in force. It refers to the matters referred to as "cross-certification" at the previous session of the Working Group. Draft article 18 essentially contains a provision on the allocation of liability to the domestic certification authority in the event that the foreign certificate is found to be defective (see A/CN.9/437, paras. 77-78).

Article 19. Recognition of foreign certificates

(1) Certificates issued by a foreign certification authority are recognized as legally equivalent to certificates issued by certification authorities operating under ... [*the law of the enacting State*] if the practices of the foreign certification authority provide a level of reliability at least equivalent to that required of certification authorities under these Rules. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

(2) Signatures and records complying with the laws of another State relating to digital or other electronic signatures are recognized as legally equivalent to signatures and records complying with these Rules if the laws

of the other State require a level of reliability at least equivalent to that required for such records and signatures under ... [*the Law of the enacting State*]. [Such recognition may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

(3) Digital signatures that are verified by reference to a certificate issued by a foreign certification authority shall be given effect [by courts and other finders of fact] if the certificate is as reliable as is appropriate for the purpose for which the certificate was issued, in light of all the circumstances.

(4) Notwithstanding the preceding paragraph, Government agencies may specify [by publication] that a particular certification authority, class of certification authorities or class of certificates must be used in connection with messages or signatures submitted to those agencies.

References

A/CN.9/437, paras. 74-89 (draft article I)
A/CN.9/WG.IV/WP.71, paras. 73-75

Remarks

75. Draft article 19 refers to the matters referred to as "cross-border recognition" at the previous session of the Working Group (see A/CN.9/437, paras. 77-78). Paragraphs (1) and (2) deal with the ways in which the reliability of foreign certificates and signatures may be established in advance of any transaction being made (and any dispute having arisen as to the level of reliability of a signature). Paragraph (3) establishes the standard against which foreign signatures and certificates may be assessed in the absence of any prior determination of their reliability. Paragraph (4) preserves the right of Government agencies to determine the procedures to be used in communicating with them electronically.

C. Working paper submitted to the Working Group on Electronic Commerce at its thirty-second session: incorporation by reference: proposal by the United Kingdom of Great Britain and Northern Ireland: note by the Secretariat

(A/CN.9/WG.IV/WP.74) [Original: English]

1. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). With respect to the issue of incorporation by reference, the Working Group concluded that no further study by the Secretariat was needed, since the fundamental issues were well known and it was clear that many aspects of battle-of-forms and adhesion contracts would need to be left to applicable national laws for reasons involving, for example, consumer protection and other public-policy considerations. The Working Group was of the opinion that the issue should be dealt with as the first substantive item on its agenda, at the

beginning of its thirty-second session (see A/CN.9/437, para. 155). The Commission endorsed the conclusions reached by the Working Group.¹

2. Following the thirty-first session of the Working Group, the Secretariat received from the delegation of the United Kingdom of Great Britain and Northern Ireland a proposal for a provision dealing with the topic of incorporation by reference, with explanatory notes. The draft

¹Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17), paras. 249-251.

article proposed by the United Kingdom together with the explanatory notes are reproduced in the annex to this note as they were received by the Secretariat.

ANNEX

Note by the United Kingdom of Great Britain and Northern Ireland

1. Incorporation by reference is acceptable in most States, usually with some rules of law providing safeguards. In conventional paper communications it is relatively normal and possible to set out in full all or most of the information in the relevant documents. However, in electronic communications, practitioners do not overload their "data messages" with quantities of free-text when they can take advantage of extrinsic sources of information, databases, code lists, glossaries, etc. by making use of abbreviations, codes and other references to such information. In fact, practical electronic commerce depends on this to a great extent. The ability to incorporate by reference effectively is therefore particularly important in electronic commerce.

2. The purpose should not be to change existing rules of law on incorporation by reference nor to make new rules for it when using electronic rather than other forms of communication. The provision is intended merely to confirm, for the sake of clarity, that incorporation by reference by electronic means is equally effective as by any conventional, non-electronic means.

3. Throughout this Note reference has been made to "information" being incorporated. Some commentaries assume that it is only the terms of a contract which will be incorporated by reference. In many instances, of course, this will be the case. However, sometimes other information may be involved, which is not necessarily part of a contract. Consequently this note uses "information" in preference to "terms", "conditions", "clauses", etc.

4. Not all information which is incorporated is intended to have legally binding effect; for example, purely factual information may be included. A rule relating to incorporation of information by electronic means should cover all information. Consequently this note refers to the incorporated information having the same effect as if it were fully expressed; it says nothing about giving it any particular legal status.

5. Attached is a draft of a possible rule. It is drafted as if for use as an article for the Model Law, or something similar, but it could easily be put into a modified form for use in another context, if desired.

6. (i) The draft rule starts by saying that it applies when a data message (not other forms of communication) uses incorporation by reference (see para. 1 of the draft).
- (ii) It states the overall principle that the incorporated information should have the same effect as if it were fully expressed in the data message (see para. 2).
- (iii) It then sets out the general safeguards: clear and precise identification of what is being incorporated; identification of where and how it may be accessed; and an indication of intent to incorporate (see para. 3).
- (iv) In electronic commerce, use is sometimes made of a reference to an extrinsic source which is itself made up of abbreviations or other codes which refer, in turn, to another source. This should be acceptable,

provided the same safeguards apply (see para. 4).

- (v) As for the other particular safeguards it is assumed that, any existing rules of law applying to conventional communications should extend to electronic communications. Such rules of law would include those relating to (see para. 5):

(a) requirements to give adequate notice of what is being incorporated;

Adequacy is as to timeliness, clarity and emphasis. This is particularly important where there is any existing rule of law to protect consumers or a weaker contracting party.

- (b) accessibility to other persons;

This would include contractually affected third parties and any other persons who would need to know about the incorporated information.

- (c) acceptance of terms in the context of contract formation;

In some States rules of law may require actual approval of terms by the party who is intended to be bound. Some States, too, may require some terms to be in writing and approved by signature; for example, clauses about limiting liability, cancelling or suspending a contract, restricting the ability to object to exceptions and restricting the freedom to contract or sub-contract with third parties. The requirements for writing and signature would, of course, be met by the UNCITRAL Model Law, articles 6 and 7. However, a provision should be made to ensure that States' particular rules of law on these matters are not bypassed when incorporation of terms is done by electronically referring to an extrinsic source.

- (d) possible conflicts between provisions which are expressed in a data message and those which are incorporated into it;

The Working Group need not make a new rule about whether incorporated information always, or in certain circumstances, prevails over other information or vice versa. However, where existing law governs this, it is important to make it clear that such law is not being changed.

All these are precepts which will be more sensitive, as well as being more likely to being ignored or neglected, when using rapid electronic communications for incorporating information, than when using conventional means of conveying the information. It is therefore particularly important to draw attention to the fact that this suggested new article does not purport to change them. They remain valid.

Article 'ZZZ': Incorporation by reference

(1) This article applies when a data message contains reference to, or its meaning is only fully ascertainable by reference to, information recorded elsewhere ('the further information').

(2) Subject to paragraph (5), the data message shall have the same effect as if the further information were fully expressed in the data message and any reference to the data message will constitute a reference to that message including all further information, if the conditions in paragraph (3) are satisfied.

(3) The conditions mentioned in paragraph (2) are that the data message:

- (a) identifies the further information —

- (i) by a collective name or description or code; and
- (ii) by specifying adequately the record, and the parts of that record, containing the further information and, where that record is not publicly available, the

place where, and, in cases where the means of access is either not obvious or is restricted in some way, the means by which, it may be found; and

(b) expressly indicates or carries a clear implication that the data message is intended to have the same effect as if the further information were fully expressed in the data message.

(4) The identification mentioned in paragraph (3)(a) may be made indirectly, by referring to information recorded elsewhere, which contains the necessary identification, provided the conditions in paragraph (3) are satisfied with respect to that reference.

(5) Nothing in this article affects —

(a) any rule of law which requires adequate notice to be given of the content of the further information, or of the record or place where, or the means by which such information may be found, or which requires that place or record to be accessible to another person; or

(b) any rule of law relating to the validity of terms for the purpose of contract formation, including the acceptance of an offer.

(c) any rule of law prescribing the effectiveness of the further information being incorporated or the validity of the process of incorporation.

**D. Possible addition to the UNCITRAL Model Law on Electronic Commerce:
draft provision on incorporation by reference:
note by the Secretariat
(A/CN.9/450) [Original: English]**

1. At various stages in the preparation of the Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (1996)^a, hereinafter referred to as “the Model Law”, it was suggested that the text should contain a provision to the effect of ensuring that certain terms and conditions that might be incorporated in a data message by means of a mere reference would be recognized as having the same degree of legal effectiveness as if they had been fully stated in the text of the data message. That effect was generally referred to as “incorporation by reference” (for earlier discussion of the issue of incorporation by reference by the Commission, by the Working Group on Electronic Commerce, and in notes prepared by the Secretariat, see A/52/17, paras. 248-250; A/51/17, paras. 222-223; A/CN.9/446, paras. 14-24; A/CN.9/437, paras. 151-155; A/CN.9/421, paras. 109 and 114; A/CN.9/407, paras. 100-105 and 117; A/CN.9/406, paras. 90 and 178-179; A/CN.9/360, paras. 90-95; A/CN.9/350, paras. 95-96; A/CN.9/333, paras. 66-68; A/CN.9/WG.IV/WP.74; A/CN.9/WG.IV/WP. 71, paras. 77-93; A/CN.9/WG.IV/WP.69, paras. 30, 53, 59-60 and 91; A/CN.9/WG.IV/WP.66; A/CN.9/WG.IV/WP.65; A/CN.9/WG.IV/WP.55, paras. 109-113; and A/CN.9/WG.IV/WP.53, paras. 77-78).

2. At its thirtieth session (1997), the Commission had before it the report of the Working Group on the work of its thirty-first session (A/CN.9/437). With respect to the issue of incorporation by reference, the Working Group concluded that no further study by the Secretariat was needed, since the fundamental issues were well known and it was clear that many aspects of battle-of-forms and adhesion contracts would need to be left to applicable national laws for reasons involving, for example, consumer protection and other public-policy considerations. The Working Group was of the opinion that the issue should be dealt with as the first substantive item on its agenda, at the beginning of its thirty-second session (see A/CN.9/437, para.

155). The Commission endorsed the conclusions reached by the Working Group.¹

3. At its thirty-second session, the Working Group discussed the issue of incorporation by reference on the basis of various texts that were proposed as possible additions to the Model Law. That discussion is recorded in the report on the Working Group on the work of its thirty-second session (A/CN.9/446, paras. 14-23), together with the text of the various proposals that were considered by the Working Group.

4. At the close of that discussion, the Working Group adopted the text of the draft provision reproduced in annex I to this note, decided that it should be presented to the Commission for review and possible insertion as a new article 5 *bis* of the Model Law, and requested the Secretariat to prepare an explanatory note to be added to the Guide to Enactment of the Model Law (A/CN.9/446, para. 24). A draft text prepared pursuant to that decision for possible insertion in the Guide to Enactment of the Model Law is set forth in annex II to this note.

5. It may be noted that the text adopted by the Working Group embodies a minimalist approach to the issue of incorporation by reference. Consistent with the earlier deliberations of the Working Group (see para. 2, above), it does not attempt to achieve any substantial unification of the existing rules of domestic law regarding that issue. Instead, it restates in the context of incorporation by reference the general principle of non-discrimination embodied in article 5 of the Model Law.

6. The text adopted by the Working Group is aimed at facilitating incorporation by reference in electronic commerce by removing the uncertainty that might prevail in certain jurisdictions as to whether the rules applicable to traditional paper-based incorporation by reference also apply in an electronic environment. Another aim of the

^aOfficial Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

¹Ibid., Fifty-second Session, Supplement No. 17 (A/52/17), paras. 249-251.

provision is to make it clear that consumer-protection or other national or international law of a mandatory nature (e.g. rules protecting weaker parties in the context of contracts of adhesion) should not be interfered with.

7. As currently drafted, the text presupposes a certain degree of familiarity of enacting States with the concept of incorporation by reference. However, although the expression “incorporation by reference” has been used consistently by the Working Group as a concise way of referring to a complex range of legal and factual situations, it might not convey the same meaning in all enacting States. With a view to reducing the difficulties that may arise in the interpretation of the text, the Commission may wish to consider whether more descriptive language might be used. For example, consistent with the negative formulation adopted by the Working Group, language along the following lines might be considered:

“Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is not contained in the data message purported to give rise to such legal effect, but is merely referred to in that data message.”

ANNEX I

Draft provision possibly to be added to the UNCITRAL Model Law on Electronic Commerce

(as adopted by the Working Group on Electronic Commerce at its thirty-second session)

Article 5 bis. Incorporation by reference

Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is incorporated by reference in a data message.

ANNEX II

Draft section possibly to be inserted in the Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce

(prepared by the Secretariat pursuant to a decision made by the Working Group on Electronic Commerce at its thirty-second session)

Article 5 bis. Incorporation by reference

Article 5 bis is intended to provide guidance as to how legislation aimed at facilitating the use of electronic commerce might deal with the situation where certain terms and conditions, although not stated in full but merely referred to in a data message, might need to be recognized as having the same degree of legal effectiveness as if they had been fully stated in the text of that data message. Such recognition is acceptable under the laws of many States with respect to conventional paper communications, usually with some rules of law providing safeguards, for example, rules on consumer protection. The expression “incorporation by reference” is often used as a concise means of

describing situations where a document refers generically to provisions which are detailed elsewhere, rather than reproducing them in full.

In an electronic environment, incorporation by reference is often regarded as essential to widespread use of electronic data interchange (EDI), electronic mail, digital certificates and other forms of electronic commerce. For example, electronic communications are typically structured in such a way that large numbers of messages are exchanged, with each message containing brief information, and relying much more frequently than paper documents on reference to information accessible elsewhere. In electronic communications, practitioners should not be placed under the burdensome obligation to overload their data messages with quantities of free text when they can take advantage of extrinsic sources of information, such as databases, code lists or glossaries, by making use of abbreviations, codes and other references to such information.

Standards for incorporating data messages by reference into other data messages may also be essential to the use of public key certificates, because these certificates are generally brief records with rigidly prescribed contents that are finite in size. The trusted third party which issues the certificate, however, is likely to require the inclusion of relevant contractual terms limiting its liability. The scope, purpose and effect of a certificate in commercial practice, therefore, would be ambiguous and uncertain without external terms being incorporated by reference. This is the case especially in the context of international communications involving diverse parties who follow varied trade practices and customs.

The establishment of standards for incorporating data messages by reference into other data messages is critical to the growth of a computer-based trade infrastructure. Without the legal certainty fostered by such standards, there might be a significant risk that the application of traditional tests for determining the enforceability of terms that seek to be incorporated by reference might be ineffective when applied to corresponding electronic commerce terms because of the differences between traditional and electronic commerce mechanisms.

While electronic commerce relies heavily on the mechanism of incorporation by reference, the accessibility of the full text of the information being referred to may be considerably improved by the use of electronic communications. For example, a message may have embedded in it uniform resource locators (URLs), which direct the reader to the referenced document. Such URLs can provide “hypertext links” allowing the reader to simply direct a pointing device (such as a mouse) on a key word associated with a URL. The referenced text would then be displayed. In assessing the accessibility of the referenced text, factors to be considered may include: availability (hours of operation of the repository and ease of access); cost of access; integrity (verification of content, authentication of sender and mechanism for communication error correction); and the extent to which that term is subject to later amendment (notice of updates; notice of policy of amendment).

One aim of article 5 bis is to facilitate incorporation by reference in an electronic context by removing the uncertainty prevailing in many jurisdictions as to whether the provisions dealing with traditional incorporation by reference are applicable to incorporation by reference in an electronic environment. However, in enacting article 5 bis, attention should be given to avoid introducing more restrictive requirements with respect to incorporation by reference in electronic commerce than might already apply in paper-based trade.

Another aim of the provision is to recognize that consumer-protection or other national or international law of a mandatory nature (e.g. rules protecting weaker parties in the context of contracts of adhesion) should not be interfered with. That result could also be achieved by validating incorporation by reference in an electronic environment “to the extent permitted by law”, or by listing the rules of law that remain unaffected by article 5 bis. For

example, in a number of jurisdictions, existing rules of mandatory law only validate incorporation by reference provided that the following three conditions are met: (a) the reference clause should be inserted in the data message; (b) the document being referred to, e.g. general terms and conditions, should actually be known to the party against whom the reference document might be relied upon; and (c) the reference document should be accepted, in addition to being known, by that party.

References

A/53/17, paras. 212-221
A/CN.9/446, paras. 14-24
 A/CN.9/WG.IV/WP.74
A/52/17, paras. 248-250

A/CN.9/437, paras. 151-155
 A/CN.9/WP. 71, paras 77-93
A/51/17, paras. 222-223
A/CN.9/421, paras. 109 and 114
 WP.69, paras. 30, 53, 59-60 and 91
A/CN.9/407, paras. 100-105 and 117
 A/CN.9/WG.IV/WP.66
 A/CN.9/WG.IV/WP.65
A/CN.9/406, paras. 90 and 178-179
 A/CN.9/WG.IV/WP.55, paras. 109-113
A/CN.9/360, paras. 90-95
 A/CN.9/WG.IV/WP.53, paras. 77-78
A/CN.9/350, paras. 95-96
A/CN.9/333, paras. 66-68

III. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects: report of the Secretary-General
(A/CN.9/444 and Add.1-5) [Original: English]

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*The Secretariat wishes to express its appreciation to the Private Sector Development Department of the International Bank for Reconstruction and Development (World Bank) for having contributed the substance of this draft chapter.

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A/CN.9/444

I. INTRODUCTION

1. At its twenty-ninth session, in 1996, the Commission decided to prepare a legislative guide on build-operate-transfer (BOT) and related types of projects.¹ The Commission reached that decision after recommendations by many States and consideration of a report prepared by the Secretary-General (A/CN.9/424) which contained information on work then being undertaken by other organizations in that field, as well as an outline of issues covered by relevant national laws. The Commission considered that it would be useful to provide legislative guidance to States preparing or modernizing legislation relevant to those projects. The Commission requested the Secretariat to review issues suitable for being dealt with in a legislative guide and to prepare draft materials for consideration by the Commission.

2. At its thirtieth session, in 1997, the Commission had before it a table of contents setting out the topics proposed

¹Official Records of the General Assembly, Fifty-first Session, Supplement No. 17 (A/51/17), paras. 225-230.

to be covered by the legislative guide, which were followed by annotations concerning the issues suggested to be discussed therein (A/CN.9/438). The Commission further had before it initial drafts of chapter I, "Scope, purpose and terminology of the *Guide*" (A/CN.9/438/Add.1), chapter II, "Parties and phases of privately financed infrastructure projects" (A/CN.9/438/Add.2) and chapter V, "Preparatory measures" (A/CN.9/438/Add.3). It was pointed out that the annotated table of contents contained in document A/CN.9/438 had been prepared by the Secretariat for the purpose of enabling the Commission to make an informed decision on the proposed structure of the draft legislative guide and its contents.

3. The Commission noted the proposal that the draft legislative guide should consider which aspects of the issues mentioned in document A/CN.9/438 should be dealt with in legislation, and which aspects should be left to be addressed by the parties in the agreements concerning the implementation of the project. It was generally felt that the documents submitted by the Secretariat presented a good basis for the work of the Commission in that field.

4. The Commission exchanged views on the nature of the issues to be discussed in the draft legislative guide and possible methods for addressing them and considered a number of specific suggestions.^a The Commission generally approved the line of work proposed by the Secretariat, as contained in documents A/CN.9/438 and Add.1-3. The Commission requested the Secretariat to seek the assistance of outside experts, as required, in the preparation of future chapters. The Commission invited Governments to identify experts who could be of assistance to the Secretariat in that task.

5. The Secretariat has revised the documents considered by the Commission at its thirtieth session and has prepared initial drafts of additional chapters with the assistance of outside experts and in consultation with other international organizations. For the purpose of distinguishing the advice provided by the legislative guide from the background discussion contained therein, it is proposed that each substantive chapter be preceded by the legislative recommendations pertaining to the matters dealt with in the chapter. Drafts of the introduction and of chapters I, II, III and IV are contained in documents A/CN.9/444/Add.1-5. Initial drafts of chapters V-XI are currently being prepared by the Secretariat for consideration by the Commission at its thirty-second session, in 1999.

II. PROPOSED STRUCTURE AND CONTENTS OF THE LEGISLATIVE GUIDE

“Introduction and background information on privately financed infrastructure projects”

6. At its thirtieth session, the Commission considered an initial draft of chapter I, “Scope, purpose and terminology of the *Guide*” (A/CN.9/438/Add.1), which was intended to provide information on the projects covered by, and on the purpose of, the legislative guide, as well as an explanation of terms frequently used therein. The Commission further considered an initial draft of chapter II, “Parties and phases of privately financed infrastructure projects” (A/CN.9/438/Add.2), which contained general background information on the concept of project finance, the parties to a privately financed infrastructure project and the phases of their implementation.

7. In the consultations subsequently conducted by the Secretariat with outside experts and international organizations, it was suggested that the usefulness of the legislative guide would be enhanced by establishing a clearer distinction between those introductory portions and the remaining chapters of the legislative guide, which are intended to contain substantive discussion and legislative advice. For that purpose, the Secretariat has combined the former draft chapters I and II into one single introduction, which takes into account, as appropriate, the suggestions made at the thirtieth session of the Commission in respect of documents A/CN.9/438/Add. 1 and 2.^b

^aIbid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 231-246.

^bIbid., paras. 238-243.

8. A draft of the introduction is contained in document A/CN.9/444/Add.1.

Chapter I, “General legislative considerations”

9. In the opening section of chapter I (previously numbered chapter III) it is proposed to discuss two issues concerning the general legal framework for privately financed infrastructure projects, namely, the legislative authorization for the host Government to undertake such projects and the legal regime to which they are subject. The second section of chapter II would consider the possible impact of other areas of legislation on the successful implementation of those projects. The concluding section of chapter II would discuss the possible relevance of international agreements entered into by the host country for domestic legislation governing privately financed infrastructure projects. An initial outline of issues proposed to be covered in chapter I was contained in document A/CN.9/438, paragraphs 6-16.

10. At the thirtieth session of the Commission, it was suggested that chapter II should elaborate on the different legal regimes governing the infrastructure in question, as well as on the services provided by the project company, issues in which there were significant differences among legal systems. It was further suggested that attention should be given to constitutional issues relating to privately financed infrastructure projects.^c

11. A draft of chapter I, which reflects the above suggestions, is contained in document A/CN.9/444/Add.2. It also includes some of the contents of former chapter V, “Preparatory measures” (A/CN.9/438/Add.3).

Chapter II, “Sector structure and regulation”

12. At the thirtieth session of the Commission, it was noted that issues pertaining to privately financed infrastructure projects involved also issues of market structure and market regulation and that consideration of those issues was important for the treatment of a number of individual topics proposed to be covered by the legislative guide. For instance, issues of sector structure (such as the level of competition the host Government wishes to promote in the sector concerned) would affect a governmental decision as to whether to grant exclusivity to one concessionaire or whether to award multiple concessions. Similarly, issues of sector regulation (such as the possible role of a regulatory agency in establishing the quality of services provided by the project company and the prices of those services) would be crucial for establishing an appropriate regulatory mechanism.^d

13. In order to deal with issues of competition, sector structure and regulation at the level of detail envisaged by the Commission, the Secretariat proposes the addition of a separate chapter. A draft of this chapter is contained in document A/CN.9/444/Add.3.

^cIbid., para. 237(a).

^dIbid., para. 235.

Chapter III, "Selection of the concessionaire"

14. Chapter III (previously numbered chapter IV) is intended to deal with methods and procedures recommended to be used for the award of privately financed infrastructure projects. An initial outline of issues proposed to be covered in chapter IV was contained in document A/CN.9/438, paragraphs 17-26.

15. At the thirtieth session of the Commission, it was suggested that chapter IV should emphasize that the appropriateness of the selection procedure depended not only on the nature of each individual project, but also on the policy pursued by the Government for the sector concerned. It was also suggested that the legislative guide should discuss issues raised by unsolicited proposals.^e

16. A draft of chapter III is contained in document A/CN.9/444/Add.4.

Chapter IV, "Conclusion and general terms of the project agreement"

17. In the opening section of chapter IV (previously numbered chapter VI), it is proposed to deal with general considerations concerning the project agreement, discussing in particular the different approaches taken by national legislation concerning the project agreement (from those that scarcely refer to the project agreement to those that contain extensive mandatory provisions concerning clauses to be included in the agreement). The remaining sections would deal with rights and obligations of the project company that, in addition to being dealt with in the project agreement, might be usefully addressed in the legislation, as they might affect the interests of third parties. An initial outline of issues proposed to be covered in chapter IV was contained in document A/CN.9/438, paragraphs 29-38.

18. A draft of chapter IV is contained in document A/CN.9/444/Add.5. It also includes some of the contents of former chapter V, "Preparatory measures" (A/CN.9/438/Add.3).

Chapter V, "Government support"

19. The opening section of chapter V (previously numbered chapter VII) is intended to discuss support measures, incentives and facilities that may be offered by the host Government for the purpose of enhancing the commercial viability of a project, ensuring its technical feasibility or reducing the political or other risks faced by investors and lenders. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 39-45.

20. At the thirtieth session of the Commission, it was suggested that chapter V should discuss possible manners in which privately financed infrastructure projects could be facilitated with a minimum involvement of governmental guarantees. With regard to forms of governmental sup-

port to infrastructure projects, it was suggested that the legislative guide should give attention to specific forms of governmental support, such as facilitation of entry visas and work permits; waiver of immigration or repatriation restrictions for foreign personnel; waiver of currency exchange restrictions.^f

Chapter VI, "Construction phase"

21. Chapter VI (previously numbered chapter VIII) is intended to discuss issues that arise during the construction of infrastructure facilities, such as the relations between the host Government, the project company and the construction contractors, procedures for monitoring the progress of the construction works and for final inspection and approval of the infrastructure. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 46-54.

Chapter VII, "Operational phase"

22. It is proposed to consider in chapter VII (previously numbered chapter IX) the main issues relating to the conditions of operation of the infrastructure, such as: the scope and quality of the services provided by the project company; the establishment and adjustment of the price charged by the project company; the relations of the project company with the purchasers of the goods or services or the users of the infrastructure; procedures for monitoring the performance of the project company. This chapter is intended to supplement, on a more practical level, the general analysis of regulatory issues provided in chapter II. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 55-66.

Chapter VIII, "Delays, defects and other failures to perform"

23. In the opening section of chapter VIII (previously numbered chapter X), it is proposed to deal with the possible consequences of, and remedies for, default by the project company, during both the construction and the operation of the infrastructure. Another section of chapter VIII would consider possible approaches for dealing with events that might preclude the project company, temporarily or permanently, from performing its contractual obligations. The closing section of the chapter would deal with unforeseen events and changes of circumstances, including changes that are brought about by subsequent acts of the host Government. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 67-73.

24. At the thirtieth session of the Commission, it was suggested that this chapter should consider the desirability and appropriateness of dealing with issues relating to delays, defects and failures to perform in legislation specific to privately financed infrastructure projects.^g

^eIbid., para. 237(a).

^fIbid., para. 237(d).

^gIbid., para. 237(e).

Chapter IX, "Duration, extension and early termination of the project agreement"

25. It is suggested to discuss in chapter IX (previously numbered chapter XI) the consequences of the expiry of the concession period, the possibility of an extension of the project agreement, and the events or circumstances that may cause or justify its early termination. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 74-83.

26. At the thirtieth session of the Commission, it was suggested that this chapter should give particular attention to questions such as ownership of infrastructure and related property; responsibility for residual liabilities of the project company; terms of transfer of the infrastructure to the host Government in BOT projects. In addition to that, it was suggested that attention should be given to cases where the host Government might decide to keep the infrastructure permanently under private operation.^h

Chapter X, "Governing law"

27. Chapter X (previously numbered chapter XII) is intended to deal with the issue of the law applicable to privately financed infrastructure projects and the possible implications of different laws applying to different aspects of the project. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 84-87.

28. At the thirtieth session of the Commission, it was suggested that this chapter should elaborate on the possibility and the limitations of choice-of-law clauses, taking into account the specific nature of the various contractual arrangements involved, emphasizing the role of choice-of-law clauses in the contracts between the project company and its suppliers and other contractors. It was also suggested to further consider the desirability for the parties to make use of commercial law rules elaborated by international bodies.ⁱ

Chapter XI, "Settlement of disputes"

29. Chapter XI (previously numbered chapter XIII) is intended to deal with the legislative framework for the settlement of disputes that might arise in connection with privately financed infrastructure projects. An initial outline of issues proposed to be discussed in this chapter was contained in document A/CN.9/438, paragraphs 88-92.

30. At the thirtieth session of the Commission, it was suggested that this chapter should elaborate on the possibility and the limitations of arbitration agreements, taking into account the specific nature of the various contractual arrangements involved.

III. CONCLUSIONS

31. The Commission may wish to note that the proposed time-table for the Commission's session, as set out in the

^hIbid., para. 237(f).

ⁱIbid., para. 237(g).

provisional agenda (A/CN.9/443), provides that the first five days of the session would be devoted to a discussion of the subject of privately financed infrastructure projects. It is suggested that the Commission use this period for an in-depth discussion of the draft legislative guide. The Commission may wish to consider the proposed structure of the legislative guide, as set out above in paragraphs 6-30 and take up the introduction and chapters I-IV (addenda 1-5 to the present report). The Commission may wish to consider the concept of the draft chapters, whether they cover the relevant issues, whether statements made adequately cover the practical needs of privately financed infrastructure projects and whether the advice given is appropriate. The Commission may wish to consider, where appropriate, the desirability of formulating the legislative recommendations in the form of sample provisions for the purpose of illustrating possible legislative solutions for the issues dealt with in the legislative guide, as was suggested at its thirtieth session.^j

32. On the basis of its discussion of the draft chapters and of the schedule of meetings of the Commission and its Working Groups during the remainder of 1998 and in 1999, the Commission may further wish to consider the future procedure that should be followed in the preparation of the legislative guide.

A/CN.9/444/Add.1

INTRODUCTION AND BACKGROUND INFORMATION ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

A. INTRODUCTION

1. Purpose and scope of the *Guide*

1. The purpose of the *Guide* is to assist national authorities and legislative bodies wishing to establish a favourable legal framework for promoting infrastructure development through private investment. The advice provided in the *Guide* aims to achieve an appropriate balance between the need to facilitate private participation in infrastructure projects and the need to foster the interests of the host Government and the public. In addition to legislative and policy-making bodies, the *Guide* may be of interest to other authorities, at the national or local level, involved in the execution of privately financed infrastructure projects.

2. The *Guide* is intended to be used as a reference in the preparation of new laws or in the review of the adequacy of existing laws and regulations. For that purpose, the *Guide* discusses a number of issues often addressed in national laws and regulations pertaining to infrastructure projects. The *Guide* considers the desirability of dealing with those issues in legislation and, where appropriate, offers recommendations for the formulation of possible legislative solutions. The *Guide* does not provide a single

^jIbid., para. 235.

set of model solutions, but it helps the reader to evaluate different approaches available and to choose the one most suitable in the national or local context.

3. While the *Guide* is primarily concerned with legislative issues, some of its chapters (e.g. chapter IV, "Conclusion and general terms of the project agreement") discuss selected issues that arise under the agreements executed by the parties to a privately financed infrastructure project. Where such a discussion is offered, its focus is on matters that might be usefully addressed in the legislation, in addition to being dealt with in the relevant agreements. The *Guide* is not intended to provide advice on drafting agreements for the execution of privately financed infrastructure projects or on contractual solutions for problems that arise under such agreements.

4. The *Guide* is concerned with projects in which private entities participate in the financing, construction, maintenance or operation of certain types of public infrastructure in exchange for the right to charge a price, either to the public or to a State entity, for the use of the infrastructure or for the services it generates. The *Guide* gives special attention to infrastructure projects that involve an obligation, on the part of the selected entity, to undertake physical construction, repair, or expansion works in the infrastructure concerned prior to its operation. Some chapters deal specifically with issues that arise in connection with that obligation (e.g. chapter VI, "Construction phase"). However, a number of chapters discuss issues that may well arise in projects where the private operator takes over an existing infrastructure or where such infrastructure is permanently owned by the private operator (e.g. chapter I, "General legislative considerations"; chapter IV, "Conclusion and general terms of the project agreement"; and chapter VII, "Operational phase").

5. Projects in which a private operator takes over an existing public infrastructure are sometimes grouped together with other transactions for the "privatization" of State functions or property. However, the *Guide* does not cover "privatization" transactions that do not relate to infrastructure development and operation. A number of reasons justify this limitation of the scope of the *Guide*. "Privatization" transactions may be carried out for various reasons, depending on the activity or property being "privatized". In many cases, they are carried out for the purpose of obtaining revenue for the Government or to free the Government of economic activities that can be more efficiently carried out by the private sector. This is typically the case in the sale of State-owned land and other real estate property, but may also be the motivation for the sale of shares in State-owned companies. In the particular case of infrastructure projects, however, the main purposes are typically to expand the availability of needed infrastructure and to improve the management and operation of existing infrastructure.

6. Furthermore, the infrastructure projects discussed in this *Guide* involve the establishment of a lasting bundle of rights and obligations between the infrastructure operator and the Government, through a project agreement or sector-specific regulations. In turn, the activities of most pri-

vatised companies other than public utilities would not be subject to special regulation; for example, upon transfer to the private sector, a steel corporation or a privatized automobile plant previously owned by the Government would in most cases operate in essentially the same manner as competing companies in the same market.

7. It should be further noted that the *Guide* does not cover projects for the exploitation of natural resources. This limitation, too, is due to a number of reasons. For historic or strategic grounds, many countries have established a special ownership regime for natural resources or other particular categories of goods and property. Common examples may include water sources, minerals, oil, natural gas and other substances found in the subsoil. In some countries they may extend to forests, beaches, the territorial waters or the continental shelf. Many countries have a well established tradition of granting private persons and entities the right to exploit economically those natural resources under some "concession", "licence" or "permission" issued by the State. The mechanisms for awarding concessions for the exploitation of natural resources are in most cases different from those commonly used for selecting a company to carry out an infrastructure project. By the same token, the function of a concessionaire of natural resources, as a commodity producer, is quite distinct from the position of a project company in a privately financed infrastructure project. While infrastructure facilities are destined to be used by the public or to generate public services, mines and other natural resources are not intended for public use and in most cases are exploited by the concessionaire in its own private interest. Furthermore, unlike public services that are provided under some form of regulatory oversight by the State, the minerals or other materials extracted or processed by the concessionaire usually become its own property and are in most cases sold freely on the market. Lastly, the concessionaire of an infrastructure facility is typically under an obligation to ensure its permanent operability, whereas at the end of a mining concession the mineral deposits are returned to the State with their substance diminished or even exhausted.

2. Terminology used in the *Guide***

8. The following paragraphs explain the meaning and use of certain expressions that appear frequently in the *Guide* or which are often used in national laws in connection with infrastructure projects. For terms not mentioned below, such as terms of art used in financial and business management writings, the reader is advised to consult other sources of information on this subject, such as the *Guidelines on Infrastructure Development through Build-Operate-Transfer (BOT) Projects* prepared by the United Nations Industrial Development Organization (UNIDO).²

**[N.B.: This section may be expanded so as to cover other terms that might appear in future chapters and might require prior explanation.]

²United Nations Industrial Development Organization, *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects*, Vienna, 1996. (UNIDO Sales Publication No. UNIDO.95.6.E) (hereafter referred to as the "UNIDO BOT Guidelines").

(a) "Infrastructure projects"

9. In the context of this *Guide*, the term "infrastructure projects" is used to refer specifically to the development and operation of physical facilities, equipment or systems used to generate public services for purposes of economic production or personal or household use. Examples of infrastructure projects within that meaning may be found in various sectors, and include various types of facilities, equipment or systems: power generation plants and power distribution networks (electricity sector); systems for local and long-distance telephone communications and data transmission networks (telecommunications sector); waste water treatment plants, water distribution facilities (water sector); facilities and equipment for waste collection and disposal (sanitation sector); physical installations and systems used for public transportation, such as urban and interurban railways, underground trains, bus lines, roads, bridges, tunnels, ports, airlines, airports (transportation sector).

10. Infrastructure projects do not always require the construction or operation of large physical facilities. Indeed, in some cases (e.g. cellular telephony) the main element of the project may consist of services obtained from others (e.g. owners of communications equipment) rather than of construction works.

(b) "Public services" and "public utilities"

11. Infrastructure projects typically entail the provision of services or commodities to the public (or to an intermediary who distributes them to the public) or the operation or maintenance of a facility open to public use. These activities are often referred to under national law as "public services" and, according to the legal tradition of the country concerned, their providers may be referred to with different expressions, such as "public utilities", "public services enterprises" or "public service providers". It should be noted, however, that those expressions are not uniformly understood and may encompass different activities in different legal systems. While infrastructure projects as defined above would, under most legal systems, involve some form of "public service", this expression may also be used in connection with a number of other activities not covered by the *Guide*.

12. The notions of "public utilities" and "public services" are well established in the legal tradition of some countries, being sometimes the subject of constitutional law or detailed statutory provisions. In some countries the provision of public services may be governed by a specific body of law, which is typically referred to as "administrative law" (see chapter I, "General legislative considerations", paras. 12-15). However, such a high degree of specificity is not present in all legal systems. In a number of countries, aside from being subject to special regulations, public utilities are not regarded as being intrinsically distinct from other types of business.

13. As used in this *Guide*, the expression "public services" refers to services provided in connection with public infrastructure or as a result of its operation. The expres-

sions "public utilities" and "public service providers" refer to the legal entities responsible for the management of infrastructure facilities or systems that supply those public services. In this *Guide* the expressions should not be understood in the technical meaning that may be attached to them under any particular legal system.

(c) "Concession"

14. In many countries, public services constitute State monopolies or are otherwise subject to special regulation by Government. Where that is the case, the provision of a public service by a private entity typically requires an act of authorization by the appropriate State body. Different expressions are used to define such acts of authorization under national laws, and in some legal systems different expressions may be used to denote different types of authorizations. Commonly used expressions include terms such as "concession", "franchise" or "licence". In some national laws, particularly those belonging to the civil law tradition, certain forms of infrastructure projects are referred to by well-defined legal concepts such as "public works concession" or "public service concession".

15. The *Guide* uses the word "concession" to refer generally to the right given to the project company or consortium to construct and operate or only to operate the public infrastructure facility and to charge for its use or for the services it generates. As used in the *Guide*, the word "concession" is not to be understood in a technical meaning that may be attached to it under any particular legal system or national laws.

(d) "Build-operate-transfer (BOT)" and related expressions

16. A number of acronyms are sometimes used to refer to various types of privately financed infrastructure projects, according to the type of private participation or the ownership of the relevant infrastructure.

17. An infrastructure project is said to be a "build-operate-transfer" (BOT) project when the host Government selects a private entity to finance and construct an infrastructure facility or system and gives the entity the right to operate it commercially for a certain period, at the end of which the infrastructure and the right to its operation is transferred to the Government. In those projects, the host Government usually holds title to the facility and the land on which it is built throughout the life of the project. The expression "build-transfer-operate" (BTO) is sometimes used to emphasize that the infrastructure facility becomes the property of the host Government immediately upon its completion, the project company being awarded the right to operate the facility for a certain period. One variation of BOT or BTO projects are the "build-rent-operate-transfer" (BROT) projects or "build-lease-operate-transfer" (BLOT) projects, where, in addition to the obligations and other terms usual to BOT projects, the private entity rents the physical assets on which the facility is located for the duration of the agreement.

18. “Build-own-operate-transfer” (BOOT) are projects in which a private entity is engaged for the financing, construction, operation and maintenance of a given infrastructure facility in exchange for the right to collect fees and other charges from its users. In contrast to BOT projects, under this arrangement the private entity owns the facility and its assets until it is transferred to the host Government. However, the parties may provide that the private entity will own the facility permanently and is not under an obligation to transfer them back to the host Government in which case the project is referred to as a “build-own-operate” (BOO) project.

19. Besides acronyms used to highlight the particular ownership regime, other acronyms may be used to emphasize one or more of the obligations of the project company. In some projects, existing infrastructure facilities are turned over to private entities to be modernized or refurbished, operated and maintained, permanently or for a given period of time. Depending on whether the private sector will own such an infrastructure facility, those arrangements are called either “refurbish-operate-transfer” (ROT) or “modernize-operate-transfer” (MOT), in the first case; or “refurbish-own-operate” (ROO) or “modernize-own-operate” (MOO) in the latter case. The expression “design-build-finance-operate” (DBFO) is sometimes used to emphasize the private sector’s additional responsibility for designing the facility and financing its construction.

20. Sometimes all of the above transactions and other possible forms of infrastructure projects are generally referred to with the acronym “BOT”. In the *Guide*, however, the term “BOT” is only used in reference to the particular type of infrastructure projects described in paragraph 16.

(e) “*Project agreement*”, “*project consortium*”, “*project company*”

21. As used in the *Guide*, the words “project agreement” mean an agreement between the host Government and the private entity or entities selected by the host Government to carry out the project, and which sets forth the terms and conditions for the construction or modernization, operation and maintenance of the infrastructure. Other expressions which may be used in some legal systems to refer to such an agreement, e.g. “concession agreement” or “concession contract”, are not used in the *Guide*.

22. The expression “project consortium” refers to the group of companies that submit a joint proposal for the development of an infrastructure project and agree to carry it out jointly if awarded the project by the host Government.

23. The words “project company” are used to refer to the independent legal entity especially established by the project consortium for the purpose of carrying out the construction works and operating the infrastructure facility.

24. When in the context of the *Guide* particular reference is made to the fact that the project consortium or the project company has been granted a concession (i.e. the right to construct or operate the infrastructure facility as

defined in para. 15, above), the expression “concessionaire” may be used for such a project consortium or project company. Furthermore, the word “concessionaire” is sometimes used in the *Guide* to refer, generally, to entities which operate public infrastructure pursuant to a concession by the host Government.

(f) *References to national authorities*

25. The expression “host Government” is generally used in the *Guide* to refer to the authority that has the overall responsibility for the project and on behalf of which the project is awarded. Such authority may be national, provincial or local.

26. The expression “regulatory body” is used in the *Guide* to refer to the governmental organ or entity that is entrusted with the authority to issue rules and regulations governing the operation of the infrastructure. The regulatory body may be established by statute with the specific purpose of regulating the sector in which the infrastructure operates.

27. The term “awarding authority” is used in the *Guide* to refer to the organ, agency or office within the host Government which is responsible for selecting the concessionaire. Depending on the system of the host country, more than one organ, agency or office may be involved in the selection process and related procedures leading to the award of the project.

(g) “*Procurement*” and “*selection procedures*”

28. The word “procurement” is generally used in the *Guide* to refer to the systematized acquisition by the Government, on a commercial basis, of the items or services it needs in order to perform its functions or fulfil its objectives. The body of those rules is usually known as “procurement law”. The word “procurement” usually denotes a purchasing activity and this narrow connotation may be inappropriate to refer to the award of privately financed infrastructure projects. For clarity purposes, the *Guide* uses the words “selection procedures” to refer to the procedures used by the Government to award the right to construct and operate an infrastructure project.

(h) *Turnkey contract; design-build contract*

29. The *Guide* uses the term “turnkey contract” to refer to a construction contract whereby a contractor or consortium of contractors is engaged to perform all obligations needed for the completion of the entire works, i.e. the transfer of the technology, the supply of equipment and materials, the installation of the equipment and the performance of the other construction obligations (such as civil engineering and building).³ In a turnkey contract, the

³The notion of turnkey contract is discussed in the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works*, New York, 1988 (United Nations publication, Sales No. E.87.V.10) (hereafter referred to as the “*UNCITRAL Construction Legal Guide*”), p. 16.

contractor is normally obliged to undertake all necessary works so that the purchaser receives a facility which is ready for being put to operation. A contract is said to be "design-build and turnkey" when the construction organization also assumes the responsibility for the design of the infrastructure.

B. BACKGROUND INFORMATION ON INFRASTRUCTURE PROJECTS

30. The following sections discuss basic issues of privately financed infrastructure projects, such as private sector participation in public infrastructure and the concept of project finance. They further identify the main parties involved in those projects and their respective interests, and briefly describe the evolution of a privately financed infrastructure project. These sections are conceived as general background information on matters that are examined from a legislative perspective in the subsequent chapters of the *Guide*. For additional information, the reader is particularly advised to consult publications by other international organizations, such as the United Nations Industrial Development Organization (UNIDO),⁴ the World Bank⁵ or the International Finance Corporation.⁶

1. Private sector and public infrastructure

31. The roles of the public and the private sectors in the development of infrastructure have evolved considerably in history. Public services such as gas street lighting, power distribution, telegraphy and telephony, steam railways, electrical tramways were launched in the nineteenth century and in many countries they were provided by private companies that had obtained a licence or concession from the Government. Numerous privately funded road or canal projects were carried at that time, and there was a rapid development of international project financing, including international bond offerings to finance railways or other major infrastructure.

32. However, during most of the twentieth century the international trend was, in turn, toward public provision of infrastructure and other services. Infrastructure operators were often nationalized and competition was reduced by mergers and acquisitions. The degree of openness of the world economy also receded during this period. Infrastructure sectors remained privately operated only in a relatively small number of countries, often with little or no competition. In many countries the pre-eminence of the public sector on infrastructure service provision became enshrined in the constitution (see chapter I, "General legislative considerations", paras. 1-4).

33. The current reverse trend toward private sector participation and competition in infrastructure sectors started in

⁴UNIDO *BOT Guidelines* (see footnote 2).

⁵International Bank for Reconstruction and Development, *World Development Report 1994: Infrastructure for Development* (Oxford, Oxford University Press, 1994); *World Development Report 1996: From Plan to Market*, (Oxford, Oxford University Press, 1996).

⁶International Finance Corporation, *Financing Private Infrastructure* (Washington, D.C., 1996).

the early 1980s and it has been driven by general as well as country-specific factors. Among the general factors are significant technological innovations; high indebtedness and stringent budget constraints limiting the public sector's ability to meet increasing infrastructure needs; deepening of international and local capital markets improving the access to private funding; as well as an increasing number of successful international experiences with private participation and competition in infrastructure.

34. Various projects for the development of new infrastructure have been carried out by private entities in recent years. In addition to that, many countries have launched extensive privatization programmes transferring public utility companies to private operators. In many countries, new legislation was adopted, not only to govern these transactions, but also to modify the market structure and competition rules governing the sectors in which they were taking place (see chapter II, "Sector structure and regulation", ____).

2. Forms of private sector participation

35. Recent developments show that private sector participation in infrastructure projects may be devised in a variety of different forms, ranging from publicly-owned and operated infrastructure to fully privatized projects. The paragraphs below discuss the following three main variants: (a) public ownership and operation; (b) public ownership and private operation; and (c) private ownership and operation. The appropriateness of a particular variant for a given type of infrastructure is a matter to be considered by the Government in view of the national needs for infrastructure development and an assessment of the most efficient ways in which particular types of infrastructure may be developed and operated. In a particular sector more than one option may be used.⁷

(a) Public ownership and operation

36. The traditional modality of infrastructure provision offered limited or no scope for private sector participation, with the Government being both the owner and the operator of the infrastructure. However, some countries have devised mechanisms for attracting direct private financing or for facilitating the operation of public infrastructure under commercial principles.

37. A way of achieving those results may be for the Government to establish a separate legal entity, such as a joint stock company, controlled by the Government but managed as an independent private commercial enterprise that is subject to the same rules and business principles that apply to private companies. Some countries have a well established tradition in operating national infrastructure through these types of companies. Opening the capital of such companies to private investment, or making use of such a company's ability to issue bonds or other security may create an oppor-

⁷For a more detailed discussion of these forms, see International Bank for Reconstruction and Development, *World Development Report 1994* ..., p. 8-9.

tunity for attracting private investment in infrastructure. Some of these companies have been used as “special purpose vehicle” for raising private funds for infrastructure investment through the project finance modality.

38. Another form of involving private participation in publicly owned and operated infrastructure may be the negotiation of “services contracts” whereby the public operator contracts out specific operations and maintenance activities to the private sector. The host Government may also entrust a broad range of operation and maintenance activities to a private entity acting on behalf of the relevant public authority. Under this arrangement, which is sometimes referred to as a “management contract”, the private operator’s compensation may be linked to its performance, often through a profit-sharing mechanism, although compensations on the basis of a fixed fee may also be used, particularly where the parties find it difficult to establish mutually acceptable mechanisms to assess the operator’s performance.

(b) Public ownership and private operation

39. There are various ways in which the whole operation of public infrastructure may be transferred to private entities. One possibility is to give the private entity, usually for a certain period, the right to use a given infrastructure, to supply the relevant services and to collect the revenue generated by that activity. Such infrastructure may already be in existence, or may have been especially built by the private entity concerned, such as in a typical “build-operate-transfer” (BOT) project (see para. 18, above). This combination of public ownership and private operation has the essential features of arrangements which in some legal systems may be referred to as “public works concessions” or “public services concessions” (see chapter I, “General legislative considerations”, para. 12).

40. Another form of private participation in infrastructure is where a private entity is selected by the host Government to operate a facility which has been built by or on behalf of the host Government, or whose construction has been financed with public funds. Under such an arrangement, the operator assumes the obligation to operate and maintain the infrastructure and is granted the right to charge for the services it provides. In such a case, the operator assumes the obligation to pay to the Government a portion of the revenue generated by the infrastructure which is used by the Government to amortize the construction cost. These arrangements are referred to in some legal systems as “lease” or “*affermage*”.

41. The nature of the private entity’s rights in the equipment and assets related to the infrastructure, as well as the regime under which such infrastructure is operated (whether pursuant to a contract or to a unilateral “licence”), may vary greatly between different legal systems (see further chapter I, “General legislative considerations”, paras. 12-15). In a number of countries some types of publicly owned infrastructure are rarely taken over by the Government at the end of the concession period since the Government usually prefers to maintain that infrastructure under private operation. In these cases, the private use and possession of public assets, which was originally awarded

for a definite period, may, in practice, become indefinite (see further chapter IX, “Duration, extension and early termination of the project agreement”, ___).

(c) Private ownership and operation

42. The third basic modality entails that the private entity not only operates the infrastructure, but also owns the assets related to it. Here, too, there may be substantial differences in the treatment of those projects under national laws, for instance as to whether the Government retains the right to reclaim title to the infrastructure or to assume the responsibility for its operation (see also chapter I, “General legislative considerations”, paras. 16-19).

43. Where the infrastructure is operated pursuant to a governmental licence, private ownership of physical assets (e.g. telecommunication network) is often separable from the licence to provide the service to the public (e.g. long-distance telephone services), in that the licence can be withdrawn by the Government under certain circumstances. Thus, private ownership of the infrastructure may not necessarily entail an indefinite right to provide the service.

3. Financing infrastructure projects

44. Alternatives to traditional public financing are playing an increasing role in the development of infrastructure. In recent years, new infrastructure investment in various countries included projects with exclusively or predominantly private funding sources. The two main types of funds are debt finance, usually in the form of loans obtained at commercial markets, and equity investment. However, financing sources are not limited to those. Public and private investment have often been combined in arrangements sometimes called “public-private partnerships”.

(a) Equity capital

45. The first type of capital for infrastructure projects is provided in the form of equity investment. Equity capital is obtained in the first place from the members of the project consortium or other individual investors interested in taking stock in the project company. However, such equity capital normally represents only a portion of the total cost of an infrastructure project. In order to obtain commercial loans or to have access to other sources of funds to meet the capital requirements of the project, the members of the project consortium and other individual investors have to offer priority payment to the lenders and other capital providers, thus accepting that their own investment will only be paid after payment of those other capital providers. Therefore, the members of the project consortium, as the main promoters of the project, typically assume the highest financial risk. At the same time, they will hold the largest share in the project’s profit, once the initial investment is paid. Substantial equity investment by the companies participating in the project consortium is typically welcomed by the lenders and the host Government, as it helps reduce the burden of debt service on the

project company's cash flow and serves as an assurance of those companies' commitment to the project.

(b) Commercial loans

46. Debt capital often represents the main source of funding for infrastructure projects. It is obtained in the financial market primarily by means of loans extended to the project company by national or foreign commercial banks, typically using funds which originate from short to medium-term deposits remunerated by those banks at floating interest rates. Consequently, loans extended by commercial banks are often subject to floating interest rates and have normally a maturity term shorter than the project period. However, where feasible and economic, given financial market conditions, banks may prefer to raise and lend medium- to long-term funds at fixed rates, so as to avoid exposing themselves and the project company over a long period to interest rate fluctuations, while also obviating the need for hedging operations.

47. Due to the magnitude of the investment required for a privately financed infrastructure project, loans are often organized in the form of "syndicated" loans with one or more banks taking the lead role in negotiating the finance documents on behalf of the other participating financial institutions, mainly commercial banks.

48. Commercial loans are usually provided by the lenders under the condition that their payment takes precedence over the payment of any other of the borrower's liabilities. Therefore, commercial loans are said to be "unsubordinated" or "senior" loans. Senior loans may be divided into "unsecured" and "secured" according to whether their payment is guaranteed by any security provided by the borrower. Unsecured loans (i.e. loans that are not guaranteed by any security offered by the borrower) are typically provided on account of the borrower's creditworthiness. However, with a view to minimizing their exposure, lenders providing unsecured loans often require an undertaking from the borrower that its net assets will not be pledged in the favour of another party in preference to the unsecured creditors (such an undertaking is usually referred to as "negative pledge"). Secured loans, in turn, are typically guaranteed by collaterals provided by the borrower, such as shares of the project company or its property and receivables. The borrower's ability to offer such types of security and the creditworthiness of the borrower and their guarantors typically limit the risk to which the lenders are exposed, thus reducing the cost at which the credit is offered.

(c) "Subordinated" debt

49. The third type of funds typically used in these projects are "subordinated" loans, sometimes also called "mezzanine" capital. These loans rank higher than equity capital in order of payment, but are subordinate to senior loans. This subordination may be general (i.e. ranking generally lower than any senior debt) or specific, in which case the loan agreements specifically identify the type of debt to which it is subordinated. Subordinated loans are often provided at fixed rates, usually higher than those of senior debt. As an additional tool to attract such form of

capital, or sometimes as an alternative to higher interest rates, providers of subordinated loans may be offered the prospect of direct participation in capital gains, by means of the issue of preferred or convertible shares or debentures, sometimes providing an option to subscribe for shares of the project company at preferential prices.

50. Subordinated loans may be provided by the project company's shareholders, as a supplement to equity investment or may originate from other sources, such as governmental financial institutions, financing companies, investment funds and other so-called "institutional investors" such as insurance companies, collective investment schemes (e.g. mutual funds) or pension funds. These institutions normally have large sums available for long-term investment and may represent an important source of additional capital for infrastructure projects. Their main reason for accepting the risk of providing capital to infrastructure projects are the prospect of remuneration and the interest in diversifying investment. Normally, institutional investors do not participate otherwise in the development of the project or the operation of the facility.

(d) Capital market funding

51. As more experience is gained with privately financed infrastructure projects, increased use is being made of capital market funding. Funds may be raised at the capital market by the placement of bonds and other negotiable instruments on a recognized stock exchange. Typically, the public offer of negotiable instruments requires regulatory approval and compliance with applicable requirements of the relevant jurisdiction, such as requirements concerning the information to be provided in the prospectus of issuance and, in some jurisdictions, the need for prior registration. Bonds and other negotiable instruments may have no other security than the general credit of the issuer, or may be secured by a mortgage or other lien on specific property.

52. The possibility of gaining access to capital markets is usually greater for existing public utilities with an established commercial record than for companies specially established to build and operate a new infrastructure and lacking the required credit rating. Indeed, a number of stock exchanges require that the issuing company must have some established record over a certain minimum period before being permitted to issue negotiable instruments.

(e) Financing by Islamic financial institutions

53. One additional group of potential capital providers are Islamic financial institutions. Those institutions operate under rules and practices derived from the Islamic legal tradition. One of the most prominent features of banking activities under their rules is the absence of interest payments, and consequently the establishment of other forms of consideration for the borrowed money, such as profit sharing or direct participation of the financial institutions in the results of the transactions of their clients. As a consequence of their operating methods, Islamic financial institutions may be more inclined to consider direct or indi-

rect equity participation in a project than other commercial banks. At the same time, those financial institutions would give emphasis to reviewing economic and financial assumptions of projects for which financing is sought and would follow closely all phases of its implementation.

(f) Financing by international financial institutions

54. International financial institutions may also play a significant role as providers of loans, guarantees or equity to privately financed infrastructure projects. A number of projects have been co-financed by the World Bank, the International Finance Corporation or by regional development banks.

55. International financial institutions may play an instrumental role also in the formation of “syndications” for the provision of loans to the project. Some of those institutions have special loan programmes under which they become the sole “lender of record” to a project, acting on its own behalf and on behalf of participating banks and assuming the responsibility for processing disbursements by participants and for subsequent collection and distribution of loan payments received from the borrower, either pursuant to specific agreements or other rights that are available under their status of preferred creditor. Some international financial institutions may also provide equity or mezzanine capital, by investing in capital market funds specialized in securities issued by infrastructure operators.

56. International financial institutions may also provide guarantees against a variety of political risks, including, *inter alia*, expropriation or nationalization, failure of the host Government to make agreed payments (where the project company is a supplier of goods or services to a Governmental agency), to make available sufficient foreign exchange or to grant necessary regulatory approvals. The availability of these types of guarantees may facilitate the project company’s task of raising funds in the international financial market.

(g) Support by export credit agencies

57. Export credit agencies may provide support to the project in form of loans, guarantees or a combination of both. The participation of export credit agencies may provide a number of advantages, such as: lower interest rate than the rates applied by commercial banks and longer-term loans, sometimes at a fixed interest rate. However, insurance coverage or other form of support by export credit agencies is usually tied to the purchase of equipment originating from their countries or containing a certain minimum percentage of national components.

(h) Combined public and private finance

58. In addition to loans and guarantees extended by commercial banks and national or multilateral public financial institutions, in a number of cases public funds have been combined with private capital for financing new projects. Such public funds may originate from State income or

sovereign borrowing. They may be combined with private funds as initial investment or as long-term payments, or take the form of governmental grants or guarantees (see chapter V, “Government support”, ____).

59. Infrastructure projects may be co-sponsored by the Government through equity participation in the project company, thus reducing the amount of equity and debt capital needed from private sources. Land grants may also be made to the project company, so as to provide additional revenue sources (e.g. service areas or shopping malls alongside toll roads). In the case of new infrastructure, the risk to which the private sector is exposed may be mitigated by ancillary concessions for operation of infrastructure already in existence (e.g. a concession over an existing toll bridge may complement a concession for building and operating a new one).

60. In some cases, Governments undertake to make direct payments to the project company with a view to stimulating investment in projects perceived to be of high commercial risk. Private sector investment in new toll roads, for instance, may be discouraged by the fact that traffic forecasts, however professionally they may be prepared, are uncertain and depend on a number of unforeseeable factors. In order to attract investment to new projects deemed to be of public interest, some countries have introduced a system of direct payment by the Government of a flat sum established, for example, on the basis of a traffic estimate. Flat-fee payments may also be used in the case of infrastructure of low commercial potential (e.g. railbed and stations, piped sewerage and treatment).

61. Government support is often justified by the public interest in developing infrastructure which the private sector alone might not be willing to develop without some form of financial support. It is also argued that, even when some form of public financial support is provided, private investment in infrastructure reduces significantly the need for public subsidies and expenditures that would otherwise be incurred without private investment. Therefore, direct Government support is not considered to be inconsistent with the concept of private infrastructure financing. However, some forms of financial support offered by Governments have been criticized as constituting undesirable incentives contrary to the principles of private operation of infrastructure leading to project mismanagement (see chapter V, “Government support”, ____).

4. Parties involved in infrastructure projects

62. The parties to a privately financed infrastructure project may vary greatly depending on the infrastructure sector, the modality of private sector participation and the arrangements used for financing the project. The following paragraphs identify the parties in a typical privately financed infrastructure project involving the construction of a new infrastructure facility and carried out under the “project finance” modality.⁸

⁸This section discusses selected issues that arise in connection with different phases of a privately financed infrastructure project. For more information, including an analysis of economic, financial and management issues, the reader is advised to consult general literature on the subject, such as the *UNIDO BOT Guidelines*.

(a) *The host Government*

63. The execution of a privately financed infrastructure project frequently involves a number of public authorities in the host country. The awarding authority and the main body responsible for the project within the host Government may rest at the national, provincial or local level. Furthermore, the execution of the project may necessitate the active participation (e.g. for the issuance of licences or permits) of other agencies in addition to the awarding authority, at the same or at a different level of Government. These authorities (which, as indicated in paragraph 25, are collectively referred to in the *Guide* as “the host Government”) play a crucial role in the execution of privately financed infrastructure projects.

64. The host Government normally identifies the project pursuant to its own policies for infrastructure development in the sector concerned and determines the type of private sector participation that would allow the most efficient operation of the infrastructure. Thereafter, the host Government conducts the process that leads to the selection of the concessionaire. Furthermore, throughout the life of the project, the host Government may need to provide various forms of support—legislative, administrative, regulatory and sometimes financial—so as to ensure that the infrastructure is successfully built and adequately operated. Finally, in some projects the host Government may become the ultimate owner of the facility.

65. The host Government has a legitimate interest in ensuring that the project is properly executed and that the construction work meets the expected standards. Thus, the Government will usually reserve the right to monitor the execution of the project, a task that might involve governmental officials at different offices and ministries, and which requires an adequate level of coordination among them. For that purpose, it may be helpful to appoint an agency, committee or officer invested with the authority to coordinate all monitoring procedures in connection with the project (see chapter I, “General legislative considerations”, paras. 22-27).

66. The host Government also has an interest in receiving high quality infrastructure that will benefit the national economy by the provision of needed services. Additionally, the host Government might be interested in creating employment opportunities for local workers, or gaining advanced technology related to the project. Those objectives are sometimes reflected in legislative or contractual provisions concerning technology transfer or margins of preference for companies that undertake to hire local personnel.

67. The host Government remains accountable to the public and will therefore be interested in ensuring that the infrastructure is operated efficiently and in accordance with its overall policy for the sector concerned. Besides evaluating their qualifications, the host Government reviews carefully the composition of project consortia, so as to satisfy itself of their commitment to the project in all its phases (see further chapter III, “Selection of the concessionaire”, paras. 36-38). Issues affecting the general public, such as quality and continuity of services, environmental protection, level of tariffs or the observance of health and safety standards, are of

particular concern for the host Government. Thus, the host Government may wish to retain the right to exercise some form of control over the operation of the project, sometimes through a special regulatory body or through the enforcement of the terms of the project agreement (see chapter VII, “Operational phase”, ___).

(b) *The project company and its shareholders*

68. The bulk of the investment in the project, in terms of money, supplies and labour, is made in the construction, expansion or renovation of the infrastructure. Thus, the project consortium usually includes construction and engineering companies and suppliers of heavy equipment interested in becoming the main contractors or suppliers of the project. Those companies will be intensively involved in the development of the project during its initial phase, and their ability to cooperate with each other and to engage other reliable partners will be essential for a timely and successful completion of the works. However, by the very nature of their business, construction companies and equipment suppliers may not be at ease with a long-term equity participation in a project. Therefore, they will often seek to involve a company with experience in the operation and maintenance of the type of infrastructure being built. The presence of one or more of such companies may be encouraged or even required by the host Government as an assurance that the technical feasibility and the financial viability of the project in all its phases, and not only during the construction period, have been adequately considered.

69. For the project company’s shareholders it is important to have a return on their investment commensurate with the level of risk they assume. Besides commercial aspects, such as the level of revenue that the project is expected to generate, the legal security afforded to investments in the host country will play an important role in the decisions of those companies to invest in a given project (for a discussion of the need for a favourable legal framework for private investment in infrastructure, see chapter I, “General legislative considerations”, paras. 28-62). In particular, they will seek to obtain assurances that their investment will be protected from confiscation or dispossession. Foreign companies will also look for guarantees that they will be able to convert into foreign currency the revenue earned in local currency, and that they will be able to repatriate or take abroad their profits and residual investment after the expiry of the project term (see chapter V, “Government support”, ___).

70. The companies participating in the project consortium typically establish a separate company with legal capacity, assets and management of its own for the specific purpose of carrying out the project (see chapter IV, “Conclusion and general terms of the project agreement”, paras. 22-34). It is relatively simple to vest all rights, assets and obligations related to the project in a single independent legal entity. Under such a model, the direct involvement of other parties such as the project company’s shareholders may be limited, and the project company will enter into the project agreement and other instruments in its own name and will have its own personnel and management. Furthermore, a project company established as an

independent legal entity allows a clear separation between the assets, proceeds and liabilities of the project and those of the project company's shareholders, thus facilitating accounting and auditing procedures. The project company normally becomes the vehicle for raising the financial means required in addition to the equity contributed by its shareholders. Typically, the shareholders will choose a type of company in which their liability will be limited by the value of their shares (such as a joint stock company). Sometimes, the shareholders of the project company may also include "independent" equity investors not otherwise engaged in the project (usually institutional investors, investment banks, bilateral or multilateral lending institutions, sometimes also the host Government or a State-owned corporation). The participation of private sector investors from the host country is sometimes encouraged by the host Government.

71. The project company will have the overall responsibility for the project and will establish a number of contractual arrangements with construction contractors, equipment suppliers, the operation and maintenance company and other contractors, as required for the implementation of the project. Having usually no recourse to the individual shareholders, the host Government may require the project company to provide various types of guarantees for the performance of its obligations under the project agreement (see chapter VIII, "Delays, defects and other failures to perform", ___).

(c) *Lenders*

72. In traditionally secured transactions, the lenders typically rely on the overall creditworthiness of the borrower and are protected against failure of the project by guarantees provided by the project company's shareholders or their parent companies. This form of financing is usually described as "corporate finance" or "balance-sheet" finance, to emphasize that the amounts borrowed to finance the project become a corporate liability of the project company's shareholders. Corporate finance would typically be provided to borrowers with a sufficiently strong credit to stand the risk of project failure. Insofar as the lenders are protected against that risk, corporate finance may be available to creditworthy borrowers at relatively favourable terms.

73. However, for large-scale projects involving the construction of new infrastructure the shareholders are often not ready to guarantee the obligations of the project company. Therefore, these projects are often carried out as "project finance", where the repayment of loans taken by the borrower is primarily assured by the revenue generated by the project. Other guarantees are either absent or cover only certain limited risks. To that end, the project's assets and revenue, and the rights and obligations relating to the project, are independently estimated and are strictly separated from the assets of the project company's shareholders.

74. Project finance is said to be "non-recourse" financing due to the absence of recourse to the shareholders of the project company. In practice, however, lenders are seldom ready to commit the large amounts needed for infrastruc-

ture projects solely on the basis of a project's expected cash flow or assets. The lenders may reduce their exposure by incorporating into the project documents a number of back-up or secondary security arrangements and other means of credit support provided by the project company's shareholders, the host Government, purchasers or other interested third parties. This modality is commonly called "limited recourse" financing.

75. The risks to which the lenders are exposed in project finance, be it non-recourse or limited recourse, are considerably higher than in traditionally secured transactions, even more so in the case of infrastructure projects where the security value of the physical assets involved (e.g. a road, bridge or tunnel) would rarely cover the total financial cost of the project, given the lack of a "market" where such assets could be easily realized. This circumstance affects not only the terms under which the loans are provided (e.g. the usually higher cost of project finance, as compared to corporate finance), but also the composition of the lending syndicate and the role played by the lenders in structuring the project.

76. Before agreeing to finance the project, the lenders would review carefully the economic and financial assumptions of the project so as to assure themselves of its feasibility and commercial viability. The lenders' attention will typically be focused on assessing the following types of project risks: (a) pre-completion risks, i.e. the risk that the infrastructure might not be completed at all, or that it might be completed later than originally planned or at a higher cost than the original estimate; (b) operating risk, i.e. the risk that the facility might fail to operate at the expected level of efficiency; and (c) market risk, i.e. the risk that the commodity produced or service provided might not be marketable at the price and at the volume originally estimated. Commercial banks that specialize in lending for certain industries are typically not ready to assume risks with which they are not familiar. For example, long-term lenders may not be interested in providing short-term loans to finance infrastructure construction. Therefore, in large-scale projects, different lenders are often involved at different phases of the project.

77. The lenders usually negotiate with the project consortium to structure the project in a way that limits their exposure to those risks to an acceptable level. As for pre-completion risks, for example, the lenders examine carefully the management, specific skills and financial strength of the construction contractor or contractors and typically require that they provide an adequate level of equity investment and an acceptable form of guarantee of performance (see further chapter VI, "Construction phase", ___; and chapter VIII, "Delays, defects and other failures to perform", ___). A similar approach will be taken with regard to operation risks (see further, chapter VII, "Operational phase", ___; and chapter VIII, "Delays, defects and other failures to perform", ___). Acceptable protection against market risk will depend on the nature of the commodity produced or service provided. In power generation projects, for example, the lenders might find comfort in the existence of a firm commitment by a power distribution company to a certain minimum level of purchase (e.g. a "take-or-pay" agreement). Where services are provided directly to the

public, the lenders will be concerned about the criteria for fixing and adjusting the prices and whether regulatory controls apply (see chapter VII, "Operational phase", ____). They will further review carefully the terms of the concession granted to the project company (whether it is an exclusive concession or and whether the project company will compete with other service suppliers) (for a discussion of issues concerning competition, see chapter II, "Sector structure and regulation"; see also chapter IV, "Conclusion and general terms of the project agreement", paras. 17-21).

78. In addition to that, extensive security arrangements are negotiated with the project company and its shareholders with a view to guaranteeing priority payment of commercial debts before payments are made to other creditors or dividends are distributed to equity investors or to the project company's shareholders, and to conferring control of the project on the lenders in the event of default by the project company.

79. Security used in project finance typically includes mortgages, fixed or floating charges over all the assets of the project and assignments of future receivables arising from the operation of the project. Also, the lenders usually require the automatic deposit of an agreed part of those proceeds into a blocked account. Often loan agreements give the lenders the right to appoint a substitute in the event of default or inability of the project company to continue operating the infrastructure. The greater the amount of security the laws of the host country allow to be stipulated, the greater is the likelihood that financing will be available for the project at more favourable terms (see chapter I, "General legislative considerations", paras. 18-19; and chapter IV, "Conclusion and general terms of the project agreement", paras. 39-45).

80. With a view to avoiding disputes that might arise from conflicting actions taken by individual lenders, or disputes between lenders over payment of their loans, lenders extending funds to large projects typically negotiate a so-called "inter-creditor agreement". An inter-creditor agreement usually contains provisions dealing with matters such as provisions for disbursement of payments, pro rata or in a certain order of priority; conditions for declaring events of default and accelerating the maturity of credits; coordination of foreclosure on security provided by the project company.

(d) International financial institutions and export credit agencies

81. International financial institutions and export credit agencies will have concerns of generally the same order as other lenders to the project. In addition to this, they will be particularly interested in ensuring that the project execution and its operation will not be in conflict with particular policy objectives of those institutions and agencies. Increasing emphasis is being given by international financial institutions to the environmental impact of infrastructure projects and their long-term sustainability.

82. The methods and procedures applied to select the concessionaire will also be carefully considered by inter-

national financial institutions providing loans to the project. Many global and regional financial institutions and bilateral development funding agencies have established guidelines or other requirements governing procurement with funds provided by them. These institutions and agencies usually require procurement proceedings to be conducted in accordance with their guidelines or requirements, even if national procurement laws differ. This requirement is typically reflected in their standard loan agreements (see further, chapter III, "Selection of the concessionaire", para. 17).

(e) Other capital providers

83. Capital providers other than commercial banks and international financial institutions may include "institutional investors" such as insurance companies, mutual funds, pension funds or investment funds. Under the terms of their investment, these other capital providers are usually entitled to priority payment of principal and interest, or priority dividend payment, before dividends are distributed to the project company's shareholders and other shareholders of the project company. They will often have the right to receive periodic reports and financial statements. In the case of institutional investors holding preferential shares or debentures, they will enjoy other rights available to them under the laws of the country where the project company is established or where the shares or debentures were issued, which may include any of the following: the right to be collectively represented by an agent; the right to be consulted on and to approve certain changes in the statutes of the project company and to be kept informed of them until repaid; a preferential right to distribution of surplus assets.

(f) Construction contractors and suppliers

84. The construction contractor or contractors usually assume responsibility for the design of the facility and caretaking of it through all stages of construction until its physical completion. Their main interest is to be able to complete the works within the agreed schedule and original cost estimate and in conformity with the technical requirements. Typically, the construction contractor will be required to indemnify the other members of the project consortium against losses that arise from that contractor's failure to perform.⁹

85. Often one or more of the companies that conclude contracts with the project company for the construction of the infrastructure facility or the supply of equipment are also members of the project consortium. This situation carries with it the risk that equipment suppliers or construction contractors might attempt to secure contracts at preferential terms. This is one reason why some host Governments insist on the right to review or approve the terms of such contracts (see chapter VI, "Construction phase", ____).

⁹For a discussion of remedies for, and contractual approaches for dealing with, default by the construction contractor, see *UNCITRAL Construction Legal Guide*, pp. 182-195 and pp. 199-212.

(g) Operation and maintenance company

86. The operation and maintenance of the infrastructure may be carried out by the project company itself or may be entrusted to a contractor or group of contractors. Among all private parties to a project, infrastructure operators are the ones with the longest lasting involvement in the project. The operating company in particular will be in a singular position, as the task of operating the facility will place it in direct relation with its customers and will expose the operating company to public scrutiny. For those reasons, the operating company's viewpoint as regards the assessment of the economic and financial viability and profitability of the project may differ from the viewpoint of the other members of the project consortium and, therefore, it may be valuable to obtain the input of the prospective operating company at the early stages of the project, for instance by including the operating company among the project company's shareholders.

87. Where a contractor is retained for the operation and maintenance of the infrastructure, possible methods of payment may vary from lump-sum payments to cost-plus methods, in which the variable portion above and beyond the recovery of costs may be either a fixed sum, a percentage of the cost or a share in the revenue of the project. Combinations of any of those methods are also common. From the perspective of the project company, performance-based contracts are in most cases preferable to cost-plus contracts. The project company will normally establish some form of control mechanism over the operation of the facility (e.g. audit rights and cost review) so as to ensure that the operating costs are kept as much as possible within original estimates. Where the reimbursement of costs is subject to a maximum ceiling, the interest to reduce cost will be shared with the operating company.

88. The performance by the operation and maintenance company is normally subject to standards of quality that may derive from many different sources, including the law, the project agreement, the operation and maintenance contract or the instructions or guidelines issued by the competent regulatory body. In addition to that, a number of other requirements may be contained in legislation such as labour or environmental law. The operation and maintenance company is usually required to provide guarantees in the form of independent (or "on-demand") guarantees, contract or performance bonds or surety bonds, and to purchase and maintain adequate insurance, including casualty insurance, worker's compensation insurance, environmental damage and third party liability insurance.

(h) Insurers

89. Privately financed infrastructure projects involve a variety of risks during both the construction and operational phases of the project which the project company, the host Government, the lenders or the contractors may not be able to absorb. Thus, obtaining adequate insurance against such risks is essential for the viability of a privately financed infrastructure project. Typically, an infrastructure project will involve casualty insurance covering its plant and equipment, third party liability

insurance, and worker's compensation insurance. Other possible types of insurance include insurance for business interruption, interruption in cash flows, and cost overrun insurance. Those types of insurance are usually available in the commercial insurance markets, although the availability of commercial insurance may be limited for certain *force majeure* risks (e.g. war, riots, vandalism, earthquakes, hurricanes). The private insurance market is playing an increasing role in the coverage against some types of political risks, such as contract repudiation, failure by a governmental agency to perform its contractual obligations or unfair calls of independent guarantees. In addition to private insurance, guarantees against political risks may be provided by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency (MIGA), the International Finance Corporation, regional development banks or by export credit agencies.

(i) Independent experts and advisers

90. Independent experts and advisers play an important role at various stages of the development of privately financed infrastructure projects. Experienced companies typically supplement their own technical expertise by retaining the services of outside experts and advisers, such as financial experts, outside international counsel or consulting engineers. Independent experts and advisers may also assist the host Government in devising sector-specific strategies for infrastructure development and in formulating an adequate legal and regulatory framework. Furthermore, independent experts and advisers may assist the Government in the preparation of feasibility and other preliminary studies, in the formulation of requests for proposals or standard contractual terms and specifications, in the evaluation and comparison of proposals or in the negotiation of the project agreement.

91. Merchant and investment banks often act as advisers to project consortia in arranging the finance and in formulating the project to be implemented, an activity which, while essential to project finance, is quite distinct from the financing itself. They may also provide advisory services to Governments in seeking solutions to legal, economic, financial and environmental problems that arise in the preliminary phases of infrastructure projects.

92. In addition to private entities, a number of inter governmental organizations (e.g. UNIDO, the regional economic commissions of the United Nations) and international financial institutions (e.g. the World Bank, the regional development banks) have special programmes whereby they may either provide this type of technical assistance directly to the host Government or assist the host Government in identifying qualified advisers.

5. Phases of execution

93. Depending on the type of infrastructure, the phases through which a privately financed infrastructure project evolves may include the initial identification of the project and the selection of the concessionaire, the conclusion of

the project agreement and related instruments, the execution of the construction or modernization works to the operation of the infrastructure facility and possibly the transfer of the project to the host Government. The following paragraphs describe briefly the various phases of a privately financed infrastructure project involving the construction of a new infrastructure facility and carried out under the "project finance" modality. These phases may not necessarily be present in other types of projects, or may evolve in a different way.

(a) Identification of the project

94. One of the initial steps taken by the host Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. It is also important at this stage to assess the technical feasibility of the project as well as its environmental impact. The preliminary conclusions reached by the host Government at this stage will play a crucial role in conceiving the type of private sector involvement that is sought for the implementation of the project, for instance, whether the infrastructure facility will be owned by the host Government and temporarily operated by the private entity, or whether the facility will be owned and operated by the private entity. The choice of the modality of private sector participation will be significant for a series of legal issues commonly dealt with in the legislation, such as the ownership of the infrastructure facility and related assets and the acquisition of land (see chapter IV, "Conclusion and general terms of the project agreement", paras. 8-12).

95. In projects that involve the transfer to the private sector of a governmentally-owned public utility, the host Government may need to take a number of additional preparatory steps with a view to enabling its operation as a private company, such as restructuring the company according to commercial principles or abolishing statutory monopolies.

96. Following the identification of the future project, it is for the host Government to establish its relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the host Government review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main governmental bodies that have to give approvals, licences or authorizations or which have to be otherwise involved in the project. Depending on the importance and level of authority assigned to the project, the host Government, at that stage, may wish to designate an office or agency for the purpose of coordinating the input of other offices and agencies concerned and monitoring the issuance of licences and approvals (for further consideration of this issue, see below, chapter I, "General legislative considerations", paras. 22-27).

97. Furthermore, the host Government may need to make advance budgeting arrangements, to enable it to meet financial commitments that extend over several budgetary

cycles, such as long term commitments to purchase the project's output (e.g. "take-or-pay" arrangements) or other forms of support provided to the project (see chapter V, "Government support", ___).

(b) Selection of the concessionaire

98. Once a project has been identified, its viability and feasibility have been assessed, and the need or interest for private financing has been confirmed, the host Government will turn to the selection of the concessionaire. For projects involving the construction of new infrastructure, the selection method often involves competitive proposals submitted by a selected number of candidates who have met the relevant prequalification requirements.

99. The confidence of project consortia in the viability of the project and their readiness to invest the time and funds required for preparing tenders or proposals is often influenced by their assessment of the rules governing the selection process. Project consortia might be discouraged to participate in a selection process that they perceive as unclear or cumbersome. Therefore, for Governments wishing to attract private sector investment in infrastructure it is advisable to have procedures in place that maximize economy and efficiency in procurement, provide a fair and equitable treatment of all project consortia and ensure transparency in the selection process.

100. Whatever method is chosen by the host Government, the selection process for infrastructure projects is often complex and might require considerable time and entail significant cost for project consortia, thus adding to the overall cost of the project. Ensuring that documents distributed to project consortia are sufficiently clear and contain all elements necessary for the preparation of their tenders or proposals is important to reduce the need for clarifications, as well as minimize the potential for complaints or disputes. The legislation plays a significant role by providing a clear framework for the award of privately financed infrastructure projects (see further, chapter III, "Selection of the concessionaire").

(c) Preparations for the implementation of the project

101. Following the selection of the concessionaire, a number of measures will have to be taken with a view to beginning the implementation of the project. The project agreement will set forth the obligations of the parties concerning the implementation of the project. For projects as complex as infrastructure projects, it is not unusual that several months elapse in negotiations before the parties are ready to sign the project agreement. A number of factors have been reported to cause delay in the negotiations, such as inexperience of the parties, poor coordination between different governmental agencies, uncertainty as to the extent of governmental support, or difficulties in establishing security arrangements acceptable to the lenders.¹⁰ A

¹⁰For a discussion of issues having an impact on achieving financial closure, see International Finance Corporation, *Financing Private Infrastructure ...*, p. 37.

significant contribution may be made by the host Government by ensuring appropriate coordination among all offices and agencies involved, or by identifying in advance the types of guarantees and facilities it may provide to the implementation of the project (see chapter V, "Government support", ___). The clearer the understanding of the parties as to the matters to be provided in the project agreement, the greater the chances that the negotiation of the project agreement will be conducted successfully. Conversely, where important issues remain open after the selection process and little guidance is provided to the negotiators as to the substance of the project agreement, there might be considerable risk of costly and protracted negotiations.

102. In addition to the conclusion of the project agreement and related instruments, the project company will also enter into agreements with the lenders for the provision of loans for the implementation of the project and will establish contractual arrangements with contractors and suppliers. Moreover, a number of other arrangements are usually made in the period immediately following the award of the project in preparation for the commencement of the construction. The project company may also have at this stage to bring in the country the equipment and other material, as well as the personnel needed for the execution of the project. Where licences are required, the host Government will be instrumental in avoiding unnecessary delays.

(d) Construction phase

103. Following the satisfactory completion of the preliminary arrangements referred to above, funds may be disbursed for the implementation of the project, and the construction works may begin. It is during the construction phase that most of the investment is made in the project, at a time when no revenue is yet generated by the infrastructure. Thus, the overall financial viability of the project is largely predicated upon a successful construction phase. Delays in the construction and cost overruns are the two main reasons of concern for all the parties involved.

104. From the perspective of the host Government, delay and cost overruns also carry negative political implications and may undermine the credibility of the host Government's policy on privately financed infrastructure projects. The host Government usually requires the project company to assume full responsibility for the timely completion of the construction. The project company, in turn, will seek relief in the event of *force majeure* and other exempting circumstances, as well as assurances that it will not incur additional cost or liability for delays that result from requests by the host Government for changes in the original design or specifications of the project. Therefore, a number of provisions will be made in the project agreement, sometimes pursuant to a statutory requirement, so as to deal with the possible consequences of those situations (see chapter VIII, "Delays, defects and other failures to perform", ___). Furthermore, the host Government, as well as the lenders, will want to be assured that the technology proposed for the implementation of the project has been sufficiently used and is of proven safety and reliability. They will consider with great caution any suggestion

to use new or untested technologies. In any event, a number of tests may be required to be performed prior to final acceptance of the infrastructure facility.

105. Completion and cost-overrun risks will normally be allocated by the project company to the construction contractors and, for that purpose, the construction contract will normally be a fixed-price, fixed-time turnkey contract with guarantees of performance by the contractors. The contract usually requires the construction contractor to provide guarantees that the infrastructure facility will operate to predetermined performance standards. The liability of the construction contractors may extend beyond the completion date pursuant to the terms of their contracts or provisions of the applicable law. Also, the equipment suppliers are usually asked to provide extensive warranties as to the fitness of the technology provided.

(e) Operational phase

106. After completion of the construction works, and upon authorization by the host Government for the operation of the facility, the longest phase of the project begins. During that phase the project company undertakes to operate and maintain the infrastructure facility and to collect revenue from the users. Conditions for the operation and maintenance of the facility, as well as quality and safety standards, are often provided in the law and spelled out in detail in the project agreement. In addition to that, a regulatory body may exercise an oversight function over the operation of the facility (see chapter VII, "Operational phase", ___).

107. For the project company, the revenue generated by the infrastructure facility is the sole source of funds for repaying its debts, recouping its investment and making a profit. Therefore, one of the main concerns of the project company during the operational phase is to avoid as much as possible any interruption in the operation of the facility and to protect itself against the consequences of any such interruption. In this respect, the interests of the lenders will normally be convergent with those of the project company. It will be important for the project company to ensure that supplies and power needed for the operation of the facility will be constantly available. Also, the project company will be concerned that the exercise by the host Government of its monitoring or regulatory powers does not cause disturbance or interruption in the operation of the facility, and that it does not result in additional costs to the project company.

108. The host Government, too, will be interested in ensuring the continuous provision of services or goods to the users and customers of the infrastructure facility. At the same time, however, the host Government will have a legitimate interest in ensuring that the operation and maintenance of the facility are performed in accordance with the applicable quality and safety standards and operating rules and conditions (see chapter VII, "Operational phase", ___). These aspects will be of particular concern to the host Government in respect of infrastructure facilities open to use by the general public (such as a bridge or tunnel) or of a hazardous nature (such as power plants or gas distri-

bution networks). The particular perspective of the host Government, which results from its being accountable to the public for the infrastructure facility, may lead to conflicts or disagreements with the project company. Thus, the importance can be seen of having in place clear rules concerning the operation of the infrastructure facility and of establishing adequate methods for settling disputes between the host Government and the project company that might arise at that phase of the project (see chapter XI, "Settlement of disputes", ___).

(f) End of the project

109. With the exception of those cases where the infrastructure facility is to be permanently owned by the project company, most privately financed infrastructure projects are undertaken for a certain period. In some projects, extensions of the project period in favour of the same project company may be possible; in other cases, the law requires any extension of the concession to be submitted to competitive tendering (a more detailed discussion of these issues is contained in chapter IX, "Duration, extension and early termination of the project agreement", ___). In some countries, it is customary to award consecutive concessions for the same infrastructure, so that the assets are transferred directly from one concessionaire to its successor.

110. Some Governments may, however, have an interest in receiving the infrastructure facility and all related assets and equipment at the end of the term of a BOT project. In those cases, the host Government will be interested in ensuring that modern technology has been transferred, that the infrastructure facility has been properly maintained, and that national personnel have been adequately trained for the operation of the facility.

A/CN.9/444/Add.2

Chapter I. General legislative considerations

LEGISLATIVE RECOMMENDATIONS

Constitutional issues

1. It is advisable to review existing constitutional provisions so as to identify possible restrictions to private sector participation in infrastructure development and operation, limitations to the use of public property by private entities and obstacles to private ownership of infrastructure (see paras. 1-4).

Legislative approaches

2. General enabling legislation may be usefully supplemented by special laws dealing with specific infrastructure sectors. Where sector-specific laws already exist, it is desirable to review them with a view to ascertaining their

suitability for privately financed infrastructure projects (see paras. 5-8).

Legislative authority to grant concessions

3. The law should state clearly the authority of the host Government to award infrastructure projects to the private sector and name those fields of activity or types of infrastructure that may be developed by private entities (see para. 10).

4. It is advisable for the law to recognize the right of the project company to charge a price for the use of the infrastructure or the service or goods it provides, in accordance with the laws of the country and under the conditions to be provided in the project agreement. It is further advisable for the law to empower the parties to agree on mechanisms for calculating and adjusting those prices (see para. 11).

Legal regime of the project

5. It may be useful to incorporate into special legislation pertaining to privately financed infrastructure projects those rights and obligations which would otherwise have been applied by implication, and which are found to be appropriate in connection with those projects. The enactment of general enabling legislation may provide an opportunity for excluding the application of those rules of law which are found to pose obstacles to the execution of privately financed infrastructure projects (see paras. 12-15).

Ownership and use of infrastructure

6. The law should authorize the State to transfer or make available to the project company such public land or existing infrastructure that may be required for the execution of the project (see paras. 16-19).

Legal status of public service providers

7. It is desirable for the law to authorize the State to grant to the project company the rights, privileges and facilities that are necessary to build and operate the infrastructure and to provide the relevant public services, in its own name or as an agent of the host Government, where the operation of public infrastructure or the provision of public services is reserved to the State (see paras. 20-21).

Administrative coordination

8. It is advisable for the law to indicate the organs of the host Government, including, as appropriate, national, provincial and local authorities that are authorized to award concessions for infrastructure projects (see paras. 22-23).

9. The law might entrust one organ with the authority to receive the applications for licences needed for the implementation of infrastructure projects, to transmit them to the appropriate agencies and monitor the issuance of all licences required at the time of the award of the project and other licences that might be introduced thereafter (see paras. 24-26).

10. The law might also authorize the relevant agencies to issue provisional licences and provide a time period be-

yond which those licences are deemed to be granted unless they are rejected in writing (see paras. 24-26).

11. To the extent that the host Government is not in a position to make provisions such as those referred to in (9) and (10) above, it may wish to include in the law a provision requiring the awarding authority to use its best efforts to assist the project company in obtaining the required licences (see para. 27).

Other relevant areas of legislation

12. In addition to legislation immediately relevant for privately financed infrastructure projects, adequate provisions in other areas of law would facilitate transactions necessary to carry out infrastructure projects and reduce the perceived legal risk of investment in the country (e.g. investment protection law, property law, rules and procedures on expropriation, intellectual property law, security law, company law, accounting practices, contract law, insolvency law, tax law, environmental protection law, settlement of disputes) (see paras. 28-62)

National legislation and international agreements

13. The host Government may wish to consider the desirability of adhering to international agreements on trade facilitation or agreements on promotion of trade in specific industries and services that would have a positive impact on the implementation of privately financed infrastructure projects (see paras. 63-67).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. LEGAL FRAMEWORK FOR PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

1. Constitutional issues

1. The constitutional law of a number of countries refers generally to the duty of the State to ensure the provision of public services. Some of them list the infrastructure and services sectors which come under the responsibility of the State, while in others the task of identifying those sectors is delegated to the legislator. Under some national constitutions, the provision of certain public services is reserved exclusively to the State or to specially created public entities. Other constitutions, however, authorize the State to award concessions to private entities for the development and operation of infrastructure and the provision of public services. In some countries, there are limitations to the participation of foreigners in certain sectors, or there exist requirements that the State should participate in the capital of the companies providing public services.

2. For countries wishing to promote private investment in infrastructure it is important to review the existing constitutional provisions so as to identify possible restrictions to the implementation of privately financed infrastructure projects. In some countries, privately financed infrastructure projects have been delayed by uncertainties regarding the extent of the State's authority to award them. Some-

times, concerns that those projects might contravene constitutional provisions on State monopolies or on the provision of public services have led to judicial disputes, with negative impact on the implementation of the projects.

3. Another important category of constitutional provisions includes those relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations concerning private property of land and certain types of means of production. In other countries private property is recognized, but the constitution declares all or certain types of infrastructure to be State property. Prohibitions and restrictions of this nature might be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure.

4. Irrespective of the choice made by the host Government regarding the ownership of infrastructure, it is important for a country wishing to attract private investment in infrastructure to ensure that the State is authorized to make available to the project company such land or existing infrastructure as may be required for the execution of infrastructure projects. In some countries it has been found necessary to amend the constitution so as to provide the State with that authority.

2. General and sector-specific legislation

5. In some countries, as a matter of legislative practice, it has been considered appropriate to adopt specific legislation regulating the execution and operation of one or more individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the State is authorized by general legislation to award to the private sector any activity carried out by the public sector which has an economic value that makes such activity capable of being exploited by private entities. General enabling legislation of this type creates a framework for providing a uniform treatment to issues that are common to privately financed projects in different infrastructure sectors. Countries that consider it desirable to adopt general legislation may wish to determine what issues are suitable for being dealt with at this legislative level, and what issues should be left for specific legislation, regulations or for the project agreement.

6. By its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. In fact, the provision of certain public services is in several countries subject to special legislation governing specific infrastructure sectors (e.g. telecommunications, power generation and distribution, road and railway transportation). One of the arguments in favour of the adoption of sector-specific legislation, even in countries that have adopted general enabling legislation addressing cross-sectoral issues, is that it allows the legislator to take into account the market structure in devising regulatory mechanisms for individual infrastructure sectors.

7. Sector-specific legislation typically sets forth the policy of the Government for the sector concerned, lays down the

mechanisms for implementing such policy and provides the general rules for the provision of the relevant services. In many countries, sector-specific legislation was adopted at times when a significant portion, or even the entirety of the national infrastructure constituted State monopolies. Recent national strategies for promoting private sector investment in infrastructure were often based on the results of extensive studies that analysed questions such as the extent of competition that could be introduced in the market as a whole or within specific segments of it, and considered the potential economic costs and expected benefits of abolishing legal monopolies or retaining them in full or in part (see chapter II, "Sector structure and regulation", ___). For countries interested in promoting private sector investment in infrastructure it is advisable to review existing sector-specific legislation so as to ascertain their suitability for privately financed infrastructure projects.

8. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see chapter II, "Sector structure and regulation", ___). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such guidance is also useful to reassure the lenders and the project consortium that the regulators do not have unlimited discretion in the exercise of their functions, but are bound by the parameters provided by the law. However, it is generally advisable to avoid rigid or excessively detailed legislation, which in most cases would not be adequate to the long-term nature of privately financed infrastructure projects.

3. Elements for an enabling legislation

9. The implementation of privately financed infrastructure projects may require the enactment of special legislation or regulations authorizing the State to entrust the provision of public services to private entities or decentralized entities wholly or partially owned by the State. Besides being sometimes needed to satisfy national constitutional and other requirements, the enactment of express legislative authorization may be an important measure to foster the confidence of potential private sector investors, national or foreign, in a national policy to promote private sector investment in infrastructure. While it is generally not advisable to attempt to regulate through general legislation specific aspects of the mutual rights and obligations of the project company and the Government, there is a number of core issues that might usefully be addressed in general legislation.

(a) *Legislative authority to grant concessions*

10. In some legal systems the State is directly responsible for the provision of public services and may not delegate such a function without prior legislative authorization. For those countries that wish to attract private investment in infrastructure, it is therefore particularly important that the law states clearly the authority of the Government to entrust to entities other than governmental agencies the right to provide certain public services and to charge a price for them. For clarity purposes, it is further advisable

to identify in such general legislation those fields of activity in which concessions may be awarded.

11. The law should also empower the parties to agree on mechanisms for calculating and adjusting those prices, when they are not established by a regulatory body. Such a general provision in the enabling legislation may be particularly important in those countries where public services are State monopolies, or where it is envisaged to engage private entities to provide certain services that used to be available to the public free of charge. In some countries the absence of prior legislative authorization has given rise to judicial disputes challenging the project company's authority to require the payment of a price for the service provided.

(b) *Legal regime of privately financed infrastructure projects*

12. In some legal systems belonging to or influenced by the civil law tradition, the provision of public services may be governed by a body of law known as "administrative law", which governs a wide range of State functions. In most of those countries there are well-defined concepts of administrative law that may cover certain forms of infrastructure projects, such as "public works concession", "public services concession", or "delegations", "licences" or "permissions" for the provision of certain forms of public services. Various rights and obligations of the parties may derive from statutory provisions, judicial precedent or general principles of law, according to the type of the project and the nature of the instrument of award (e.g. whether a bilateral agreement or a unilateral act).

13. In some of those legal systems, for instance, the Government generally has the right to revoke administrative contracts or to modify their scope and terms, for reasons of public interest, usually subject to compensation of loss caused to its contractors, or additional cost incurred by them. Additional rights might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private operator for failure to perform. In some countries, there are special provisions for the settlement of disputes arising out of Government contracts, and there may be limitations to the right of governmental agencies to agree on non-judicial procedures for settlement of disputes (see chapter XI, "Settlement of disputes", ___). At the same time, some legal systems recognize certain implied conditions in all Government contracts that afford a certain level of protection to Government contractors, such as the right to review the terms of the contract following unforeseen changes in the circumstances (see chapter VIII, "Delays, defects and other failures to perform", ___). In some countries, however, the ability of the Government to revoke or alter the terms under which a private entity provides a public service might be limited to those cases where the relevant instrument was issued in the form of a unilateral act of discretion.

14. The existence of a special legal regime applicable to infrastructure operators and public service providers is not limited to the legal systems referred to above. In several countries belonging to or influenced by the common law

tradition there are special rules for each type of public utility (e.g. telecommunications, railways, electricity), which may not always be systematically grouped into a broader body of law. In these countries, too, particular rules have been developed for Government contracts, often through the extensive use of standard forms and terms. Those special rules typically give the Government certain powers of termination or modification balanced by an obligation to indemnify the contractor against the damage sustained by reliance on the contract. In that regard, an important distinction is made in some common law jurisdictions between “franchises”, which create vested rights in the public utility to provide the relevant service, from mere “licences”, which are personal privileges usually capable of being revoked by the grantor. However, in some countries it is understood that even unilateral acts licensing a private entity to carry out a given activity may create vested rights and, therefore, they may not be changed by the Government without the consent of the private entity, unless such possibility is expressly provided for in the law or in the terms of the licence.

15. In countries where Government contracts are subject to a special regime, it may be advisable for the legislature to review the adequacy of the existing regime for privately financed infrastructure projects and to identify possible difficulties that might result from the application of such a special regime. For purposes of transparency and to avoid any doubts by potential foreign as well as domestic investors, it may be useful to incorporate into special legislation pertaining to privately financed infrastructure projects those rights and obligations that are implied or are not treated systematically in the legal system and which are found to be appropriate in connection with those projects. By the same token, the enactment of general enabling legislation may provide an opportunity for excluding the application of those rules of law which are found to pose obstacles to the execution of privately financed infrastructure projects.

(c) Ownership and use of infrastructure

16. A number of countries have extensive provisions on the preservation and protection of State property, including special procedures and authorizations required for transferring the title to such property to private entities or granting to private entities the right to use governmental property. Whatever choice is made by the host Government regarding the ownership of the infrastructure facility to be built, modernized or rehabilitated, it is important for a country wishing to attract private investment in infrastructure to authorize the State to transfer or make available to the project company any land or existing infrastructure required for the execution of the project for a period not less than the duration of the project agreement.

17. The ownership regime for a particular project may be the result of practical considerations, such as the operational life of the infrastructure or the interest of the Government in retaining title to it. Moreover, in some projects the parties may wish to distinguish between assets that are to be owned by or reverted to the Government at the end of the concession period, and other assets acquired by the project company during that period and which remain the

project company's property. In some countries the law expressly provides that title to all assets originally furnished by the host Government for the construction of the facility, and to the facilities and improvements built thereafter by the project company, is vested in the host Government throughout the duration of the agreement. Some laws, on the other hand, authorize the transfer to the project company of title to the property required for the purposes of the concession or provide that the project company will own all assets that are acquired as a result of the concession. Other laws, while not authorizing the transfer of title to the project company, provide for some other rights *in rem* and provide in detail for their nature and scope (e.g. leasehold, right to use, usufruct).

18. Whatever form its rights may take, for the project company it is important to be assured that they are based on sufficient legislative authority and that it will be able to enforce them against third parties. The same concern will be shared by the lenders and other project investors. Furthermore, in view of the legal restrictions that apply in many countries to the use of public property by private entities, the Government may necessitate prior legislative authorization to allow the project company to use any additional public property.

19. Therefore, it might be desirable for the relevant legislation to clarify the nature of the property rights, if any, that may be granted to the project company, taking into account the type of infrastructure concerned. Furthermore, it might be useful for the law to authorize the Government to grant to the project company the right to use land, roads and other supporting facilities not directly related to the project, as required for the construction and operation of the infrastructure, under the terms and conditions to be provided in the project agreement.

(d) Legal status of public service providers

20. Public agencies or State organs providing public services are typically entrusted with powers designed to facilitate the provision of the service and to ensure that the users comply with and observe the pertinent regulations and rules. This may include, for instance, the right to issue, or control compliance with, safety regulations and the right to suspend the provision of service for emergency or safety reasons or because of default or non-compliance by the users (see chapter VII, “Operational phase”, ___). Those powers typically derive from the overall authority of the State and in some legal systems they are inherently governmental.

21. In countries with a well established tradition of awarding concessions for the provision of public services, the concessionaire is typically entrusted with the necessary powers by a delegation of authority from the State. The extent of powers delegated to the concessionaire is usually defined in the project agreement and may not need to be provided in detail in general enabling legislation of the type discussed in the *Guide*. However, where the operation of public infrastructure or the provision of public services is reserved to the State, it is desirable for the law to provide the State with the general authority to grant to the project company the rights, privileges and facilities that are necessary to

build and operate the infrastructure and to provide the relevant public services, in its own name or as an agent of the host Government.

4. Administrative coordination

22. Depending on the administrative structure of the host country, privately financed infrastructure projects may require the involvement of several different governmental agencies, at various levels of Government. For instance, the competence to lay down regulations and rules for the activity concerned may rest in whole or in part with a governmental agency at a level different from the one that is responsible for providing the relevant service. It may also be that both the regulatory and the operational functions are combined in one entity, but that the authority to award Government contracts is centralized in a different governmental agency. For projects involving foreign investment, it may also happen that certain specific competences may fall within the mandate of the agency of the host Government that is responsible for approving foreign investment proposals.

23. Where general enabling legislation is adopted, it is advisable to indicate clearly the agencies or levels of government competent to award infrastructure projects to the private sector. It may be useful to consider the extent of powers that may be needed by authorities other than the central Government to carry out projects falling within their purview. General legislation may itself provide the procedures for identifying or prioritizing infrastructure projects to be awarded to the private sector or it may refer to the rules that will establish those procedures. Similarly, the legislation may provide the procedures to be followed for the selection of the concessionaire, or indicate under which rules the selection is to be carried out (see further, chapter III, "Selection of the concessionaire").

24. In addition to clarifying matters relating to the overall authority to award projects in a specific sector, the legislation may play a useful role in facilitating the issuance of approvals and licences that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the project company; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; importation licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; spectrum allocation for mobile communication). The required licences and authorizations may fall within the competence of various organs at different levels of the national administration and the time required for their issuance may be significant, particularly when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms.

25. By the time the project agreement is signed, the project consortium will normally have spent considerable time and invested significant sums in the project (e.g. preparation of feasibility studies, engineering design and other technical documents; preparation of tendering documents and participation in the tendering proceedings;

negotiation of the project agreement, loan agreements and other project-related contracts agreements; hiring consultants and advisers). The possibility of not obtaining the licences needed for the construction of the facility may dissuade serious investors from competing for the award of the project. Furthermore, delay in bringing an infrastructure project into operation as a result of failing licences is likely to compromise the project's financial viability or cause considerable loss to its sponsors. Where the additional financial cost cannot be recovered by means of an extension of the concession period, or by raising the tariffs or charging higher prices, the project company might turn to the host Government for redress or support. The consequence would often be an increase in the cost of the project and in its cost to the public.

26. An early assessment of licences needed for a particular project may significantly contribute to avoiding delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and approvals might be to entrust one organ with the authority to receive the applications for licences, to transmit them to the appropriate agencies and monitor the issuance of all licences listed in the request for proposals and other licences that might be introduced by subsequent regulations. The law may also authorize the relevant agencies to issue provisional licences and provide a time period beyond which those licences are deemed to be granted unless they are rejected in writing.

27. However, there might be instances where the host Government, for constitutional or other reasons pertaining to its internal organization, might not be in a position to assume responsibility for the issuance of all licences or to entrust one single body with such a coordinating function. In that case, the host Government might wish to consider providing some assurance that nevertheless it will as much as possible assist the project company in obtaining licences required by national law, for instance as by designating an office or agency dedicated to provide information and assistance to project consortia regarding the required licences to be obtained, as well as the relevant procedures and conditions.

B. OTHER RELEVANT AREAS OF LEGISLATION

28. In addition to issues pertaining to legislation immediately relevant for privately financed infrastructure projects, a favourable legal framework may include provisions in other areas of legislation. Private investment in infrastructure would be encouraged by the existence of legislation that promotes private investment in economic activities. The following paragraphs point out only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects.¹¹ The existence of adequate legal provisions in these other fields may

¹¹For a general overview of the legal framework required for fostering private investment in privatized sectors, see United Nations Conference on Trade and Development, *Comparative Experiences with Privatization* (New York and Geneva, 1995), pp. 40-52. Particularly in respect of economies in transition, see United Nations Economic Commission for Europe, *Legal Aspects of Privatization in Industry* (New York, 1992), pp. 13-30.

facilitate a number of transactions necessary to carry out infrastructure projects and to reduce the perceived legal risk of investment in the country.

1. Investment protection

29. One matter of particular concern for the project consortia and the lenders is the degree of protection afforded to investment in the host country. The confidence of investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and appropriate compensation. Companies participating in project consortia will also be concerned about their ability, *inter alia*, to bring to the country without unreasonable restrictions the qualified personnel required for working with the project, to import needed goods and equipment, to have access to foreign exchange as needed, transfer abroad or repatriate their profits.

30. For countries that already have adequate investment protection legislation, it may be useful to consider expressly extending the protection provided in such legislation to private investment in infrastructure projects.

31. In addition to adopting domestic legislation on investment protection, an increasing number of countries have entered into bilateral investment agreements which aim at facilitating and protecting the flow of investment between the contracting parties. Investment protection agreements usually contain provisions concerning the admission and treatment of foreign investment; transfer of capital between the contracting parties (e.g. payment of dividends abroad, repatriation of investment); availability of foreign exchange for transfer or repatriation of proceeds of investment; protection from expropriation and nationalization and settlement of investment disputes. The existence of such an agreement between the host country and the originating country or countries of the members of the project consortium may play an important role in their decision to invest in the host country. Depending on its terms, such an agreement may reduce the need for assurances or guarantees by the Government geared to individual infrastructure projects.

32. A multilateral agreement on investment is currently being negotiated under the auspices of the Organization for Economic Cooperation and Development (OECD). The OECD multilateral agreement on investment is intended to deal with dispute settlement, protection of investors and investments, liberalization, privatization and monopolies, key personnel, environment and labour issues, performance requirements, investment incentives.

2. Property law

33. It is desirable that the property laws of the host country reflect modern acceptable standards and contain adequate provisions on the ownership and use of land and buildings, as well as moveable and intangible property (e.g. copyrights), and ensure the project company's ability to purchase, sell, transfer and license the use of property, as appropriate.

34. Whether the project company owns the land on which the facility is built, or is only granted a right to use it, it is important that the ownership of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The project company and lenders will need reasonable proof that ownership of the land will not be subject to dispute. They will therefore be reluctant to commit funds to the project if the laws of the host country do not provide adequate means for ascertaining ownership of the land. It is also desirable to ensure that the project company will be able to create security interest on such property, for the purpose of obtaining financing for the project (see chapter IV, "Conclusion and general terms of the project agreement", paras. 39-45).

35. It is further necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the project company against violation by third parties. Enforcement should also extend to easements and rights of way that may be needed by the project company for providing and maintaining the relevant service (e.g. placing of poles and cables on private property to ensure the distribution of electricity) (see chapter IV, "Conclusion and general terms of the project agreement", paras. 13-16).

3. Rules and procedures on expropriation

36. Usually the host Government assumes the responsibility for providing the land required for the implementation of the project, which may be either purchased from its owners, or, if necessary, acquired through expropriation (see chapter IV, "Conclusion and general terms of the project agreement", paras. 8-12). Many countries have legislation governing expropriation procedures and that legislation would apply to any expropriation required for privately financed infrastructure projects.

37. Expropriation procedures are usually lengthy and complex. They may also involve a number of offices at different ministries or levels of Government. Particular delay may be encountered in some countries where the expropriation takes the form of court proceedings. The host Government might thus wish to review existing provisions on expropriation for reasons of public interest with a view to assessing their adequacy to the needs of large infrastructure projects and to determining whether such provisions allow quick and cost-effective procedures, with due consideration to the rights of the owners. It is particularly important to enable the host Government to take possession of the property as early as possible, so as to avoid start-up delay and increased project costs (see chapter VIII, "Delays, defects and other failures to perform", ___).

4. Intellectual property law

38. Privately financed infrastructure projects frequently involve the use of new or advanced technologies protected under patents or similar intellectual property rights. They may also involve the formulation and submission of original or innovative solutions, which may constitute the pro-

ponent's proprietary information under copyright protection. Private investors, national and foreign, bringing new or advanced technology into the country or developing original solutions, will need to be assured that their intellectual property rights will be protected and that they will be able to enforce those rights against infringements.

39. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of property rights. *[The Commission may wish to consider whether a list of the main international instruments and a brief description of their contents, which could be prepared in consultation with the World Intellectual Property Organization (WIPO), should be inserted in this paragraph.]*

5. Security law

40. The type and extent of security offered by the project company or its shareholders will play a central role in the contractual arrangements for the financing of infrastructure projects. The security arrangements may be complex and consist of a variety of forms of security, including fixed security over physical assets of the project company (e.g. mortgages or charges), pledges of shares of the project company and assignment of receivables of the project. While the loan agreements are usually subject to party autonomy as to the law applicable to them, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the country and the remedies available. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of considerable practical difficulties. It is therefore important to ensure that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements.

41. Basic legal protection may include provisions ensuring that fixed security (e.g. a mortgage) is a registrable interest and that, once such security is registered in the central register of title or other public register, any purchaser of the property to which the security attaches should take the property subject to such security. Furthermore, security should be enforceable against third parties, have the nature of a property right and not a mere obligation and should entitle the person receiving security to a sale, in enforcement proceedings, of the assets taken as security. Secured creditors should enjoy preference to unsecured creditors in insolvency proceedings.

42. Another important aspect concerns the flexibility given to the parties to define the debt or debts which are secured and the assets which are given as security. In some legal systems, broad freedom is given to the parties in the definition of assets that may be given as security. In some legal systems, it is possible to create security that covers all the assets of an enterprise, making it possible to sell the enterprise as a going concern, which may enable an enterprise in financial difficulties to be rescued while increasing the recovery of the secured creditor. Other legal systems, however, allow only the creation of security that attaches to specific assets and do not recognize security covering

the entirety of the debtor's assets. There may also be limitations on the debtor's ability to trade in goods given as security. The existence of limitations and restrictions of this type makes it difficult or even impossible for the debtor to create security over generically described assets or over assets traded in the ordinary course of its business.

43. Given the long-term nature of privately financed infrastructure projects, the parties may wish to be able to define both the debt or debts which are secured and the assets which are given as security specifically or generally. They may further wish such security to cover present or future assets and assets which might change during the life of the security. It may be desirable to review existing provisions on security interests with a view to including provisions enabling the parties to agree on suitable security arrangements.

44. Another form of security typically given in connection with certain privately financed infrastructure projects is an assignment to lenders of proceeds from contracts with customers of the project company. Those proceeds may consist of the proceeds of a single contract (e.g. a power purchase commitment by a power distribution entity) or of a large number of individual transactions (e.g. monthly payment of gas or water bills). In most cases it would not be practical for the project company to specify individually the receivables being assigned to the creditors. Therefore, assignment of receivables in project finance typically takes the form of a bulk assignment of future receivables. However, there may be considerable uncertainty in various legal systems with regard to the validity of the wholesale assignment of receivables and of future receivables.

45. Thus far, no comprehensive uniform regime or model for the development of domestic security laws has been elaborated by international intergovernmental bodies. A model for the development of modern legislation on security interests is offered in the Model Law on Secured Transactions, which was prepared by the European Bank for Reconstruction and Development (EBRD) to assist legislative reform efforts in central and eastern European countries.¹² Besides general provisions on who can create and who can receive a security right, and general rules concerning the secured debts and the charged property, the EBRD Model Law on Secured Transactions covers other matters, such as the creation of security rights, the interests of third parties, enforcement of security and registration proceedings. The solutions proposed in the EBRD Model Law on Secured Transactions are intended to achieve the objectives discussed in paragraphs 41-44 above. *[A description of the work done by UNCITRAL in the field of assignment of receivables might be inserted in this paragraph, at the appropriate stage.]*

6. Company law

46. In most projects involving the development of a new infrastructure, the members of the project consortium will establish the project company as a separate legal entity in

¹²European Bank for Reconstruction and Development, *Model Law on Secured Transactions* (London, 1994).

the host country (see chapter IV, “Conclusion and general terms of the project agreement”, paras. ____). It is therefore important for the host Government to have adequate company laws with modern provisions on essential matters such as establishment procedures, corporate governance, issuance of shares and their sale or transfer, accounting and financial statements and protection of minority shareholders.

47. The project company’s shareholders are interested in limiting their liability to the value of their shares in the company’s capital. If it is intended that the project company will offer shares to the public, limited liability will be necessary, as the prospective investors will usually only purchase those shares for their investment value and will not be closely involved in the operation of the project company. It is therefore important that the laws of the host country provide adequately for the limitation of liability of shareholders. Furthermore, adequate provisions governing the issuance of bonds, debentures or other securities by commercial companies will enable the project company to obtain funds from investors on the security market, thus facilitating the financing of certain infrastructure projects.

48. Modern company laws often contain specific provisions regulating the conduct of managers so as to prevent conflicts of interest. Provisions of this type require that managers act in good faith in the best interest of the company and do not use their position to foster their own or other person’s financial interests to the detriment of the company. Provisions intended to curb conflicts of interests in corporate management may be particularly relevant in connection with infrastructure projects, where the project company may wish to engage its own shareholders, at one or the other stage of the project, to perform works or provide services in connection therewith (see chapter VI, “Construction phase”, ____).

49. It is important for the law to regulate adequately the decision-making process both for meetings of the shareholders and meetings of management organs of the company (e.g. board of directors or supervisory board). Protection of shareholders’ rights and in particular protection for minority shareholders from abuse by controlling or majority shareholders are important elements of modern company laws. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the project company through agreements among themselves.

7. Accounting practices

50. The adoption of standard accounting practices is a measure taken in many countries so as to achieve uniformity in the valuation of businesses. The use of modern and internationally acceptable accounting practices may be instrumental for ensuring the marketability of bonds and other security issued by the project company for the purpose of raising funds in international financial markets. In connection with the selection of the concessionaire, the use of standard accounting practices may also facilitate the task of evaluating and comparing proposals and establishing which proposal offers best value for money over the

entire concession period (see chapter III, “Selection of the concessionaire”, paras. 75-77). Standard accounting practices are further essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the verification of compliance by the regulatory body (see chapter VII, “Operational phase”, ____).

8. Contract law

51. It is important that the domestic law on commercial contracts provide adequate solutions to the needs of the project company and the lenders, including flexibility in devising contracts as needed for the construction and operation of the infrastructure facility. Besides some essential elements of adequate contract law, such as general recognition of party autonomy, judicial enforceability of contract obligations and adequate remedies for breach of contract, the laws of the host country may create a favourable environment for privately financed infrastructure projects by facilitating contractual arrangements likely to be used in these projects.

52. Where a new infrastructure is to be built, the project company may need to import large quantities of supplies and equipment. Greater legal certainty for those transactions may be facilitated if the laws of the host country contain provisions specially adapted to international sales contracts. A particularly suitable legal framework may be provided by adherence to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)^a or other international instruments dealing with specific contracts, such as the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988).

9. Insolvency law

53. The insolvency of an infrastructure operator or public service provider raises a number of issues that have led some countries to establish special rules to deal with those situations, including rules that enable the host Government to take the measures required to ensure the continuity of the project (see chapter IX, “Duration extension and early termination of the project agreement”, ____). Of particular concern for the secured lenders will be provisions concerning secured claims, particularly as to whether secured creditors may foreclose on the security despite the opening of insolvency proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked.

54. The insolvency of a project company is likely to involve creditors from more than one country or affect assets located in more than one country. It may therefore be desirable for the host country to have provisions in place that facilitate judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings. A suitable model that may

^aOfficial Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 11 March-11 April 1980 (United Nations publication, Sales No. E.81.IV.3), part I.

be used by States wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency.¹³

10. Tax law

55. The general taxation regime of the host country plays a significant role in the investment decisions of private companies. Beyond an assessment of the impact of taxation in the project cost and the expected margin of profit, private investors consider questions such as the overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers, the objectivity of criteria used to calculate tax liabilities.

56. Some countries, particularly developing countries and economies in transition, have made use of tax incentives to attract foreign investment or to promote investment in specific industries or regions. Common types of tax incentives may include reduced corporate income tax, exemption from income tax for foreign personnel required to staff the project, exemption from real estate tax, and tax concession on royalties or import duties. It should be noted, however, that project-specific tax incentives in the form of waivers or reductions of particular taxes, special tax withholding or deduction schemes or other ad hoc deviations from the general taxation regime of the host country are potentially discriminatory and may be less transparent than more direct forms of governmental support to the project (see chapter V, "Government support", paras. ____). Furthermore, it may be advisable for national Governments to review extensive tax incentives to foreign enterprises, particularly those which are indefinite and awarded to all kinds of foreign investment, since their continuation might put domestic investors at an unfair competitive disadvantage.

57. One particular problem of privately financed infrastructure projects involving foreign investment is the possibility that foreign companies participating in a project consortium might be exposed to double taxation, i.e. taxation of profits, royalties and interests in their own home countries as well as in the host country. A number of countries have entered into bilateral agreements to eliminate or at least reduce the negative effects of double taxation, and the existence of such agreements between the host country and the home countries of the consortium members often plays a role in their tax considerations.

11. Environmental protection

58. Environmental protection laws are likely to have a direct impact on the implementation of infrastructure projects at various levels. Environmental protection laws often require prior authorization for the exercise of a number of business activities, which may be particularly

stringent for some types of infrastructure (e.g. waste water treatment, waste collection). Authorizations and licences are often required for undertaking construction works or for installing certain physical structures. The denial of an environmental licence may in some cases constitute an impediment to the execution of the whole project.

59. Therefore, it is advisable to ensure the highest possible degree of clarity in provisions concerning the tests that may be applied by the environmental authorities, the documentary and other requirements to be met by the applicants, the conditions under which licences are to be issued, the circumstances that justify the denial or withdrawal of a licence and the appeals procedures and judicial remedies, as appropriate, that are available to the applicants. It may be further advisable to ascertain to the extent possible, prior to the final award of the project, whether the conditions for obtaining such a licence are met (see paras. 22-27). In some countries, special governmental agencies or advocacy groups may have a right to institute legal proceedings to seek to prevent environmental damage, which may include the right to seek the withdrawal of a licence deemed to be inconsistent with applicable environmental standards. In some of those countries it was found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences.

60. Further issues under the host country's environmental laws may arise when the project company takes over an existing infrastructure facility, in particular where the question of responsibility for environmental damage caused by State-owned industry prior to privatization has not been clarified. Private investors may be reluctant to take over an existing infrastructure or purchase shares in public utilities which may be called upon in the future to compensate for or remedy environmental damage caused by the enterprise before it was privatized. It may therefore be advisable to establish mechanisms for compensating the private investors for liability incurred as a result of environmental damage caused during the period of State operation.

12. Settlement of disputes

61. Another important factor for the implementation of privately-financed infrastructure projects is the legal framework in the host country for the settlement of disputes (see chapter XI, "Settlements of disputes", ____). Investors, contractors and lenders may be encouraged to participate in projects in countries that provide a hospitable and internationally acceptable legal climate for the settlement of disputes, as offered by the UNCITRAL Model Law on International Commercial Arbitration (1985).^b The efficiency of the national judicial system, the expeditiousness of court proceedings and the availability of forms of judicial relief that are adequate to commercial disputes are additional factors to be taken into account. Of particular importance is the possibility of recognition and enforcement of foreign arbitral awards, which will be fostered by adherence to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).^c

^bOfficial Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17), annex I.

^cUnited Nations, *Treaty Series*, vol. 330, No. 4739.

¹³The text of the Model Law was adopted by the Commission at its thirtieth session (Vienna, 12-30 May 1997) and is set forth in annex I to the report of UNCITRAL on the work of its thirtieth session (*Official Records of the General Assembly, Fifty-second Session, Supplement No. 17 (A/52/17)*).

62. A framework for the settlement of disputes between the host Government and foreign companies participating in a project consortium (see chapter XI, "Settlement of disputes", ___) may be provided by adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington, 1965).^d The Convention, which has thus far been adhered to by 139 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is voluntary. However, once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. ICSID is an autonomous international organization with close links with the World Bank.

C. NATIONAL LEGISLATION AND INTERNATIONAL AGREEMENTS

63. In addition to the internal legislation of the host country, privately financed infrastructure projects may be affected by international agreements entered into by the host country. The implications of certain international agreements is briefly discussed below.

1. General agreements on trade facilitation and promotion

64. A number of multilateral agreements have been negotiated to promote free trade at the global level. The most notable of those agreements have been negotiated under the auspices of the General Agreement on Tariffs and Trade (GATT), and later the World Trade Organization (WTO). Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (e.g. a most-favoured-nation clause, prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (e.g. prohibition of dumping and limitations on the use of subsidies). Some specific agreements are aimed at the removal of barriers for the provision of services by foreigners in the contracting States or promoting transparency and eliminating discrimination of suppliers in public procurement. Those agreements may be relevant for national legislation on privately financed infrastructure projects which contemplates restrictions on the participation of foreign companies in infrastructure projects, or establishes preferences for national entities, or for the procurement of supplies in the local market.

2. International agreements on specific industries

65. The telecommunications sector to date is governed by specific international commitments on matters of market

^dIbid., vol. 575, No. 8359.

structure, competition and regulation. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of World Trade Organization (WTO) member States representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. Other WTO member countries may still file specific commitments, those that already made them may offer improvements at any time, whereas new WTO members may be asked as part of the accession negotiations to include specific telecommunications commitments.

66. It should be noted that all WTO member States (even those that have not made specific telecommunications commitments) are bound by the general GATS rules on services, including specific requirements dealing with most-favoured-nation treatment, transparency, regulation, monopolies and business practices. The WTO telecommunications agreement adds sector-and country-specific commitments to the overall GATS agreement. Typical commitments cover the opening of various segments of the market, including voice telephony, data transmission and enhanced services, to competition and foreign investment. Legislators of current or prospective WTO member States would thus ensure that the country's telecommunications laws are consistent with the GATS agreement and their specific telecommunications commitments.

67. Another important sector-specific agreement at the international level is the Energy Charter Treaty, concluded at Lisbon on 17 December 1994 and in force since 16 April 1998, which has been enacted to promote long-term cooperation in the energy field. The Treaty provides various commercial measures like the development of open and competitive markets for energy materials and products, the facilitation of transit and the access to and transfer of energy technology. Furthermore, the Treaty aims at avoiding market distortions and barriers to economic activity in the energy sector and promotes the opening of capital markets to encourage the flow of capital in order to finance trade in economic materials and products. The Treaty also contains regulations about investment promotion and protection: equitable conditions for investors, monetary transfers related to investments, compensation for losses owing to war, civil disturbance or other similar events, and compensation for expropriation.

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Chapter II. Sector structure and regulation

LEGISLATIVE RECOMMENDATIONS

Market structure and competition

1. In devising programmes to promote private sector investment in infrastructure development and operation, it

is useful to review the assumptions under which State monopolies had been established, with a view to:

(a) identifying the activities that still maintain the characteristics of natural monopoly; and

(b) assessing the feasibility and desirability of introducing competition in other infrastructure sectors or segments thereof (see paras. 1-13).

Abolition of legal barriers and obstacles

2. The opening of infrastructure sectors to private participation and competition requires the abolition of rules that prohibit private participation or new entry and the removal of other legal impediments to competition (see paras. 15-16).

Restructuring infrastructure sectors

3. When formulating competition policies for individual infrastructure sectors, it is desirable to consider the possible need for, and the possible cost entailed by, separating the provision of infrastructure services from the operation of the underlying physical infrastructure (see paras. 18-21).

Transitional measures

4. Where it is not advisable to introduce competition at once, the law may provide for temporary exclusivity rights, limitation in the number of concessionaires or other restrictions on competition. The scope and duration of such restrictions should normally be limited to the minimum required. The law may provide for periodic revisions of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail (see paras. 33-34).

5. Where the reform requires the restructuring or privatization of the incumbent public service provider, it is advisable to remove, restrict or shorten its exclusive rights or monopolies prior to the privatization (see para. 35).

Controlling residual monopolies

6. Where the right to provide a specific service is restricted, it is advisable to award the pertinent licences or concessions through competitive selection procedures and to require that exclusive licences or concessions be rebid from time to time. The period between the initial award and the subsequent rebidding should take into account the level of investment and other risks faced by the licensee or concessionaire (see paras. 37-38).

7. Where economically and technically feasible, it may be useful to divide the territory of residual monopolies into smaller regions (see para. 40).

Conditions for the award of licences and concessions

8. Where entry to the market is not restricted, the role of the licensing authority may be only to ascertain whether the new entrant meets the basic legal requirements to provide the services. Where the number of entrants is limited, it is advisable to use a competitive selection procedure for the award of the single or multiple licences offered (see para. 50).

Interconnection and access regulation

9. Service providers should have the right to use the infrastructure of the network operator on conditions that are not less favourable than those granted by the network operator to its own services or to competing providers (see paras. 51-54).

Price and profit regulation

10. Where monopolistic conditions prevail or where markets are not yet truly competitive, it may be desirable to introduce a price or profit regulation mechanism (see paras. 55-56).

11. Price regulation may be limited to non-competitive market segments, while leaving prices in competitive segments free. It may be useful to set only the broad pricing principles in legislation while leaving their actual implementation to the regulatory body concerned and the terms and conditions of licences or concessions. It is advisable to provide a mechanism for revision of the tariff formula (see para. 57).

Subsidies and universal service

12. Where service providers are required to offer specific services without compensation or below cost, it may be necessary to consider appropriate forms of direct compensation (see para. 62).

Performance standards

13. Service providers should be required to meet technical and service standards, which should be provided in detail, as appropriate, in implementing decrees, concessions, licences or other documents (see para. 63).

Independence and autonomy of regulatory bodies

14. It is advisable to consider separating the regulatory functions from operational ones by removing any regulatory functions that may still be vested with public service providers and entrust them to a legally and functionally independent body (see paras. 67-69).

15. It is further advisable to consider granting the regulatory body a sufficient level of autonomy to ensure that its decisions are made on technical rather than political grounds (see paras. 70-71).

Sectoral attributions of regulatory bodies

16. It is advisable to consider the possible advantages and disadvantages, including cost considerations, of organizing regulatory responsibilities on a sectoral or rather cross-sectoral basis (see paras. 72-73).

Mandate of regulatory bodies

17. It is useful for the law setting up a regulatory mechanism to stipulate a number of general objectives that should guide the actions of regulatory bodies (e.g. the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability,

the safeguarding of the public interest or of public service obligations, and the protection of investors' rights) (see para. 74).

Powers of regulatory bodies

18. The law should set out with clarity whether the regulatory bodies have decision-making powers or purely advisory powers. The law should further specify which powers are vested with other governmental agencies and which ones with the regulatory body (see paras. 75-78).

Composition of the regulatory body

19. Where the regulatory body takes the form of a regulatory commission, it may be advisable to keep the number of its members small (see para. 80).

20. It may be useful to involve different institutions in the process leading to the nomination of the members of the regulatory commission and to require certain minimal professional qualifications, as well as the absence of conflicts of interest that might disqualify them for the function (see para. 81).

Disclosure requirements

21. It may be desirable for the law to spell out certain specific obligations of public service providers, including the obligation to provide the regulatory body accurate and timely information on the operation of the company, and to grant the regulatory body specific enforcement rights. They may include enquiries and audits, including detailed performance and compliance audits; sanctions for non-cooperative companies; power to issue orders or at least to initiate the issuance of orders; or penalty procedures to enforce disclosure (see paras. 84-86).

Procedures

22. Legislation should require the publication of regulatory procedures, which should be objective and clear. Legislation should further require that regulatory decisions state the reasons on which they are based and be accessible to interested parties through publication or other means (see paras. 87-88).

23. The regulatory process may include consultation procedures for major decisions or recommendations. To enhance transparency, comments or recommendations resulting from the consultation process may have to be published or made publicly available (see para. 89).

Sanctions

24. The law may give the regulatory body adequate enforcement powers, including the power to modify a licence, concession or authorization, or to suspend it or withdraw it; the power to set the terms of contracts between public service providers (e.g. interconnection or access agreement); to initiate the break-up of a dominant public service provider; to issue orders to public service providers; to impose civil penalties including penalties for any delay in implementing the regulatory body's decision, and to initiate judicial proceedings (see para. 94).

Appeals

25. It is advisable for the law to establish appeal procedures against decisions of a regulatory body. The law may limit the causes that give ground to appeals in order to prevent frivolous or dilatory appeals (see para. 95).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. MARKET STRUCTURE AND COMPETITION

1. In most of the countries that have recently built new infrastructure through private investment, privately financed infrastructure projects are not only an alternative for traditional financing of public infrastructure, but an important tool for meeting national infrastructure needs. Therefore, the conditions under which individual projects are executed have been typically devised in the light of the overall policy of the host Government for the infrastructure sector concerned. Essential elements of national policies include the level of competition sought for each infrastructure sector, the way in which the sector is structured and the mechanisms used to ensure adequate functioning of infrastructure markets.

2. National policies to promote private investment in infrastructure are often accompanied by measures destined to introduce competition between public service providers or to prevent abuse of monopolistic conditions, where competition is not feasible. Competition has been found to reduce costs and increase the productivity of infrastructure investment, as well as to enhance responsiveness to the needs of the customers. Through the lower costs and better quality obtained, competition typically improves the business environment in all sectors of the economy, thus increasing the country's competitiveness. Private participation has further been found to foster the development of modern management techniques and innovative solutions. Where it involves companies from other countries, it can make an important contribution to foreign direct investment and the international transfer of know-how.

1. Elements for the analysis of infrastructure markets

3. The scope for competition varies considerably in different infrastructure sectors. While certain sectors have been successfully opened to free competition, other sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative (see paras. 5-9). In order to analyse monopolistic conditions (including presence of a dominant position) and to determine the potential for competition, it is necessary to assess carefully the relevant market, taking into account, as appropriate, the degree to which some markets may be interrelated or segmented. For instance, reforms in the power and gas sectors have in some countries been considered together in view of the significant degree of substitutability (and thus competition) between these two sources of energy. The same

holds true for transport, where different modes often compete with each other; the relevant market may, for example, be the market for freight transport, including rail, road, water and air freight, as the case may be.

4. The measures that may be required to promote competition in various infrastructure sectors will essentially depend on the prevailing market structure (see paras. 22-32). Key elements that characterize a particular market structure include barriers to entry of competitors (e.g. economic, legal, technical or other), the degree of vertical or horizontal integration, the number of companies operating in the market as well as the availability of substitute products or services. Together, these elements determine the degree to which a market is competitive or not. Therefore, their analysis is crucial to develop strategies for policy intervention.

2. Competition policy and monopolies

5. In devising programmes to promote private sector investment in infrastructure development and operation, a number of Governments have found it useful to review the assumptions under which State monopolies had been established with a view to (a) identifying those activities that still maintain the characteristics of natural monopoly and (b) assessing the feasibility and desirability of introducing competition in certain infrastructure sectors.

6. The term monopoly in the strict sense refers to a market with only one supplier. However, pure monopoly and perfect competition mark two ends of a spectrum. Most markets for commodities or services are characterized by a degree of competition that lies between those two ends. Generally, monopolies can be classified as natural monopolies, legal monopolies and *de facto* monopolies; each of them may require different policy approaches:

(a) *Natural monopolies* are those economic activities that allow a single provider to supply the whole market at a lower cost than two or more providers. This situation is typical for economic activities that entail large investment and high fixed costs but decreasing costs of producing an additional unit of services (e.g. an additional cubic metre of water) to attend an increase of demand. Natural monopolies tend to exhibit large up-front fixed investment requirements which make it difficult for a new company, lacking comparable economies of scale, to enter the market and undercut the incumbent;

(b) *Legal monopolies* are established by law and may cover sectors or activities that are natural monopolies or not. In the latter category, monopolies exist solely because competition is prohibited. The developments that had led many countries to the establishment of legal monopolies were often based on the consideration that national infrastructure needs, both in terms of quality and quantity, could not be adequately met by leaving infrastructure to the free market;

(c) Lastly, *de facto monopolies* may not necessarily be the result of economic fundamentals nor of legal provisions but simply the absence of competition resulting, for example, from the integrated nature of the infrastructure company and its ability to control essential facilities to the exclusion of other suppliers.

7. From a policy perspective, monopolies (of whatever form) pose a variety of problems. A service provider operating under monopolistic conditions is typically able to fix prices. The surplus profit that results from insufficient competition is called a "monopoly rent". Monopoly rents may be perceived as being unfair, because they imply a transfer of wealth from consumers to producers. Furthermore, monopoly rents may be economically questionable, because they impose a net loss of welfare to the economy. This loss of welfare, which is sometimes called a "deadweight loss", is the result of three main reasons:

(a) Monopoly rents are obtained through inflated prices which result from artificially low production (static inefficiency);

(b) Lack of competition reduces the rate of innovation and efforts to reduce production costs (dynamic inefficiency); and

(c) Particularly in infrastructure sectors, there may be secondary effects on other markets (e.g. lack of competition and efficiency in telecommunications has negative repercussions on, or increases the costs for, the economy at large).

8. Despite their negative economic effects, monopolies and other regulatory barriers have sometimes been maintained in the absence of natural monopoly conditions. One of the reasons cited for retaining monopolies is that they may be used to foster certain policy objectives, such as ensuring the provision of services in certain regions or to certain categories of consumers at low prices or even below cost. Examples of services for which the price may not cover costs include lifeline telephone, water or power service, discounted transport for certain categories of travellers (e.g. school children, senior citizens), as well as other services for low-income or rural users. A monopolistic service provider is able to finance the provision of such services through internal "cross-subsidies" from other profitable services provided in other regions or to other categories of consumers. However, the experience of a number of countries has shown that cross-subsidies may be costly and poorly targeted; furthermore, they are usually not transparent and bypass the normal budget allocation mechanisms allowing to fund expenditures that may otherwise not pass public scrutiny. Some countries have found that other policy instruments, including direct subsidies payable to the service provider, were better suited to ensure the provision of those services and did not rely on a continued monopoly situation.

9. Another reason sometimes cited for retaining legal monopolies in the absence of natural monopoly conditions is to make the sector more attractive to private investors. Private operators may insist on being granted exclusivity rights to provide a certain service so as to reduce the commercial risk of their investment. However, this objective has to be balanced against the interests of consumers and the economy as a whole. Alternative, and socially less costly, options to make the environment more attractive to investors include measures aimed at enhancing transparency and reducing uncertainty related to the regulatory regime. For those countries where the granting of exclusivity rights is found to be needed as an incentive to private investment, it may be advisable to consider

restricting competition on a temporary basis only (see further, chapter IV, "Conclusion and general terms of the project agreement", paras. 17-21).

3. Scope for competition in different sectors

10. Until recently, monopolistic conditions prevailed in most infrastructure sectors either because the sector was a natural monopoly or because regulatory barriers or other factors (e.g. vertically integrated structure of public service providers) prevented effective competition. However, rapid technological progress has challenged the economic fundamentals of many former natural monopolies. These changes have in many cases resulted in a gap between the economically desirable market structure and the legislation in force. This has prompted legislators in a number of countries to extend competition to infrastructure sectors by adopting legislation that abolishes monopolies and other barriers to entry, changes the way infrastructure sectors are organized and establishes a regulatory framework fostering effective competition. The extent to which this can be done depends on the sector, the size of the market and other factors.

11. In telecommunications, for instance, new telecommunications laws have been adopted in a number of countries largely as a result of the fast-changing technology in this sector. New wireless technology not only makes mobile telecommunications services possible, but is also increasingly competing with fixed (wireline) services. Fibre optic networks, cable television networks, data transmission over power lines, global satellite systems, increasing computing power, improved data compression techniques, convergence between communications, broadcasting and data processing are further contributing to the breakdown of traditional monopolies and modes of service provision. As a result of these and other changes, telecommunications services have become competitive and countries are increasingly opening up this sector to free entry, while limiting access only to services that require the use of scarce public resources, such as radio frequency. In this context, market structure and competition rules need to be flexible enough to adapt to changing circumstances, which increasingly requires technologically neutral approaches.

12. In the energy sector, combined-cycle gas turbines and other technologies allowing for efficient power production on smaller scales and standardization in manufacturing of power generation equipment have led several countries to change the monopolistic and vertically integrated structure of domestic electricity markets. Increasing computing power and improved data processing software make it easier to dispatch electricity across a grid and to organize power pools and other mechanisms to access the network and trade in electricity. Like telecommunications, electricity is becoming a tradable commodity.

13. Technology is in many cases also at the origin of changing patterns in the transport sector: the introduction of containers and other innovations, such as satellite communications allowing to track shipments across the globe, have had profound consequences on shipping, port management, as well as rail and truck transport, while foster-

ing the development of intermodal transport. This has led to faster, cheaper and more competitive transport modes and to the removal of transport sector monopolies that often prevailed.

B. LEGISLATIVE MEASURES TO IMPLEMENT SECTORAL REFORM

14. Many countries have found that the introduction of private participation in infrastructure affords a unique opportunity to reconsider the existing market structure and regulatory setup. Legislative action typically begins with the abolition of rules that prohibit private participation in infrastructure and the removal of all other legal impediments to competition. Furthermore, where a decision has been made to open certain infrastructure sectors to competition, a number of countries have introduced changes in market structure or competition rules before, or in parallel with, the opening of the sector to private participation.¹

1. Abolition of legal barriers and obstacles

15. Monopolistic situations that are not, or have ceased to be, the result of economic and technological fundamentals, but of legal prohibitions, are the easiest targets for reform. Introduction of competition in these activities is relatively simple and may not require the restructuring of the incumbent monopolistic public service provider. The main action needed is the removal of the legal barriers, which may need to be reinforced by competition rules (such as the prohibition of collusion, cartels, predatory pricing or other unfair trading practices) and regulatory oversight (see paras. 41-95).

16. For a number of activities, however, effective competition may not be obtained through the mere removal of legislated barriers without legislative measures to restructure the sector concerned. In some countries, monopolies have been temporarily maintained only for the time needed to facilitate a gradual, more orderly and socially acceptable transition from a monopolistic to a competitive market structure.

2. Restructuring infrastructure sectors

17. Even in the absence of economic or legal barriers to entry, vertically or horizontally integrated infrastructure companies may be able to prevent effective competition. Integrated companies may try to extend their monopolistic powers in one market or market segment to other markets or segments in order to extract monopoly rents in these activities as well. Separating the monopoly element (such as the grid in many networks) from competitive elements in a sector may require the unbundling of vertically or horizontally integrated activities. Unbundling also facilitates the regulation of the residual and less complex monopolistic segments. It should be noted that many

¹See World Bank, *World Development Report 1994: Infrastructure for Development* (Washington, D.C., 1994), in particular chapter 3 "Using markets in infrastructure provision" (pp. 52-72).

unbundling options have only recently become available to policy makers as a result of technological progress.

(a) Vertical and horizontal unbundling

18. Vertical unbundling occurs when upstream activities are separated from downstream ones, for example by separating production, transmission, distribution and supply activities in the power sector. The objective is typically to separate key network components or essential facilities from the competitive segments of the business.

19. Horizontal unbundling occurs when one or more parallel activities of a monopolist public service provider are divided among separate companies, which may either compete directly with each other in the market (as is increasingly the case with power production) or retain a monopoly over a smaller territory (as may be the case with power distribution). Horizontal unbundling refers both to a single activity or segment being broken up (as in the power sector examples) and to substitutes being organized separately in one or more markets (as in the case of separation of cellular services from fixed-line telephony, for example).

20. By and large, infrastructure services tend to be competitive, whereas the underlying physical infrastructure often has monopolistic characteristics. By separating the two, many countries have found to have been able to design new and more efficient sector solutions. Unbundling allows the introduction of competition in segments of the sector that are not natural monopolies. The remaining monopolistic activities will either be exercised by a company (e.g. a power transmission or railtrack company) whose activities will need to be regulated because they include a monopolistic segment. Unbundling allows the State and the regulatory body to adopt different tools and approaches for activities that are competitive or a natural monopoly.

21. However, the costs and benefits of these changes need to be carefully considered. Costs may include the costs associated with the change itself (e.g. transaction and transition costs, including the loss incurred by companies which lose benefits or protected positions as a result of the new scheme) and the costs resulting from the operation of the new scheme, in particular higher coordination costs (e.g. more complicated network planning, technical standardization, as well as regulation). Benefits, on the other hand, may include new investments, better or new services, more choice, lower economic costs. Costs and benefits will also vary depending on how the changes are implemented.

(b) Recent experience in major infrastructure sectors

(i) Telecommunications

22. Unbundling has not been too common in the telecommunications sector. In some countries, long distance and international services were separated from local services; competition was introduced in the former, while the latter remained largely monopolistic. In some of these countries, this trend is now being reversed with local telephone com-

panies being allowed to provide long-distance services and long-distance companies being allowed to provide local services, all in a competitive context. Mandatory open access rules are common in the telecommunications sector, where the historic public service provider typically provides services in competition with other providers while controlling essential parts of the network.

(ii) Electricity

23. Most new electricity laws call for the unbundling of the power sector by separating generation, transmission and distribution. In some cases, supply is further distinguished from distribution in order to leave only the monopolistic activity (i.e. the transport of electricity for public use over wires) under a monopoly. In these countries, the transmission and distribution companies do not buy or sell electricity but only transport it against a regulated fee. Trade in electricity occurs between producers or brokers on the one hand and users on the other. In some of these countries, competition is limited to large users only or is being phased in gradually.

24. Where countries have opted for the introduction of competition in the power and gas sectors, new legislation has organized the new market structure, stipulating to what extent the market had to be unbundled (sometimes including the number of public service providers to be created out of the incumbent monopoly), or removed barriers to new entry. The same energy laws have also established specific competition rules, whether structural (e.g. prohibition of cross-ownership between companies in different segments of the market, such as production, transmission and distribution, or gas and electricity sale and distribution) or behavioural (e.g. third party access rules, prohibition of alliances or other collusive arrangements). New institutions and regulatory mechanisms, such as power pools, dispatch mechanisms or energy regulatory bodies, have been established to make these new energy markets work. Finally, other aspects of energy law and policy have had to be amended in conjunction with these changes, including the rules governing the markets for oil, gas, coal, and other energy sources.

(iii) Water and sanitation

25. The most common market structure reform introduced in the water and sanitation sector is horizontal unbundling. Some countries have created several water utilities where a single one existed before. This is particularly common in, but is not limited to, countries with separate networks that are not or are little interconnected. One of the advantages of such unbundling is to facilitate comparing the performance of service providers.

26. Some countries have invited private investors to provide bulk water to a utility or to build and operate water treatment or desalination plants, for example. In this vertical unbundling, the private services (and the discrete investments they require) are usually rendered under contract to a utility and do not fundamentally modify the monopolistic nature of the market structure: the plants usually do not compete with each other and are usually not allowed to bypass the utility to supply customers. This is a matter of design, however, and in a few countries these

services are provided in a competitive context. A number of countries have introduced competition in bulk water supply and transportation; in some cases, there are active water markets. Elsewhere, competition is limited to expensive bottled or trucked water and private wells.

27. The solid waste sector can be divided into different segments including collection, transfer stations, transport, landfill, incinerator or other disposal scheme, and recycling. Again, by unbundling these separable activities, Governments have been able to introduce competition in the sector. The size of the market will be a key parameter in determining whether competition can be introduced and the extent to which unbundling makes sense.

(iv) *Transport*

28. Increasingly, the distinction is made between transport infrastructure and transport services. The former may often have natural monopoly characteristics, whereas services are generally competitive. Competition in transport services should be considered not only within a single mode but also across modes, as trains, trucks, buses, airlines and ships tend to compete for passengers and freight.

29. With respect to railways, some countries have opted for a separation between the ownership and operation of infrastructure (e.g. tracks, signalling systems, train stations) on the one hand and of rail transport services (e.g. passenger, freight) on the other. In these schemes, the law does not allow the track operator to operate also transport services, which are operated by other companies often in competition with each other. Other countries have let integrated companies operate infrastructure as well as services but have enforced third party access rights to the infrastructure, sometimes called trackage rights. In these cases, transport companies, whether another rail line or a transport service company, have the right to access the track on certain terms, and the company controlling the track has the obligation to grant such access. Barriers to investment and operation in this sector are also gradually being removed.

30. In many countries, ports were until recently managed as public sector monopolies. When opening this sector to private participation, legislators have considered different models. Under the landlord-port system, the port authority is responsible for the infrastructure as well as overall coordination of port activities; it does not, however, provide services to ships or merchandise. In service ports, the same entity is responsible for infrastructure and services. Competition between service providers (e.g. tugboats, stevedoring, warehousing) may be easier to establish and maintain under the landlord system. In addition to competition between service providers using common facilities or between competing facilities within a port, there may be strong competition between ports. Indeed, hinterlands overlap and shippers often have a choice of ports. A second type of sector reform may thus consist in encouraging competition between ports, be it by breaking up national port authorities, by strengthening intermodal connections of weaker ports, or by other means. Many Governments have found that by fostering competition between ports and within ports, service quality improves and the need to regulate decreases.

31. Legislation governing airports may also require changes, whether to allow private investment or competition between airports or within airports. Links between airport operation and air traffic control may need to be carefully considered as well. Within airports, many countries have introduced competition in handling services, catering, and other services to planes, as well as in commercial passenger services such as retail shops, restaurants, parking and the like. In some countries, the construction and operation of a new terminal at an existing airport has been entrusted to a new operator, hence creating competition between terminals. In others, new airports have been built on a BOT basis and existing ones are transferred to private ownership. Finally, many countries have found that liberalization of air transport (airline routes) greatly contributes to the demand for airport services and hence to the financial viability of private airport projects.

3. Transitional measures

32. Whether sector reforms involve abolishing legal barriers to entry, unbundling of separable market segments, other measures, or a combination thereof, Governments have often paid great attention to the reform process. The transition from monopoly to market may need to be carefully managed. Political, social or other factors have led some countries to pursue a gradual or phased approach to implementation. As technology and other outside forces are constantly changing, some countries have adopted sector reforms that could be accelerated or adjusted to take these changing circumstances into account.

(a) *Phasing out barriers to entry*

33. Some countries have felt that competition should not be introduced at once. In such cases, legislation has provided for temporary exclusivity rights, limitation in the number of public service providers or other restrictions on competition. The scope and duration of such restrictions should normally be limited to the minimum required (typically less than the scope and duration of the licence or concession). The first is set to give the incumbent adequate time to prepare for competition, adjust tariffs, while the latter is intended to provide the public service provider adequate incentives for investment and service expansion. Some laws include provisions for the loss of all or part of these exclusivity rights or protection if the public service provider does not comply with the requirements of its licence; an exclusivity on the provision of certain services may lapse, for instance, if the dominant public service provider does not effectively provide them. Other countries have included provisions calling for the periodic revision (at the time of tariff reviews, for example) of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail.

34. Recent experience in the telecommunications sector offers examples for this type of transitional measures. A number of modern telecommunications laws in many countries allow for full competition in all or most segments of the

market. Legislators have often chosen to manage the transition to an open telecommunications sector gradually by lowering or removing barriers to entry and competition over a period of time, typically between one and seven years. Countries that have opted for the gradual approach have often started with the liberalization of terminal equipment (e.g. telephone sets, computer modems, private exchanges), followed by the introduction of one or more competing providers in mobile services (e.g. cellular telephony, paging) and the liberalization of value-added services (e.g. electronic mail, electronic databases, voice mail). After some years, long-distance and international services are opened up before local services and the sector as a whole including both infrastructure and services are liberalized. The advantage of this approach is to give incumbent public service providers the time to adjust to the new competitive context and, in particular, to adjust their tariffs in order to eliminate existing cross-subsidies between services. Some countries have pursued the same objective through other means, such as by gradually reducing high initial interconnection charges to cost-based levels as cross-subsidies are eliminated. The costs of a transition period include the delay in the benefits from competition accruing to users and, possibly, the weakening of the protected domestic public service providers relative to their foreign competitors operating in liberalized environments. In this sense, early reformers may have had more time to manage the transition to competitive markets than late reformers.

(b) Restructuring and privatization

35. Another transitional measure, at least in countries with State-owned public service providers, has been the restructuring or privatization of the incumbent service provider. All the reforms involving vertical and horizontal unbundling have by their nature required the restructuring of the incumbent public service provider. In addition, privatization of the State-owned public service provider has often been considered necessary to allow that company to compete effectively and fairly with new private entrants. While the sequence between privatization and liberalization has differed, liberalization has by and large either accompanied or preceded privatization. Some countries have proceeded otherwise and have privatized companies with significant exclusivity rights, often to increase privatization proceeds. They have, however, found it difficult and sometimes very expensive to remove, restrict or shorten at a later stage the exclusive rights or monopolies protecting private or privatized incumbents.

4. Controlling residual monopolies

36. Where natural monopoly conditions prevail and competition cannot be introduced *in* the market (that is, between companies competing for the same customers), many countries have introduced competition *for* the market (see paras. 37-39). Indirect competition between companies has also been created by way of benchmarks (see para. 40). In some cases, the Government may not be able to abolish legal barriers, to unbundle integrated sectors or to take other measures leading to the establishment of a competitive sector. In such cases, competition for the

market and indirect competition may also be used to attenuate monopoly costs.

(a) Use of competitive selection procedures

37. Competition for the market refers to a process leading to the selection of a company among several competing consortia to be awarded the right to provide the infrastructure service (for a discussion of selection methods, see chapter III, "Selection of the concessionaire"). It provides a mechanism to reduce or eliminate monopoly rents by inviting competing companies to bid against each other for this right. It requires private participation though not necessarily at the exclusion of public sector candidates. Some local governments have, for example, awarded solid waste collection franchises or concessions to the incumbent public authority or successors thereof who won tenders in which they competed with private tenderers; in these cases, the actual threat of private entry resulted in significant improvements in public sector performance.

38. A number of countries have adopted legislation requiring that exclusive licences or concessions be rebid from time to time (see below, chapter X "Duration, extension and early termination", ____). The period between the initial award and the first (and subsequent) rebidding should take into account the level of investments and other risks faced by the investor. For solid waste collection licences not requiring heavy fixed investments the periodicity may be relatively short (e.g. every three to five years) whereas longer periods may be desirable for a power or water distribution contract, for example. In many countries, rebidding coincides with the end of the contract term, but in others a concession may be granted for a long period (e.g. ninety-nine years), with periodic rebidding (e.g. every ten or fifteen years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the investor has fully recouped its investments; the incumbent has property rights that will need to be compensated if it does not win the next bidding round, in which case all or part of the bidding proceeds revert to the incumbent. Periodic rebidding may give public service providers strong performance incentives. While it may increase the longer term risk faced by investors and lenders, it may also provide them a valuable exit option.

39. Competition for the market may be used not only when the market in question is a natural monopoly, but also where resource constraints (such as wavelength spectrum availability) or Government decisions are limiting the number of concessions or licences awarded, hence creating a "scarcity" rent. If the Government decides to issue only two or three cellular licences, for example, the same mechanisms will be used to select the licensee; in these cases, however, the licence would normally not include exclusivity or, if it does, it would only be a temporary one allowing the Government to issue other licences a few years later.

(b) Geographical division of residual monopolies

40. By way of unbundling, many Governments have created the conditions for indirect, or "benchmark" competi-

tion, where concessionaires do not compete on the same territory but regulatory bodies are able to compare the performance of different companies (each with a regional monopoly) and use this information in the exercise of their regulatory functions (see chapter VIII, “Operational phase”, ___). In this way, a regulatory body with authority over several concessionaires in a given sector (some of which may be publicly owned and operated) may be in a better position to regulate them. More generally, regulatory bodies may be able to use international prices as benchmarks against which to judge the costs and performance of regulated companies. These domestic and international reference points may provide strong indirect performance incentives to companies in monopolistic sectors. In some instances, such benchmark prices have even been included in tariff formulas.

C. REGULATION OF INFRASTRUCTURE SERVICES

1. General remarks

41. Regulation involves several distinct elements, including substantive rules, procedures, instruments and institutions. The regulatory framework in a given country and sector—which defines the rights and obligations of service providers, consumers, regulatory bodies and the Government—results from the interplay of these elements. Depending on the country and its legal and political traditions, this framework may be established by treaties, constitution, laws, executive decrees, regulations, decisions of regulatory bodies, case law, licences, concessions or other contracts or instruments.

(a) *Historical context*

42. Regulation of infrastructure was in many countries introduced to contain abuses of monopolistic providers and cartels of public service providers trying to maximize their profits by reducing output and increasing prices above the economically and socially desirable level. Governments have taken various approaches to control these monopolistic tendencies. In many instances, the monopolistic infrastructure service provider was set up as (or later became, following nationalization) a public sector enterprise. State or municipal ownership was seen in itself as a guarantee against abuses and as a protection of consumer interests; regulation was in these cases exercised by way of public ownership. In other countries or sectors, the infrastructure provider was or remained a private company. To control its operations and prevent the exercise of monopolistic pricing and marketing strategies, Governments often set up general (e.g. anti-trust) and sector-specific regulatory mechanisms. The first regulatory commissions were set up in the mid nineteenth century.

43. The shift toward greater private participation and competition has been accompanied and strengthened by a shift to less intrusive regulation of public service providers (whether State owned or private entities). Realizing that

short-term political pressures often led to barriers to entry and other regulatory interventions that were not always in the public interest, many Governments have limited their level of discretion (often in contractual terms) and have opted for autonomous and independent regulatory mechanisms less exposed to political pressures. Where successfully introduced, these reforms have lowered the risks faced by private investors and hence financing costs.

(b) *Objectives of regulation*

44. The main purposes of regulation are to promote competition and efficiency, to address and correct to the extent possible market failures, and more generally to protect users from potential abuses by dominant or monopolistic public service providers and to protect investors from possible arbitrary government action. Regulatory intervention is often justified by a situation in which the market, left to its own devices, would not yield the desirable social outcome. Regulation may include control of monopoly power (including dominant positions), but also address environmental, safety, public health and other concerns. Those concerns are usually not specific to infrastructure sectors or to private companies, but are part of the overall regulatory framework that governs economic activity.

45. The nature of regulation differs substantially according to the characteristics of the sector. In natural monopolies, regulation focuses primarily on the production of the socially desirable level of services at economic prices, in particular by limiting the opportunities for the public service provider to collect monopoly rents. Where the sector as a whole is monopolistic, price control is often the key instrument. Where one or more segments of the sector are monopolistic and the rest competitive, special attention may need to be given to overseeing access by competitors to the monopolistic segments.

46. Another major factor is the degree to which market-based reforms have been or are being introduced. A change in market structure, the introduction of private participation or competition in infrastructure sectors generally require new rules and institutions. In sectors in transition to market-based competition, regulation focuses primarily on managing this transition by ensuring that competition is effectively introduced and promoted. Once a sector or segment has become competitive (as may be the case for telecommunications services in some countries), sector-specific regulation may give way to the general competition regime covering most sectors of the economy. The regulatory rules and institutions established by legislators typically take such factors into account. Flexibility is required to adapt to evolving conditions.

(c) *Costs and benefits of regulation*

47. Infrastructure regulation is a complex task requiring considerable resources. The process is relatively new for many countries and lessons can be drawn from the experience of those countries that have already implemented similar reforms.

48. However, it is important to weigh the costs and benefits of regulation. Effective regulation can foster the transition to competitive market, and protect consumers and investors, but it also has its costs. The direct costs of regulation include not only the costs of the regulatory machinery itself but also the costs of compliance by regulated enterprises. Indirect costs of regulation can be even more significant. Regulation may create distortions which at times may be larger than the market failures it was supposed to address. This may result from weak information available to regulatory bodies, capture of the regulatory process by interest groups, dearth of professional qualifications and experience of the regulatory body (which may be caused at least in part by inadequate regulatory resources and funding), lack of flexibility in rules and procedures or ill-considered or obsolete substantive rules. Finally, as a sector moves toward a competitive market structure the need for specific regulation disappears.

2. Substantive rules

49. Regulatory interventions may be divided into two broad categories. The first category includes the various actions up to the award of licences or concessions; these include sector reform and legislation, and managing the selection process for the award of licences or concessions. The second category is the regulatory intervention following the award of such licences or concessions. The following paragraphs briefly discuss some of the main regulatory issues that are encountered in a similar context in different sectors, including the regulation of entry and exit of competitors, interconnection, prices (tariffs), subsidies and universal service, and quality and performance.

(a) *Conditions for the award of licences and concessions*

50. Entry and exit rules are at the core of the organization of infrastructure sectors. Rules may allow for free entry of service providers into a sector or segment thereof or may limit such entry to a number of providers as determined by government through a licensing or concession scheme. Where free entry is the rule, as is the case in an increasing number of countries for many telecommunications services or for power generation, the role of the licensing authority may be only to ascertain whether the new entrant meets the basic legal requirements to provide such services. In some countries, the new entrant simply has to file a declaration and may start services unless the licensing authority expresses an objection within a given time limit (for example, one month). Where the number of entrants is limited, Governments are often required by law to organize a competitive process for the award of the single or multiple licences offered (see further chapter III, "Selection of the concessionaire").

(b) *Interconnection and access regulation*

51. In network industries, such as railway transport, telecommunications, power or gas supply, the historic or

dominant public service provider may try to protect or limit access by third parties to its network, which is often the monopolistic segment in these industries. In order to introduce competition, mandatory rules for access to the network by new entrants have been introduced as a key aspect of sector reform and regulation. In some cases, such rules have complemented the vertical unbundling measures (see paras. 18-21), in others they have been adopted to foster competition in sectors that remained fully or partially integrated.

52. Access rules generally impose obligations on the network operator to provide access on terms that are fair and non-discriminatory from a financial as well as technical point of view. Non-discrimination implies that the new entrant or service provider is able to use the infrastructure of the dominant public service provider on conditions that are not less favourable than those granted by the network operator to its own services or to those of competing providers. It should be noted, however, that, for example, many pipeline access regimes do not require completely equal terms for the carrier and rival users. The access obligation may be qualified in some way: it may for instance be limited to spare capacity only or be subject to reasonable (rather than equal) terms and conditions.

53. Generally, regulatory bodies will wish to ensure that access prices are high enough to give adequate incentives to invest in maintenance and expansion of the required infrastructure and low enough to encourage competition in the sector. Access pricing is usually cost-based. Where the network company provides services in competition with other providers, this may require that its activities be separated from an accounting point of view in order to determine the actual cost of the use by third parties of the network or parts thereof.

54. Technical access conditions may be equally critical, and dominant public service providers may be required to adapt their network to satisfy the access requirements of new entrants. Access may be to the network as a whole or to monopolistic parts or segments of the network (sometimes also referred to as bottleneck or essential facilities). Many Governments allow service providers to build their own infrastructure or to use alternative infrastructure where available; in such cases, the service provider may only need access to a small part of the network and cannot, under many regulations, be forced to pay more than the cost corresponding to the use of the specific facility he needs; this could be, for instance, the local loop in telecommunications, transmission capacity for the supply of electricity, or the use of a track section in railways.

(c) *Price and profit regulation*

55. Rules governing infrastructure sectors in most countries include price or profit regulation. The economic rationale is that, where monopolistic conditions prevail or where markets are not yet truly competitive, dominant public service providers may price their services too high to earn excess profits or too low (on a temporary basis) to drive out new entrants (predatory pricing). High prices and inadequate competition in infrastructure services may have

a detrimental impact on the sector concerned and also on the national economy.

56. Infrastructure sectors have different market structures and scope for unbundling and competition. Increasingly, countries limit price regulation to non-competitive market segments, while leaving prices in competitive segments free. For example, cellular telephony prices may in some countries be left unregulated while local phone tariffs may remain regulated. In countries where road transport (or water transport) provides adequate competition, prices of rail transport may similarly be left unregulated. Where a company provides price-regulated services as well as unregulated services, safeguards may need to be established to prevent the company from cross-subsidizing its competitive activities with revenues from its regulated activities; to facilitate the enforcement of the prohibition of cross-subsidization, typical safeguards include separate cost accounting or the establishment of one or more subsidiaries to house the competitive or potentially competitive activities. Furthermore, in many countries price ceilings apply only to the dominant public service providers (to keep in check their ability to abuse their dominant position) and not to new entrants.

57. Many countries have chosen to set only the broad pricing principles in legislation while leaving their actual implementation to the concerned regulatory body and the terms and conditions of licences or concessions. Others have chosen to legislate tariff formulas. By and large, a balance is sought between the interests of users and those of investors and often also current and future users. For example, where tariffs are kept too low, public service providers are hurt, investors deterred and future users penalized as they will have to pay for postponed investments. The tariff regime will also require adequate stability and predictability, to enable public service providers and users to plan accordingly.

58. Many infrastructure projects require heavy capital investment with relatively long amortization periods. Tariff formulas cannot be set once and for all, as technology, exchange rates, wage levels, productivity and other factors are bound to change significantly (and often unpredictably) over such periods. Many countries have in place mechanisms for revision of tariff formulas. Periodic revisions (e.g. every four or five years) of the formula usually amount to a renegotiation of the contract, bearing in mind the interests of users and of the economy at large, as well as investors and lenders.

59. Legislators have opted for various price control systems, the most common being rate of return regulation and price cap regulation. Many tariff regimes have elements of both. Under rate of return regulation, infrastructure service providers are allowed a given return on their investments, usually expressed in percentage terms. Each year (or each time the regulatory body, the company or other interested parties deem that the prices in effect yield too much or too little profits) the regulatory body verifies the expenses of the utility, determines to what extent investments undertaken by the company are eligible for inclusion in the rate base, and calculates the revenues that need to be generated to cover the allowable expenses and the agreed-upon

return on investment. Where available, regulatory bodies use risk-adjusted market rates to determine the rate of return figure. This system requires a substantial amount of information as well as negotiations (e.g. on eligible expenditures and cost allocation). It does not give public service providers strong incentives to improve efficiency as the efficiency gains they achieve in one year result in lower tariffs for the following year.

60. Under the price cap regime, a price formula is set for a given period (e.g. four or five years). Each year prices are allowed to fluctuate within the limits set by the formula. In some countries, the formula is a weighted average of various indices, in others it is a consumer price index minus a productivity factor. Where substantial new investments are required, the formula may include an additional component to cover these extra costs. The formula can apply to all services of the company or to selected baskets of services only, and different formulas may be used for different baskets. Services provided in a competitive environment may be excluded from the basket and deregulated, and the composition of the basket may be reviewed from time to time to take new market conditions into account. This price cap technique has been adopted increasingly in recent years. It may provide greater incentives for public service providers, as efficiency gains may be kept until the next adjustment period. In some countries, the price cap formula calls for partial pass-through of efficiency gains to consumers. The periodic readjustment of the formula is, however, based on rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

61. Another price regulation technique that may be used to set prices, or more generally to monitor price levels, is benchmark or yardstick pricing. By comparing the prices of one public service provider with those of another and with international norms, regulatory bodies may be able to judge whether tariff adjustments requested by the public service provider are reasonable. Whatever technique is chosen, the complexity of the tariff mechanism should not exceed the administrative capacity of those in charge of implementing, monitoring and adapting it.

(d) Subsidies and universal service

62. In many countries, the law requires that specific services must be provided even if they have to be provided without compensation or below cost. Examples of free services are emergency services (e.g. telephone calls to police, fire department, ambulances; inspection of alleged gas leaks or dangerous power lines). Services for which the price may not cover the costs include lifeline telephone, water or power service, discounted transport for certain categories of travellers (e.g. school children, senior citizens), as well as other services for low-income or rural users. Public service providers may recoup these service burdens or costs in several ways, including through Government subsidies, through funds or other official mechanisms created to share the financial burden of these obligations among all public service providers, or through internal cross-subsidies from other profitable services. Cross-subsidies should be distinguished from differentiated pricing, where different catego-

ries of users pay different prices (depending *inter alia* on the price elasticity of their demand), but where all prices cover, at least in the short run, marginal cost of the service. In this sense, price differentiation may be efficient and should not be prohibited. Direct Government or fund subsidies have the advantage of being more transparent and easier to monitor than cross-subsidies.

(e) Performance standards

63. Companies operating in regulated sectors generally have to meet a set of technical and service standards (see chapter IX, "Delays, defects and other failures to perform", ____). These are often too detailed to figure in the sector legislation and may be included in implementing decrees, concessions, licences or other documents. They include, for instance, minimum conditions to ensure interconnection in networked sectors, quality standards (such as requirements with respect to water purity and pressure), ceilings on time to perform repairs, ceilings on number of faults or complaints, on-time performance for transport services, continuity in supply, as well as health, safety and environmental standards. Legislation may, however, impose the basic principles that will guide the drafting of detailed standards or require compliance with international standards.

3. Regulatory bodies

64. Legislative provisions governing regulation of infrastructure sectors generally include substantive as well as institutional rules. They are established by various bodies and are implemented and monitored by others. The term "regulatory bodies" refers to the institutional mechanisms required to implement and monitor the substantive rules.

65. Regulatory bodies are needed because in the area of the operation of infrastructure facilities it is generally necessary for the rules to allow for a degree of discretion; someone needs to apply or implement the substantive rules, interpret them, monitor compliance, impose sanctions, and settle disputes arising out of the implementation of the rules. The specific regulatory tasks and the amount of discretion they involve will be determined by the rules in question, which can vary widely.

(a) Range of institutional set-ups

66. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While many countries still entrust regulatory functions to Government departments (such as the concerned ministries or departments in charge of prices or competition matters), the general trend is toward the establishment of autonomous regulatory bodies, separate from the Government. The same country may subject some infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Regulatory powers may also be shared between an autonomous regulatory body and the Government, as is often the case with respect to licensing.

(b) Independence and autonomy of regulatory bodies

67. Regulatory bodies need to be isolated and protected from inappropriate pressures. Regulatory decisions need to be taken without interference from public service providers. To that effect, legislative provisions in most countries require the independence of the regulatory decision making process. Effective independence and autonomy go a long way towards reducing regulatory risks and hence reduce the cost of infrastructure services.

68. A primary requirement is the separation of regulatory functions from operational ones by removing any regulatory functions that may still be vested with the public service providers and entrust them to a legally and functionally independent entity. Examples of confusion between regulatory and operational functions may include the right of the incumbent public service provider to certify equipment for use on a network or to set interconnection or access conditions unilaterally, or the right of a port operator to allocate berths to incoming ships.

69. Another essential requirement is the total independence of regulatory bodies from the industry they are regulating. That independence is often underpinned by prohibitions for staff of the regulatory body to hold mandates, accept gifts, enter into contracts or have any other relationship (directly or through family members or other intermediaries) with regulated companies, their parents or affiliates. This independence is a condition for the credibility of the regulatory body. It also implies that, to avoid conflicts of interest, regulation should, in particular in countries and sectors in which State-owned enterprises operate, be free from interference from the Government and the owners of enterprises in the sector.

70. This leads to a related issue, namely the autonomy of the regulatory body relative to the Government. This autonomy may be needed to minimize the risk of decisions being made or influenced by a body that is also the owner of enterprises operating in the regulated sector, or a body acting on political rather than technical grounds.

71. Independence and autonomy should not be considered solely on the basis of the institutional position of the regulatory function, but also on the basis of its functional autonomy, which requires that regulatory bodies have the financial and human resources to discharge their responsibilities professionally and with integrity.

(c) Sectoral attributions of regulatory bodies

72. Regulatory responsibilities may be organized on a sectoral or cross-sectoral basis. Countries that have opted for a sectoral approach have in many cases decided to place closely linked sectors or segments thereof under the same regulatory umbrella, as may be the case for example for telecommunications, cable television and broadcasting; power and gas; airports and airlines; or, more generally, competing transport modes. Other countries have organized regulation on a cross-sectoral basis, in some cases with one regulatory entity for all infrastructure sectors, and

in others with one entity for utilities (water, power, gas, telecommunications) and one for transport.

73. The decision to use one or another model depends in part on the country's regulatory capacity; the weaker it is, the more reason to reduce the number of independent structures and try to achieve economies of scope. Other reasons for having multi-sectoral agencies include: the common issues arising in the different infrastructure sectors and the ability to learn from the experience gained in other sectors; consistency in regulatory approach between sectors; the scope and sequence of the reform programme (if it starts with one sector only, the entity will often be sector-specific); and better resistance to pressures from sectoral interest groups. One possible drawback of cross-sectoral bodies is that it may not foster the development of technical (i.e. sector-specific) expertise.

(d) Mandate of regulatory bodies

74. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory bodies, such as the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations, and the protection of investors' rights. Having one or two overriding objectives helps clarify the mandate of regulatory bodies and establish priorities among sometimes conflicting objectives. A clear mandate also increases a regulatory body's autonomy and credibility.

(e) Powers of regulatory bodies

75. Regulatory bodies may have decision-making powers, advisory powers or purely consultative powers or a combination of these different levels of powers depending on the subject matter. In some countries, the legislator has decided to give the regulatory body limited powers initially but has increased them later as the regulatory body established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which ones with a regulatory agency. Clarity in this respect is important to avoid unnecessary conflicts and confusion. Investors, as well as consumers and other interested parties, should know to whom to turn with various requests, applications or complaints.

76. Licensing of public service providers, for example, is in many countries a process involving the Government as well as the regulatory body. If the decision to award a project involves broad judgement of a political rather than technical nature, which may often be the case in the context of infrastructure privatization, final responsibility often rests with the Government. If, however, the award criteria are more technical, as may be the case with a liberal licensing regime for power generation or telecommunications services, many countries entrust the decision to an independent regulatory body. In other cases, the Government may have to ask the regulatory body's opinion

prior to issuing the licence. On the other hand, some countries exclude direct involvement of regulatory bodies in the licensing process on the basis that it could affect the way they later regulate the use of these licences.

77. The jurisdiction of regulatory bodies normally extends to all enterprises operating in the sectors they regulate, with no distinction between private and public enterprises. The use of some regulatory powers or instruments may be limited by law to the dominant public service providers in the sector; a regulatory body may, for example, have price policing powers only vis-à-vis the incumbent or dominant public service provider, while new entrants may be allowed to set prices freely.

78. The matters on which regulatory bodies have to pronounce themselves range from normative responsibilities (e.g. rules on the award of licences, conditions for certification of equipment), to the award of licences, concessions or authorizations; the modification of such instruments; the approval of contracts or decisions proposed by the regulated entities (e.g. a schedule or contract on network access); the definition and monitoring of an obligation to provide certain services; the oversight over public service providers (in particular compliance with licence conditions, norms, performance targets); tariff setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

(f) Composition of regulatory bodies and their staff

79. The confidence of investors and the public in the professionalism, competence, efficiency and integrity of the regulatory function depends to a large extent on who is vested with this function. The way regulatory bodies and their staff are appointed, their qualifications and experience and the rules under which they operate are critical in this respect.

80. When setting up a regulatory body, a few countries have opted for a regulatory body comprised of a single officer, whereas most others have preferred a regulatory commission. A commission may provide greater safeguards against undue influence or lobbying and may limit the risk of rash regulatory decisions. A one-person regulatory body, on the other hand, may be able to reach decisions faster and may be held more accountable. To improve the management of the decision making process in a regulatory commission, the number of members is often kept small (typically three or five members). Even numbers are often avoided to prevent a deadlock, though the chairman could of course have a casting vote.

81. To increase the regulatory body's autonomy, different institutions may be involved in the nomination process; in some countries, regulatory bodies are appointed by the Head of State based on a list submitted by parliament; in others the executive branch of the Government appoints the regulatory body but subject to confirmation by parliament or upon nominations submitted by parliament, users associations or other bodies. Minimal professional qualifications are often required of regulatory bodies, as well as

the absence of conflicts of interest that might disqualify them for the function. Mandates of members of regulatory commissions may be staggered in order to prevent total turnover and appointment of all members by the same administration; staggering also promotes continuity in regulatory decision making. Mandates are often for a fixed term, may be non-renewable and may be terminated before the expiry of the term for limited reasons only (such as crime conviction, mental incapacitation, grave negligence or dereliction of duty). Certain requirements extend to the whole staff of the regulatory entity. Many laws grant a favourable personnel regime, including adequate pay scales, in order to attract qualified candidates and reduce the risk of corruption. Regulatory bodies are often faced with experienced lawyers, accountants and other experts working for the regulated industry and need to be able to acquire the same level of expertise, skills and professionalism, either in-house or by hiring outside advisors as needed. They are often allowed to subcontract certain regulatory tasks short of the ultimate regulatory decision to outside experts.

(g) Budget of the regulatory body

82. Adequate staff and pay-levels, budget for outside expertise and training, and stable funding sources are critical for the success of the regulatory body. In many countries, the budget of the regulatory entity is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the regulated companies, or be levied for the award of licences, concessions or other authorizations. In some countries, the entity's budget is complemented as needed by budget transfers provided in the annual finance law, but this creates an element of uncertainty that may reduce the regulatory body's autonomy.

4. Regulatory process and procedures

83. Any regulatory framework includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers.

(a) Disclosure requirements

84. To allow regulatory bodies to carry out their responsibilities, legislation usually imposes specific obligations on regulated industries, including the obligation to provide the regulatory body accurate and timely information on the operations of the company, and grants regulatory bodies specific enforcement rights. They may include enquiries and audits, including detailed performance and compliance audits; sanctions for non-cooperative companies; injunctions or at least initiation of injunctions or penalty procedures to enforce disclosure.

85. Regulated companies are normally required to maintain and disclose their financial accounts and statements and to maintain detailed cost accounting allowing the regulatory body to track various aspects of the company's

activities separately. Financial transactions between the company and affiliated companies may also require scrutiny, as companies may try to transfer profits to non-regulated businesses or foreign affiliates. Regulated enterprises may also have detailed technical and performance reporting requirements. However, the regulated enterprises will always be more knowledgeable about their cost structure than regulatory bodies and will only disclose the information they are effectively required to disclose and in the way that is most favourable to their interests.

86. Fostering competition in the infrastructure sector concerned is one method of dealing with this fundamental asymmetry in information. One of the benefits of introducing competition is that it provides the regulatory body multiple observations and reference points that allow it to determine whether proposals or positions of a regulated company are reasonable and in the public interest. Cost or technical information obtained from competitors may, for example, allow the regulatory body to disallow rate increases based on costs that are higher than the industry norm (see chapter VIII, "Operational phase", ___).

(b) Procedures

87. The credibility of the regulatory process requires transparency and objectivity, irrespective of whether regulatory authority is exercised by a Government department or minister or by an autonomous regulatory body. Rules and procedures should be objective and clear so as to ensure fairness and impartiality. For transparency purposes, the law should require that they be published. Regulatory decisions should state the reasons on which they are based and should be made accessible to interested parties, through publication or other appropriate means.

88. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory body of an annual report on the sector, the decisions taken during the exercise, the disputes that have arisen and the way they were settled, and so on. Such annual report may also include the accounts of the regulatory body and an audit thereof by an independent auditor. Legislation in many countries further requires that this annual report be submitted to a committee of parliament.

89. Regulatory decisions may impact on the interests of diverse groups, including the concerned public service provider, its current or potential competitors, and business or non-business users. In many countries, the regulatory process (whether managed by an agency or a ministry) includes consultation procedures for major decisions or recommendations. In some countries, this consultation takes the form of public hearings, in others of consultation papers on which comments from interested groups are solicited. Some countries have also established consultative bodies comprised of users and other concerned parties and require that their opinion be sought on major decisions and recommendations. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

(c) Dispute settlement

90. The provision of infrastructure services may give rise to a wide range of disagreements or disputes, many of which typically fall within the province of the court system; this would be the case of disputes between public service providers and their suppliers and personnel. The same is true for disputes between public service providers and users, though consumers (or consumer associations) may often, in addition, lodge complaints with the regulatory body. Most major disputes to be settled by the regulatory body are likely to arise between infrastructure service providers, as would be the case with access or interconnection proceedings.

91. Another type of conflict that may arise between the regulated companies and the regulatory body or government concerns the modification of a licence or a tariff formula. These are often dealt with by the regulatory body and may be subject to appeal.

92. In addition, the legislation organizing the sector, investment protection treaties, and licence or contractual provisions often address the right of investors to resort to international commercial arbitration between the Government and the affected entity in case of a perceived breach of contract (see chapter XI, "Settlement of disputes", ___).

93. As any of these disputes may have a negative impact on the operations of the concerned company and in view of the public nature of most infrastructure services, many laws (and licence or contract provisions) have developed mechanisms that allow disagreements to be settled promptly without recourse to courts, the regulatory body or arbitration. These may include a technical expertise, audit or certification by an independent third party, as well as permanent conciliation panels or mechanisms.

(d) Sanctions

94. In many countries, the law gives regulatory bodies coercive or punitive powers. Such powers may include the authority to modify, suspend or withdraw a licence, concession or authorization; the right to set the terms of contracts between public service providers (e.g. interconnection or access agreements); to initiate the break-up of a dominant public service provider; to issue injunctions and orders to public service providers; to impose civil penalties including penalties for any delay in implementing the regulatory body's decision, and to initiate criminal or other court procedures.

(e) Appeals

96. Legislators have often provided for appeal procedures against decisions of a regulatory body. The laws of many countries limit the causes that give ground to appeal, however, in order to prevent the regulatory uncertainty that may arise from appeals intended primarily to delay the effect of regulatory decisions. It is therefore desirable to strike a balance between the protection of legitimate rights of the regulated industry and the credibility of the regulatory system. It

is often essential that decision be made quickly. For instance a refusal to grant access to a competitor could drive the competitor into bankruptcy if the matter cannot be resolved expeditiously. Where the right to appeal is granted, it should be to a body that has the required skills and expertise to adjudicate the matter. Some laws give public service providers the right to appeal against certain decisions of the regulatory body to the country's competition authority, others to administrative tribunals or judicial courts.

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Chapter III. Selection of the concessionaire

LEGISLATIVE RECOMMENDATIONS

Appropriate selection method

1. For the selection of the concessionaire it is advisable to devise a method that promotes competition within structured, formal procedures. Direct negotiations should be reserved for exceptional circumstances (see paras. 15-18).

Prequalification of project consortia

2. It is advisable to use a prequalification procedure to narrow down the number of proposals with which the awarding authority must deal. Proceedings involving the evaluation of more than a limited number of proposals are generally not suitable for privately financed infrastructure projects (see paras. 19-20).

3. Where consortia are formed to submit proposals, their members should not be allowed to participate, directly or through subsidiary companies, in more than one consortium (see para. 38).

4. Where preferences for national candidates or candidates who offer to procure supplies, services and products in the local market are envisaged, they should be applied as a margin of preference at the evaluation phase and announced in the invitation to prequalify (see paras. 39-40).

5. It may be useful to allow the awarding authority to consider arrangements for compensating prequalified proponents if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them (see paras. 41-42).

6. No criterion, requirement or procedure with respect to the qualifications of project consortia should be used that has not been set forth in the prequalification documents (see para. 44).

7. Upon completion of the prequalification phase, the awarding authority should elaborate a short list of the prequalified project consortia which will be subsequently invited to submit proposals. Subsequent changes in the composition of prequalified consortia should require the approval of the awarding authority (see paras. 45-46).

Initial request for proposals

8. Unless the awarding authority deems it feasible to formulate input or output specifications of the project and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated, it is advisable to structure the proceedings for requesting proposals from qualified proponents in two stages (see paras. 47-49).

9. The awarding authority should be allowed to convene a meeting of proponents to clarify questions concerning the request for proposals and to engage in negotiations with any proponent concerning any aspect of its proposal (see para. 51).

10. Following those negotiations, the awarding authority should review and, as appropriate, revise the initial input or output specifications. The awarding authority should be allowed to delete or modify any aspect, originally set forth in the initial request for proposals, of the technical or quality characteristics of the project and any criterion originally set forth in those documents for evaluating and comparing proposals and for ascertaining the successful proponent (see para. 52).

Final request for proposals

11. At the final stage, the awarding authority should invite the proponents to submit final proposals with price with respect to the revised specifications and contractual terms (see paras. 53-65).

Contents and submission of final proposals

12. Technical proposals should, as a minimum, include:

- (a) Specifications and schedule of works;
- (b) Feasibility and other studies;
- (c) Description of services to be provided and applicable quality standards;
- (d) Description of maintenance services and standards (see para. 66).

13. Financial proposals should, as a minimum, include:

- (a) The proposed tariff or price structure;
- (b) The proposed duration of the concession, where it is not specified in the request for proposals;
- (c) The level of governmental financial support required for the project, including, as appropriate, any subsidy or payment expected from the host Government;
- (d) The extent of risks assumed by the concessionaire during the construction and operation phases, including unforeseen events, insurance, equity investment and other guarantees against those risks (see para. 67).

Evaluation criteria

14. Criteria for the evaluation of the non-price technical aspects of proposals should include technical feasibility; environmental effectiveness; effectiveness of the proposed construction and operation systems; soundness of the proposed financial arrangements, including resources of the proponents (see para. 72).

15. Criteria for the evaluation of the price proposals should include costs for design and construction activities; annual operation; maintenance costs; present value of capital costs and operating costs; present value of the proposed price over the concession period; the amount of subsidy, if any, expected from the host Government (see para. 73).

Opening, comparison and evaluation of proposals

16. Upon receipt of the final proposals, the awarding authority should ascertain whether they are *prima facie* responsive to the request for proposals. Incomplete or partial proposals should be rejected at this stage (see paras. 75-77).

Final negotiations

17. The awarding 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 proponent that has attained the best rating. These negotiations should not concern those terms of the contract that were deemed not negotiable in the final request for proposals (see para. 78).

18. If it becomes apparent to the awarding authority that the negotiations with the proponent invited will not result in a project agreement, the awarding authority should inform that proponent that it is terminating the negotiations and then invite for negotiations the other proponents on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals (see para. 79).

Notice of project award

19. The awarding authority should cause a notice of the award of the project to be published. The notice should indicate:

- (a) The name of the concessionaire;
- (b) A list of the annexes and enclosures that form part of the agreement;
- (c) A description of the works and services to be performed by the concessionaire;
- (d) The duration of the concession;
- (e) The tariff structure;
- (f) The rights and obligations of the concessionaire and the guarantees assumed or to be provided by it;
- (g) The monitoring rights of the awarding authority and remedies for breach of the project agreement;
- (h) The obligations of the host Government, including any payment, subsidy or compensation offered by the host Government;
- (i) Any other essential term of the project agreement, as provided in the request for proposals (see para. 80).

Circumstances authorizing the use of direct negotiations

20. Direct negotiations should be resorted to only in exceptional circumstances (see paras. 82-85). Exceptional circumstances may include the following:

- (a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a selec-

tion procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the awarding authority nor the result of dilatory conduct on its part;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount (see para. 86).

21. Direct negotiations might be further resorted to when an invitation to prequalify or a request for proposals has been issued but no applications to prequalify or proposals were submitted, or all proposals were rejected by the awarding authority, and when, in the judgement of the awarding authority, issuing a new request for proposals would be unlikely to result in a project award (see para. 87).

Unsolicited proposals

22. The awarding authority should establish transparent procedures for dealing with unsolicited proposals (see paras. 88-90).

23. Upon receipt of an unsolicited proposal, the awarding authority should determine whether it might be in the public interest to develop the proposed project. The awarding authority should examine the proposal within a reasonable period. Title to all documentation submitted should vest in the proponent throughout the procedure. If the proposal is rejected, all documents submitted should be returned to the proponent. No proposals should be solicited concerning a rejected project for a minimum number of years without the invitation of the company which submitted the original proposal (see paras. 91-92).

24. If the host Government accepts the proposal, the awarding authority should engage in a competitive selection procedure (such as request for proposals), preceded by a prequalification phase. The company that submitted the original proposal should be invited to participate in such proceedings and might be given, as a premium for submitting the proposal, a margin of preference over the final rating. If such a margin of preference is given, appropriate notice should be given to all companies invited to submit proposals (see para. 93).

Record of selection proceedings

25. The law should require that the awarding authority keep appropriate record of key information pertaining to the selection proceedings (see paras. 94-99).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. This chapter deals with methods and procedures recommended to be used for the award of privately financed infrastructure projects. In line with the advice of international organizations, such as the World Bank¹ and

¹International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a).

UNIDO,² the *Guide* expresses a clear preference for the use of competitive selection procedures, rather than direct negotiations with project consortia, as further explained in paragraphs 15 to 17 below.

2. The selection procedures recommended in this chapter present some of the features of the tendering method under the UNCITRAL Model Law on Procurement of Goods, Construction and Services³ with a number of adaptations so as to take into account the particular needs of privately financed infrastructure projects. The method herein consists of a two stage procedure with a prequalification phase. It allows some scope for negotiations between the awarding authority and the proponents within clearly defined conditions. The description of the procedures recommended for the selection of the concessionaire is primarily concerned with those elements that are special to, or particularly relevant for, privately financed infrastructure projects. Where appropriate, this chapter refers the reader to provisions of the UNCITRAL Model Law, which may *mutatis mutandis* supplement the selection procedure described herein.

B. SELECTION PROCEDURES COVERED BY THE *GUIDE*

3. Private investment in infrastructure may take various forms, each requiring special methods for selecting the concessionaire. For the purpose of discussing possible selection methods for the infrastructure projects dealt with in the *Guide*, a distinction may be made between three main forms of private investment in infrastructure:

(a) *Purchase of public utilities enterprises.* Private capital may be invested in public infrastructure through the purchase of physical assets or the shares of public utility enterprises. Those transactions are often carried out in accordance with rules governing the award of contracts for the disposition of State property. Disposition methods often include competitive proceedings such as auctions or invitations to bid whereby the property is awarded to the qualified party offering the highest price;

(b) *Provision of public services without development of infrastructure.* In other types of projects, the service providers own and operate all the equipment necessary and sometimes compete with other suppliers for the provision of the relevant service. Some national laws establish special procedures whereby the State may authorize a private entity to supply public services by means of exclusive or non-exclusive "licences". Licences may be publicly offered to interested parties who satisfy the qualification requirements set forth by the law or established by the licensing authority. Sometimes licensing procedures involve public auctions to interested qualified parties;

(c) *Construction and operation of public infrastructure.* In projects for the construction and operation of pub-

²UNIDO *BOT Guidelines*, p. 96.

³The UNCITRAL Model Law on Procurement of Goods, Construction and Services (hereafter referred to as "the UNCITRAL Model Law") and its accompanying Guide to Enactment, were adopted by the Commission at its twenty-seventh session (New York, 31 May-17 June 1994). See *Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* and Corrigendum (A/49/17 and Corr.1), annex I.

lic infrastructure, a private entity is engaged to provide both works and services to the public. The procedures governing the award of those contracts are in many aspects similar to those that govern public procurement of construction and services. National laws provide a variety of methods for public procurement, ranging from structured competitive methods, such as tendering proceedings, to less structured negotiations with prospective suppliers.

4. This chapter deals primarily with selection procedures suitable to be used for infrastructure projects which involve an obligation, on the part of the selected private entity, to undertake physical construction, repair, or expansion works in the infrastructure concerned with a view to subsequent private operation (i.e. those referred to in paragraph 3(c) above). It does not deal specifically with methods for disposal of State property for privatization purposes or procedures for licensing public service providers.

5. It should be noted, however, that some infrastructure projects may involve elements of more than one of the categories mentioned above, a circumstance which the Government may wish to consider when choosing the selection method. For instance, the acquisition of a privatized public utility (e.g. a water distribution company) may be coupled with an obligation to effect substantial investment in new infrastructure (e.g. expansion of pipe network). In those situations, it is important for the Government to identify the predominant element of the project (e.g. whether privatization or construction of new infrastructure) in order to choose the appropriate selection procedure which the Government might then wish to adjust so as to take into account the main ancillary obligations expected to be assumed by the concessionaire. To that end, some of the considerations set forth in this chapter may also be relevant, *mutatis mutandis*, for the disposal of State property or licensing procedures which involve an obligation on the part of the new concessionaire or licensee to undertake infrastructure works.

C. GENERAL OBJECTIVES OF SELECTION PROCEDURES

6. For the award of contracts for infrastructure projects, the host Government may either apply methods and procedures already provided in its laws or establish procedures specifically designed for that purpose. In either situation, it is important to ensure that such procedures are generally conducive to attaining the fundamental objectives of rules governing the award of public contracts. Those objectives are briefly discussed below.

1. Economy and efficiency

7. In connection with infrastructure projects, economy refers to the selection of a concessionaire that is capable of performing works and delivering services of the desired quality at the most advantageous price and upon the most advantageous contractual terms. It is promoted by procedures that provide a favourable climate for participation in

the selection process by competent companies and that provide incentives to them to offer their most advantageous terms.

8. In most cases, economy is best achieved by means of procedures that promote competition among project consortia. Competition provides them with incentives to offer their most advantageous terms, and it can encourage them to adopt efficient or innovative technologies or production methods in order to do so. Furthermore, economy can often be promoted through participation by foreign companies in selection proceedings. Not only can foreign participation expand the competitive base, it can also lead to the acquisition by the awarding authority and its country of technologies that are not available locally. Foreign participation in selection proceedings may be necessary where there exists no domestic expertise of the type required by the awarding authority. A country desiring to achieve the benefits of foreign participation should ensure that the relevant laws and procedures are conducive to such participation. It should be noted, however, that competition does not necessarily require the participation of a large number of proponents in a given selection process. Particularly for large projects, there may be reasons for the awarding authority to wish to limit the number of participants to a manageable number (see paras. 19-20). Provided that appropriate procedures are in place, the awarding authority can take advantage of effective competition even where the competitive base is limited.

9. Efficiency refers to selection of a concessionaire within a reasonable amount of time, with minimal administrative burdens and at reasonable cost both to the awarding authority and to participating contractors or suppliers. In addition to the losses that can accrue directly to the awarding authority from inefficient selection procedures (e.g. due to delayed selection or high administrative costs), excessively costly and burdensome procedures can lead to increases in the overall project costs or even discourage competent companies from participating altogether in the selection proceedings.

2. Promotion of integrity of, and confidence in, the selection process

10. Another important objective of rules governing the selection of the concessionaire is to promote the integrity of, and confidence in, the process. Thus, an adequate selection system will usually contain provisions designed to ensure fair treatment of project consortia, to reduce or discourage unintentional or intentional abuses of the selection process by persons administering it or by companies participating in it, and to ensure that selection decisions are taken on a proper basis.

11. Promoting the integrity of the selection process will help to promote public confidence in the process and in the public sector in general. Project consortia will often refrain from spending the time and sometimes substantial sums of money to participate in selection proceedings unless they are confident that they will be treated fairly and that their proposals or offers have a reasonable chance of being accepted. Those that do participate in selection

proceedings in which they do not have that confidence have a tendency to increase the project cost to cover the higher risks and costs of participation. Ensuring that selection proceedings are run on a proper basis could reduce or eliminate that tendency and result in more favourable terms to the awarding authority.

3. Transparency of laws and procedures

12. Transparency of laws and procedures governing the selection of the concessionaire will help to achieve various of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the awarding authority and by project consortia are fully disclosed, particularly to such participants. Transparent procedures are those which enable the participants to ascertain what procedures have been followed by the awarding authority and the basis of decisions taken by it.

13. One of the most important ways to promote transparency and accountability is to include provisions requiring that the awarding authority maintain a record of the selection proceedings (see paras. 95-99). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved project consortia to seek review. That in turn will help to ensure that the rules governing the selection proceedings are, to the extent possible, self-policing and self-enforcing. Furthermore, adequate record requirements in the law will facilitate the work of Government bodies exercising an audit or control function and promote the accountability of awarding authorities to the public at large as regards the award of infrastructure projects. A general requirement of record-keeping in procurement proceedings is contained in article 11 of the UNCITRAL Model Law.

14. Transparent laws and procedures create predictability, enabling project consortia to calculate the costs and risks of their participation in selection proceedings and thus to offer their most advantageous terms. They also help to guard against arbitrary or improper actions or decisions by the awarding authority or its officials and thus help to promote confidence in the process. Transparency of laws and procedures is of particular importance where foreign participation is sought, since foreign companies may be unfamiliar with the country's practices for the award of infrastructure projects.

D. APPROPRIATE SELECTION METHOD

15. Generally, economy and efficiency in the award of public contracts are best achieved through methods that promote competition among a range of contractors and suppliers within structured, formal procedures. Competitive selection procedures, such as tendering, are usually prescribed by national laws as the rule for normal circumstances in procurement of goods or construction.

16. In competitive selection procedures, the awarding authority typically invites a range of companies to submit

proposals which must be formulated on the basis of technical specifications and contractual terms specified by the awarding authority in the documents made available by it to proponents. Proposals are examined, evaluated and compared and the decision of which proposal to accept is made in accordance with essentially objective criteria and procedures that are set forth in the procurement laws and in the tender documents. Competitive selection procedures are said to be "open" when the awarding authority solicits proposals by means of a widely advertised invitation to tender directed to all companies wishing to participate in the proceedings. The procedures are said to be "restricted" when the awarding authority solicits proposals only from certain companies selected by it.

17. The formal procedures and the objectivity and predictability that characterize the competitive selection procedures generally provide optimal conditions for competition, transparency and efficiency. Thus, the rules for procurement under loans provided by the World Bank require that, for projects financed with loans provided by the World Bank, the concessionaire has to be selected pursuant to competitive procedures acceptable to the World Bank (e.g. "international competitive bidding").⁴ The use of competitive selection procedures in privately financed infrastructure projects has also been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures.⁵ However, no international legislative model has thus far been specifically devised for competitive selection procedures in privately financed infrastructure projects.

18. National legislative provisions on competitive procedures for the procurement of goods construction or services may not be entirely suitable for privately financed infrastructure projects. International experience in the award of privately financed infrastructure projects has revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method. In the light of the particular issues raised by privately financed infrastructure projects, which are briefly discussed below, it is advisable for the host Government to consider adapting such procedures for the selection of the concessionaire.

1. Range of proponents to be invited

19. In traditional Government procurement, the objective of economy is often maximized by allowing for as wide as possible competition among contractors and suppliers. Invitations to tender are sometimes issued directly without prior prequalification proceedings. Where prequalification is required, it is sometimes limited to verifying a number of formal requirements (e.g. the contractors' professional qualification or legal capacity).

⁴Under the World Bank Rules, a concessionaire selected pursuant to procedures acceptable to the World Bank is generally free to adopt its own procedures for the award of contracts required to implement the project. However, where the concessionaire was not itself selected pursuant to those competitive procedures, the award of subcontracts has to be done pursuant to competitive procedures acceptable to the World Bank (International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a)).

⁵UNIDO BOT Guidelines, p. 96.

20. The award of privately financed infrastructure projects, in turn, typically involves complex, time-consuming and expensive proceedings. Furthermore, the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified project consortia. In addition, competent project consortia may be reluctant to participate in procurement proceedings for high-value projects if the competitive field is too large and where they run the risk of having to compete with unrealistic proposals or proposals submitted by unqualified candidates. Therefore, open tendering without a prequalification phase is usually not advisable for the award of infrastructure projects.

2. Emphasis on output requirements

21. In traditional public procurement of construction works the Government usually assumes the position of a *maître d'ouvrage* or employer, while the selected contractor carries out the function of the performer of the works. The procurement procedures applied by the Government emphasize the inputs to be provided by the contractor, i.e. the awarding authority establishes clearly what is to be built, how and by what means. It is therefore common that invitations to tender for construction works are accompanied by extensive and very detailed specifications of the type of works and services being procured. In those cases, the Government will be responsible for ensuring that the specifications are adequate to the type of infrastructure to be built and that such infrastructure will be capable of being operated efficiently. In some privately financed infrastructure projects, particularly those involving works of moderate complexity or where the infrastructure is owned by the Government or is to be ultimately transferred to it, the Government usually wishes to establish precise specifications for the works to be performed or the technical means for the services to be provided (i.e. the "input" expected from the concessionaire).

22. However, for many privately financed infrastructure projects, the host Government may envisage a different allocation of responsibilities between the public and the private sector. One of the underlying reasons for some Governments to promote private sector participation in infrastructure development is to release themselves from the immediate responsibility for those functions that are capable of being efficiently carried out by the private sector. Instead of assuming the direct responsibility for managing the project, those Governments may prefer to transfer such responsibility to the concessionaire. In those cases, after having established a particular infrastructure need, the Government may prefer to leave to the private sector the responsibility for devising the best solution for meeting such a need. The selection procedure used by the host Government may thus give more emphasis to the output expected from the project (i.e. the services or goods to be provided) rather than to technical details of the works to be performed or means to be used to provide those services. While the host Government remains ultimately accountable to the public for the quality of the works and services, the private sector will bear the risks that might result, for instance, from the inadequacy of the technical solutions used (see paras. 47-49).

3. Evaluation criteria

23. Goods, construction works or services are typically purchased by Governments with funds available under approved budgetary allocations. With the funding sources usually secured, the main objective of the procuring entity is to obtain the best value for the funds it spends. Therefore, in those types of procurement the decisive factor in establishing the winner among the responsive and technically acceptable proposals is often the global price offered for the construction works, which is calculated on the basis of the cost of the works and other costs incurred by the contractor plus a certain margin of profit.

24. Privately financed infrastructure projects, in turn, are typically expected to be financially self-sustainable, in that the development and operational costs are to be recovered from the project's own revenue. This circumstance, compounded with the magnitude of most infrastructure projects, renders the task of evaluating proposals considerably more complex than in more traditional forms of procurement. Therefore, a number of other factors will need to be considered in addition to the construction and operation cost and the price to be paid by the users. For instance, the awarding authority will need to consider carefully the financial and commercial feasibility of the project, the soundness of the financial arrangements proposed by the project consortia and the reliability of the technical solutions used. Such interest exists even where no governmental guarantees or payments are involved, because unfinished projects or projects with large cost over-runs or higher than expected maintenance costs often have a negative impact on the overall availability of needed services and on the public opinion in the host country. Furthermore, given the usually long duration of infrastructure concessions, the awarding authority will need to satisfy itself of the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see paras. 72-74).

4. Negotiations with proponents

25. Laws and regulations governing tendering proceedings often prohibit negotiations between the awarding authority and the contractors concerning a proposal submitted by them. The rationale for such a strict prohibition, which is also contained in article 35 of the UNCITRAL Model Law, is that negotiations might result in an "auction", in which a proposal offered by one contractor is used to apply pressure on another contractor to offer a lower price or an otherwise more favourable proposal. As a result of that strict prohibition, contractors selected to provide goods or services pursuant to traditional procurement procedures are typically required to sign standard contract documents provided to them during the procurement proceedings. However, given the complexity of infrastructure projects, it is unlikely that the parties could agree on the terms of a draft project agreement without negotiation and adjustments to adapt those terms to the particular needs of the project. Therefore, it may be useful to allow for some negotiation between the awarding authority and the selected project consortium (see paras. 78-79).

E. PREPARATIONS FOR SELECTION PROCEEDINGS

26. The award of privately financed infrastructure projects is in most cases a complex exercise requiring careful planning and coordination among the offices involved. By ensuring that adequate administrative and personnel support is available to conduct the type of selection proceeding that it has chosen, the host Government plays an essential role in promoting confidence in the selection process.

1. Appointment of the award committee

27. One important preparatory measure is the appointment of the committee that will be responsible for evaluating the proposals and making an award recommendation to the awarding authority. The appointment of qualified and impartial members to the selection committee is not only a requirement for an efficient evaluation of the proposals, but may further foster the confidence of project consortia in the selection process.

2. Feasibility and other studies

28. As already indicated (see "Introduction and background information on privately financed infrastructure projects", para. 94), one of the initial steps taken by the host Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. The option to develop infrastructure as a privately financed project requires a positive conclusion of the feasibility and financial viability of the project.

29. Prior to starting the proceedings leading to the selection of a prospective concessionaire, it is advisable for the awarding authority to review and, as required, expand those initial studies. In some countries awarding authorities are advised to formulate model projects for reference purposes (typically including a combination of estimated capital investment, operation and maintenance costs) prior to inviting proposals from the private sector. The purpose of such model projects is to demonstrate the viability of the commercial operation of the infrastructure and the affordability of the project in terms of total investment cost and cost to the public. They will also provide the awarding authority with a useful tool for comparison and evaluation of proposals. Confidence of project consortia will be promoted by evidence that the technical, economic and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the host Government.

3. Preparation of documentation

30. Selection proceedings for the award of privately financed infrastructure projects typically require the preparation of extensive documentation by the awarding authority, including project outline, prequalification documents,

the request for proposals, instructions for preparing proposals and a draft of the project agreement. The quality and clarity of the documents distributed by the awarding authority plays a significant role in ensuring an efficient and transparent selection procedure. The awarding authority may need, at this early stage, to retain the services of independent experts or advisors to assist in establishing appropriate qualification and evaluation criteria, defining output specifications (and, if necessary, input specifications) and preparing the documentation to be issued to project consortia.

31. In many countries it is customary for the Government to devise standard contract forms and general conditions of contract that are used in public contracting. In some countries there may be fairly detailed standard contracts for different infrastructure sectors. Where standard contract documents are provided to project consortia during the selection proceedings, the awarding authority may have limited discretion to negotiate the terms of the project agreement with the selected group of project consortia. Standard contract terms may be useful to help expedite the conclusion of the project agreement by limiting the matters on which the parties have to elaborate contractual provisions. They may further be useful for ensuring consistency in the treatment of issues common to most projects in a given sector.

32. However, in using standard contract terms it is advisable to bear in mind the possibility that a specific project may raise issues that had not been anticipated when the standard document was prepared or that the project may necessitate particular solutions that might be at variance with the standard terms. Careful consideration should be given to the need for achieving the appropriate balance between the level of uniformity desired for project agreements of a particular type and the flexibility that might be needed for finding project-specific solutions.

F. PREQUALIFICATION OF PROJECT CONSORTIA

33. In most privately financed infrastructure projects the host Government may wish to narrow down the number of proposals with which the awarding authority must deal. This result may be achieved by applying a rigorous procedure to limit the number of prospective proponents from whom proposals will be subsequently requested. In addition, prequalification proceedings for privately financed infrastructure projects may involve elements of evaluation and selection, particularly where the awarding authority establishes a ranking of prequalified project consortia. Thus the prequalification of project consortia differs from more traditional prequalification proceedings, such as those used in the procurement of goods or services, where all candidates that meet the prequalification criteria are automatically admitted to the tendering phase.

1. Invitation to prequalify

34. In order to promote transparency and competition, it is advisable that the invitation to prequalify be published in a manner that reaches an audience wide enough to provide an effective level of competition. The laws of many

countries identify publications, usually the official gazette or other official publication, in which the invitation to prequalify is to be published. In view of the objective of the UNCITRAL Model Law of fostering participation in procurement proceedings without regard to nationality and maximizing competition, article 24(2) requires publication of the invitations to prequalify also in a language customarily used in international trade, in a newspaper of wide international circulation or in a relevant trade publication or technical or professional journal of wide international circulation.

35. Prequalification documents should contain sufficient information for project consortia to be able to ascertain whether the works and services entailed by the project are of a type that they can provide and, if so, how they can participate in the selection proceedings. In addition to elements that are usually required to be contained in prequalification documents under general rules on public procurement (e.g. those mentioned in articles 7(3)(i), (iii), (iv) and (v); 25(1)(a) and (d); and 25(2)(a)-(d) of the UNCITRAL Model Law), the invitation to prequalify should identify the infrastructure to be built or renovated and contain information on other essential elements of the project, including the services to be delivered by the concessionaire, the financial arrangements envisaged by the awarding authority (e.g. whether the project will be entirely financed by user fees or tolls or whether public funds may be provided as direct payments, loans or guarantees) and, where already known, a summary of the principal required terms of the project agreement to be entered into as a result of the selection proceedings.

2. Prequalification criteria

36. Generally, project consortia should be required to demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out the project (cf. UNCITRAL Model Law, article 6(1)(b)(i)). Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate.

37. It is advisable to avoid burdening the law with details concerning qualification requirements and to leave it instead to regulations or to the awarding authority to set forth the type of information to be provided by the project consortia, including, for instance, quality indicators of their past performance as public service providers or infrastructure operators. Such information may relate to the size and type of previous projects carried out by the project consortia; the level of experience of the key personnel to be engaged in the project; sufficient organizational capability, including minimum levels of construction, operation and maintenance equipment. The regulations may set forth in some detail the manner in which the project consortia have to demonstrate their capability to sustain the financing requirements for the engineering, construction and operational phases of the project. The awarding authority may at this stage establish

a minimum percentage of equity investment and require that the project consortia indicate the envisaged financing arrangements.

38. Given the large scale of most infrastructure projects, the interested companies typically participate in the selection proceedings through consortia especially formed for that purpose. Therefore, information required from consortium members should relate to the consortium as a whole as well as to its individual participants. For the purpose of facilitating the liaison with the awarding authority, it may be useful to require in the prequalification documents that each consortium should designate one of its members as a focal point for all communications with the awarding authority. It is further advisable for the awarding authority to review carefully the composition of consortia and their parent companies. It may happen that one company, directly or through subsidiary companies, joins more than one consortium to submit proposals for the same project. Such a situation should not be allowed, since it raises the risk of leakage of information or collusion between competing consortia, thus undermining the credibility of the selection proceedings. It is therefore advisable to provide in the invitation to prequalify that the same company, directly or through subsidiary companies, may not be a member of more than one consortium in the same selection proceedings. A violation of this rule should cause the disqualification of the consortia concerned.

3. Domestic preferences

39. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to candidates that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (e.g. a minimum percentage of national participation in the consortium) or as a condition for participating in the selection procedure (e.g. to appoint a local partner as a leader of the project consortium).

40. Where such preferences are established, it is important to weigh the expected advantages against the disadvantage of depriving the awarding authority of the possibility of obtaining better options to meet the national infrastructure needs. It is further important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. This is the reason why many countries that wish to provide some incentive to national suppliers, while at the same time taking advantage of international competition, do not contemplate a blanket exclusion of foreign participation or restrictive qualification requirements. Domestic preferences may take the form of special evaluation criteria establishing margins of preference for national candidates or candidates who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 34(4)(d) of the UNCITRAL Model Law, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the awarding authority to favour local project consortia that are capable of approaching internationally com-

petitive standards and prices, and it does so without simply excluding foreign competition. Where domestic preferences are envisaged, it is advisable that they be announced in advance, preferably in the invitation to prequalify.

4. Contribution towards costs of participation in selection proceedings

41. In some countries, a high price may be charged for the prequalification documents, while in other countries that price might reflect only the cost of printing the prequalification documents and providing them to the candidates. Expensive prequalification documents may be used as an additional tool to limit the number of candidates. At the same time, however, they add to the already considerable cost of participation in the selection proceedings. The high costs of preparing proposals for infrastructure projects and the relatively high risks that a selection procedure may not lead to a contract award may function as a deterrent for some companies to join in a consortium to submit a proposal, particularly when they are not familiar with the selection procedures applied in the host country.

42. Therefore, some countries authorize the awarding authority to consider arrangements for compensating prequalified proponents if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the prequalification phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. It is advisable that such contribution or compensation, when authorized, be announced at an early stage, preferably in the invitation to prequalify.

5. Prequalification proceedings

43. The awarding authority should respond to any request by a project consortium for clarification of the prequalification documents that is received by the awarding authority within a reasonable time prior to the deadline for the submission of applications to prequalify. The response by the awarding authority should be given within a reasonable time so as to enable the project consortia to make a timely submission of their application to prequalify. The response to any request that might reasonably be expected to be of interest to other project consortia should, without identifying the source of the request, be communicated to all project consortia to which the awarding authority provided the prequalification documents (cf. UNCITRAL Model Law, article 7(4)).

44. Qualification requirements should apply equally to all project consortia. An awarding authority should not impose any criterion, requirement or procedure with respect to the qualifications of project consortia which has not been set forth in the prequalification documents (cf. UNCITRAL Model Law, article 6(3)). When considering the professional and technical qualifications of project consortia, the awarding authority should consider the individual specialization of the consortium members and assess whether the combined qualifications of the consor-

tium members are adequate to meet the needs of all phases of the project.

45. In some countries, awarding authorities are encouraged to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (e.g. three or four). For that purpose, those countries apply a quantitative rating system for technical, managerial and financial criteria, taking into account the nature of the project. Where such a rating system is to be used, that circumstance should be clearly stated in the prequalification documents.

46. Upon completion of the prequalification phase, the awarding authority usually elaborates a short list of the prequalified project consortia which will be subsequently invited to submit proposals. One practical problem sometimes faced by awarding authorities concerns proposals for changes in the composition of project consortia during the selection proceedings. From the perspective of the awarding authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of project consortia after the closing of the prequalification phase. Changes in the composition of consortia may substantially alter the basis on which the prequalified project consortia were short-listed by the awarding authority and may give rise to questions about the integrity of the selection proceedings. As a general rule, only prequalified project consortia should be allowed to participate in the selection phase, unless the awarding authority can satisfy itself that a new consortium member meets the prequalification criteria to substantially the same extent as the retiring member of the consortium.

G. PROCEDURES FOR REQUESTING PROPOSALS

1. Phases of the procedure

47. Following the prequalification of project consortia, it is advisable for the awarding authority to review its original feasibility study and the definition of the output and performance requirements and consider whether a revision of those requirements is needed in the light of the information obtained during the prequalification proceedings. At this stage, the awarding authority should have already determined whether the project consortia will be asked to formulate proposals on the basis of input or output specifications and whether alternatives to those specifications will be considered. If it is deemed both feasible and desirable for the awarding authority to formulate specifications (whether based on expected input or output) to the necessary degree of precision or finality, the Government may wish to structure the selection process as a single-stage selection procedure and proceed to issue a final request for proposals (see paras. 53-79).

48. However, in some cases it may not be feasible for the awarding authority to formulate its requirement in terms of sufficiently detailed and precise specifications or contractual terms to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and terms. This may be the case, for instance, when

the awarding authority has not determined the type of technical and material input that would be suitable for the project in question (e.g. the type of construction material to be used in a bridge) or the exact manner in which to meet a particular need, and therefore is seeking proposals as to various possible solutions to obtain the expected output (e.g. the type of payment and traffic control system for a toll road).

49. In such cases, it might be considered undesirable, from the standpoint of obtaining the best value, for the awarding authority to proceed on the basis of specifications it has drawn up in the absence of discussions and negotiations with project consortia as to the exact capabilities and possible variations of what is being offered. For that purpose, the host Government may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions and negotiations with project consortia. The first stage of those proceedings should provide an opportunity for the awarding authority to solicit various proposals relating to the technical, quality or other characteristics of the project as well as to the contractual terms. Upon the conclusion of that first stage, the awarding authority should finalize the specifications and, on the basis of those specifications, in the second stage, request final proposals from the project consortia.

2. Initial request for proposals

50. Where the selection procedure is divided in two phases, the initial request for proposals typically calls upon the project consortia to submit proposals relating to broad output specifications and other characteristics of the project as well as to contractual terms.

51. The awarding authority may then convene a meeting of proponents to clarify questions concerning the request for proposals and accompanying documentation. The awarding authority may, in the first stage, engage in negotiations with any proponent concerning any aspect of its proposal. The awarding authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing consortia. Any negotiations need to be confidential, and one party to the negotiations should not reveal to any other person any technical, financial or other information relating to the negotiations without the consent of the other party.

52. Following those negotiations, the awarding authority should review and, as appropriate, revise the initial output specifications. In formulating those revised specifications, the awarding authority should be allowed to delete or modify any aspect of the technical or quality characteristics of the project originally set forth in the request for proposals, and any criterion originally set forth in those documents for evaluating and comparing proposals. Any such deletion, modification or addition should be communicated to project consortia in the invitation to submit final proposals. Project consortia not wishing to submit a final proposal should be allowed to withdraw from the selection proceedings without forfeiting any tender security that they may have been required to provide.

3. Final request for proposals

53. At the final stage, the awarding authority should invite the proponents to submit final proposals with respect to the revised specifications and contractual terms.

(a) Content of request for proposals

54. It might be desirable for the legislative or regulatory texts governing the selection proceedings to contain a listing of the information required to be included in the request for proposals. An indication in those laws or regulations of those requirements is useful to ensure that the request for proposals include the information necessary to provide a basis for enabling the project consortia to submit proposals that meet the needs of the awarding authority and that the awarding authority can compare in an objective and fair manner. Listings of items to be included in the solicitation documents for the procurement of goods and construction and in the request for proposals for services are contained, respectively, in articles 27 and 38 of the UNCITRAL Model Law.

55. One category of items to be contained in the request for proposals concerns instructions for preparing and submitting proposals (cf. UNCITRAL Model Law, article 27(a)). The purpose of including these provisions is to limit the possibility that qualified project consortia would be placed at a disadvantage or even rejected due to lack of clarity as to how the proposals should be prepared. Instructions for preparing proposals usually cover, as appropriate, items such as the manner and the currency or currencies in which the proposal prices (i.e. the proposed schedule of tolls, fees, unit prices and other charges) are to be formulated and expressed (cf. UNCITRAL Model Law, articles 27(i) and (j) and 38(j) and (k)).

56. The request for proposals should describe the works and services to be performed, including, as appropriate, technical specifications, plans, drawings and designs; the location where the construction is to be effected and the services to be provided; time schedule for the execution of works and provision of services (cf. UNCITRAL Model Law, articles 27(d) and 38(g)). If alternative proposals, including variations to non-mandatory elements of the request for proposals, are admitted, the awarding authority should indicate the manner in which they would be compared and evaluated. Alternative proposals should be rejected if they are not accompanied by a fully responsive proposal.

57. The level of detail provided in the specifications, as well as the appropriate balance between the input and output elements, will be influenced by considerations of issues such as the type and ownership of the infrastructure and the allocation of responsibilities between the public and the private sectors. For the construction of new infrastructure to be permanently owned by the Government and destined to be generally open for public use (e.g. roads, tunnels, bridges), the Government may see a need to have a larger degree of control over the engineering design and technical specifications than in the case of privately-owned facilities generally closed to the public and accessible only to the concessionaire (e.g. a private power plant). It is generally

advisable for the awarding authority to bear in mind the long-term needs of the project and to formulate its specifications in a manner that allows it to obtain sufficient information so as to select the project consortium that offer the highest quality of services at the best economic terms. In some countries, awarding authorities have been encouraged to formulate specifications for services in a way that define adequately the output and performance required without being over prescriptive in how that is to be achieved.

58. To the extent the terms of the contractual arrangements are already known by the awarding authority, they should be included in the request for proposals, possibly in the form of a draft of the project agreement. The availability of that information at the earliest possible stage facilitates the project consortia's task of establishing the financial viability of the project, in consultation with prospective lenders and capital providers. In order to establish clearly the scope of negotiations following the evaluation of proposals, the final request for proposals should indicate which are the terms of the project agreement that are deemed not negotiable. A requirement that the final proposals submitted by the project consortia should contain evidence showing the comfort of the project consortium's preferred lenders with the proposed commercial terms and allocation of risks, as outlined in the request for proposals, might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations (see para. 78). In some countries, project consortia are required to initial and return to the awarding authority the draft project agreement together with their final proposals as a confirmation of their acceptance of all terms in respect of which they did not propose specific amendments.

59. In addition to the items listed above, a number of other items may be particularly relevant for infrastructure projects. For build-operate-transfer projects, for instance, it is advisable to include information regarding the assets and property to be transferred to the host Government at the end of the concession. Where the host Government is selecting a new concessionaire to operate an existing infrastructure, the request for proposals should also include a description of the assets and property that will be made available to the concessionaire. It is also desirable to indicate in the request for proposals the possible alternative, supplementary or ancillary revenue sources (e.g. concessions for exploitation of existing infrastructure), if any, that may be offered to the successful proponent.

60. Other important items of the request for proposals concern in particular the manner in which the proposals will be evaluated; their disclosure is required to achieve transparency and fairness in the selection proceedings. Particularly important is the disclosure of the criteria to be used by the awarding authority in determining the successful proposal, including any margin of preference and any criteria other than price to be used, and the relative weight of such criteria (cf. UNCITRAL Model Law, articles 27(b) and 38(m)).

61. Further relevant information concerns the manner, place and deadline for the submission of proposals (cf. UNCITRAL Model Law, articles 27(n) and 38(c)); the means by which project consortia may seek clarifications

of the request for proposals, and a statement as to whether the awarding authority intends, at this stage, to convene a meeting of project consortia (cf. UNCITRAL Model Law, articles 27(o) and 38(q)); the period of time during which proposals shall be in effect (cf. UNCITRAL Model Law, article 27(o)); the place, date and time for the opening of proposals; and the procedures to be followed for opening and examining proposals (cf. UNCITRAL Model Law, article 27(q) and (r)).

62. One important aspect to be considered by the awarding authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see chapter II, "Sector structure and regulation"). Where competition is sought, the host Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise (e.g. that the same company does not operate more than a certain limited number of local telephone companies within a given territory). The host Government may thus wish to retain the possibility of rejecting a particular proposal if it determines that the award of the project to the consortium submitting the proposal might make it possible for a particular company to dominate the relevant market or otherwise distort the competition in the sector concerned. For purposes of transparency, it is desirable for the law to provide that, where the awarding authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the request for proposals.

63. Where the awarding authority further reserves the right to reject all proposals, without incurring liability towards proponents, such as compensation for their costs of preparing and submitting proposals, a statement to that effect should be included in the request for proposals (cf. UNCITRAL Model Law, articles 27(x) and 38(d)).

(b) Clarifications and modifications

64. It is desirable to establish procedures for clarification and modification of the request for proposals in a manner that will foster efficient, fair and successful conduct of selection proceedings. The right of the awarding authority to modify the request for proposals is important in order to enable it to obtain what is required to meet its needs. It is also desirable to authorize the awarding authority, whether on its own initiative or as a result of a request for clarification by a project consortium, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, in case of extensive amendments of the request for proposals, the deadline for submission of proposals may need to be extended.

65. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the awarding authority to all project consortia to whom the awarding authority provided the request for proposals (cf. UNCITRAL Model Law, article 28(1)). If the awarding authority convenes a meeting of project consortia, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarifi-

cation of the request for proposals, and its responses to those requests, without identifying the sources of the requests, and send copies to the project consortia.

4. Content and submission of final proposals

66. In view of the complexity of privately financed infrastructure projects and the variety of evaluation criteria usually applied in the award of the project, project consortia are often required to formulate and submit separately their technical and financial proposals. The technical proposals to be submitted by the project consortia should include: specifications and schedule of works; feasibility and other studies; description of services to be provided and applicable quality standards; description of maintenance services and standards.

67. Financial proposals should include: proposed tariff or price structure; proposed duration of the concession, where it is not specified in the request for proposals; level of governmental financial support required for the project, including, as appropriate, any subsidy or payment expected from the awarding authority; the extent of risks assumed by the project consortia during construction and operation phase, including unforeseen events, insurance, equity investment and other guarantees against those risks.

68. Feasibility studies are particularly important in privately financed infrastructure projects. They should substantiate the feasibility and viability of the project and should, for instance, cover the following aspects:

(a) *Commercial viability*: particularly in projects financed on a non-recourse or limited recourse basis, it is essential to establish the need for the project outputs and to evaluate and project such needs over the proposed operational life of the project, including expected demand (e.g. traffic forecasts for roads) and pricing (e.g. tolls);

(b) *Engineering design and operational feasibility*: project consortia should be requested to demonstrate the suitability of the technology they propose, including equipment and processes, to national, local and environmental conditions, the likelihood of achieving the planned performance level and the adequacy of the construction methods and schedules. This study should also define the proposed organization, methods and procedures for operating and maintaining the completed facility;

(c) *Financial viability*: project consortia should be requested to indicate the proposed sources of financing for the construction and operation phases, including debt capital and equity investment. While the loan and other financing agreements in most cases are not executed until after the signing of the project agreement, the project consortia should be required to submit sufficient evidence of the lenders' intention to extend the specified financing to the project company. This study should also indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information should allow the awarding authority to consider the reasonableness and affordability of the proposed fees or prices to be charged by the concessionaire and the potential for subsequent increases in the fees or prices;

(d) *Environmental impact*: this study should identify possible negative or adverse effects on the environment as a consequence of the project and indicate corrective measures that need to be taken.

69. In formal selection proceedings, proposals should be required to be submitted in writing, signed and in sealed envelopes. Proposals received by the awarding authority after the deadline for the submission of proposals should not be opened and should be returned to the project consortium that submitted it (cf. UNCITRAL Model Law, article 30(6)).

5. Tender securities

70. It may be advisable for the laws or regulations governing the selection process to authorize the awarding authority to require the project consortia to post a tender security so as to cover those losses that may result from withdrawal of proposals or failure by the selected project consortium to conclude a project agreement.

71. It is advisable that the request for proposals indicate any requirements of the awarding authority with respect to the issuer and the nature, form, amount and other principal terms of any tender security to be provided by project consortia submitting proposals (cf. UNCITRAL Model Law, art. 27(l)). In order to ensure a fair treatment of all project consortia, requirements that refer directly or indirectly to the conduct by the project consortium submitting the proposal should not relate to conduct other than: withdrawal or modification of the proposal after the deadline for submission of proposals, or before the deadline if so stipulated in the request for proposals; failure to achieve financial closing; failure to sign the project agreement if required by the awarding authority to do so; and failure to provide a required security for the performance of the contract after the proposal has been accepted or to comply with any other condition precedent to signing the project agreement specified in the request for proposals (cf. UNCITRAL Model Law, article 32(1)(f)(i)-(iii)). Safeguards should be included to ensure that a tender-security requirement is only imposed fairly and for the intended purpose.⁶

6. Evaluation criteria

72. Criteria for the evaluation of the non-price technical aspects of proposals should include technical feasibility; environmental effectiveness; effectiveness of the proposed construction and operation systems; soundness of the pro-

⁶Article 32 of the UNCITRAL Model Law provides certain important safeguards, including, *inter alia*, the requirement that the awarding authority should make no claim to the amount of the tender security, and should promptly return, or procure the return of, the tender security document, after whichever of the following that occurs earliest: (a) the expiry of the tender security; (b) the entry into force of the project agreement and the provision of a security for the performance of the contract, if such a security is required by the request for proposals; (c) the termination of the selection process without the entry into force of a project agreement; or (d) the withdrawal of the proposal prior to the deadline for the submission of proposals, unless the request for proposals stipulates that no such withdrawal is permitted.

posed financial arrangements, including resources of the proponents. The evaluation committee should rate the non-price elements of each proposal in accordance with the predisclosed rating systems for the non-price evaluation criteria and specify in writing the reasons for the rating. Besides criteria relating to the quality of the proposal, additional non-price criteria sometimes used by awarding authorities include the extent of participation by local suppliers and contractors, the economic development potential offered by the proposal, the encouragement of employment, the transfer of technology, the development of managerial, scientific and operational skills. For the purpose of ensuring objectivity and transparency, no weight should be given to prequalification criteria at the evaluation stage.

73. Criteria for the evaluation of the financial proposals should include costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs; present value of the proposed price over the concession period; the amount of subsidy, if any, expected from the host Government. For the awarding authority it is advisable not to limit itself to a comparison of the unit prices offered for the expected output but to consider instead all elements of the financial proposals so as to assess their financial feasibility and the likelihood of subsequent increases in the proposed prices.

74. It is important for the awarding authority to determine the relative weight to be accorded to each such criterion and the manner in which they are to be applied in the evaluation of proposals. To the extent practicable, the non-price criteria applied by the awarding authority should be objective and quantifiable, so as to enable proposals to be evaluated objectively and compared on a common basis. This reduces the scope for discretionary or arbitrary decisions. Regulations governing the selection process might spell out how such factors are to be formulated and applied.

7. Opening, comparison and evaluation of proposals

75. For the purpose of ensuring transparency, national laws often prescribe formal procedures for the opening of proposals, usually at a time previously specified in the request for proposals, and require that the project consortia that have submitted proposals, or their representatives, be permitted by the awarding authority to be present at the opening of proposals (cf. UNCITRAL Model Law, article 33). Awarding authorities selecting project consortia for infrastructure projects may wish to structure the evaluation of proposals in two stages, as in the evaluation procedure provided in article 42 of the UNCITRAL Model Law. In an initial stage, the awarding authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the criteria other than price as set out in the proposals, and rates each technical proposal in accordance with such criteria and the relative weight and manner of application of those criteria as set forth in the request for proposals. The awarding authority then compares the financial proposals that have attained a rating at or above the threshold.

76. When the technical and financial proposals are to be evaluated consecutively, the awarding authority at this stage usually opens only the technical proposals and ascertains whether they are *prima facie* responsive to the request for proposals (e.g. whether they cover all items required to be addressed in the technical proposals). Incomplete or partial proposals should be rejected at this stage. While the awarding authority may ask project consortia for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making an unresponsive proposal responsive, should be sought, offered or permitted at this stage (cf. UNCITRAL Model Law, article 34(1)(a)).

77. The most advantageous proposal should be the one with the highest combined rating in respect of both price and non-price evaluation criteria. Alternatively, the price proposed for the output (e.g. the water or electricity tariff, the level of tolls) might be the deciding factor for establishing the winning proposal among those that have passed the threshold with respect to quality and technical aspects. In order to promote the transparency of the selection process, and to avoid improper use of non-price evaluation criteria, it is advisable to require the awarding committee to provide a written justification of the reasons for selecting a proposal other than the one offering the lowest unit price for the output.

[The Commission may wish to consider the desirability of elaborating further on the evaluation criteria recommended to be used to award privately financed infrastructure projects, particularly as regards the notion of "price" and other criteria used to evaluate financial proposals.]

8. Final negotiations

78. The awarding 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 project consortium that has attained the best rating or, as appropriate, the one that offered the lowest price for the output among those that attained the minimum threshold in respect of technical aspects. One particular problem faced by awarding authorities is the danger that the negotiations with the best qualified project consortium might lead to pressures to amend, to the detriment of the host Government, the price or risk allocation originally contained in the proposal. Changes in essential elements of the proposal should not be permitted, as they may distort the assumptions on the basis of which the proposals were submitted and rated. Therefore, the negotiations at this stage may not concern those terms of the contract that were deemed not negotiable in the final request for proposals.

79. The awarding authority should inform the remaining responsive project consortia that they may be considered for negotiation if the negotiations with the project consortium with better ratings do not result in a project agreement. If it becomes apparent to the awarding authority that the negotiations with the project consortium invited will not result in a project agreement, the awarding authority should inform that project consortium that it is terminating the negotiations and then invite for negotiations the next project consortium

on the basis of its ranking until it arrives at a project agreement or rejects all remaining proposals. To avoid the possibility of abuse and unnecessary delay, the awarding entity should not reopen negotiations with any project consortium with whom they had already been terminated.

9. Notice of project award

80. Project agreements frequently include provisions that are of direct interest for parties other than the awarding authority and the project company, and who might have a legitimate interest in being informed about certain essential elements of the project. This is particularly the case for projects involving the provision of a service directly to the general public. For transparency purposes, it may be advisable to establish procedures for publicizing those terms of the project agreement that may be of public interest. One possible procedure may be to require the awarding authority to publish a notice of the award of the project, indicating, *inter alia*, the following elements: (a) the name of the project company; (b) the annexes and enclosures that form part of the agreement; (c) a description of the works and services to be performed by the project company; (d) the duration of the concession; (e) the tariff structure; (f) the rights and obligations of the project company and the guarantees to be provided by it; (g) the monitoring rights of the awarding authority and remedies for breach of the project agreement; (h) the obligations of the host Government, including any payment, subsidy or compensation offered by the host Government; and (i) any other essential term of the project agreement, as provided in the request for proposals. Where such a system is used, it is important to ensure consistency between the notice of award and the project agreement.

H. DIRECT NEGOTIATIONS

81. In some countries, concessions of public services have traditionally been regarded as a delegation of a State function and, as such, the delegating authority is not bound to follow the same procedures that govern the award of public contracts. In those countries, concessions may be awarded after direct negotiations between the delegating authority and a concessionaire of its choice. In contrast to the competitive selection procedures, which sometimes may appear to be excessively rigid, selection by negotiation is characterized by a high degree of flexibility as to the procedures involved and discretion on the part of the awarding authority. Sometimes the only requirement for those negotiations may consist in the previous publication of a notice to interested parties who wish to be invited to those negotiations.

82. In other countries, where tendering is under normal circumstances the rule for the award of public contracts, awarding authorities have been encouraged to resort to direct negotiations whenever possible for the award of privately financed infrastructure projects. The rationale for encouraging negotiations in those countries is that in negotiating with project consortia the Government is not bound by pre-determined requirements or rigid specifications and has more flexibility for taking advantage of innovative or

alternative proposals that may be submitted by the participants in the selection proceedings, as well as for changing and adjusting its own requirements in the event that more attractive options for meeting the infrastructure needs are formulated during the negotiations.

83. National laws that deal with selection by negotiation usually establish few rules and procedures governing the process by which the parties negotiate and conclude their contract. However, the laws in some countries provide for selection methods that combine certain basic features of the tendering and negotiation methods. In one of such structured methods of negotiation, which is sometimes referred to as "competitive negotiation", the awarding authority solicits proposals from a limited number of companies believed to have the appropriate qualifications and expertise. It also sets forth general criteria that proposals are requested to meet (e.g. general performance objectives, output specification). The awarding authority identifies the proposals that appear to meet those criteria and engages in discussions with the author of each such proposal in order to refine and improve upon the proposal to the point where it is satisfactory to the awarding authority. The price of each proposal does not enter into those discussions. When the proposals have been finalized, the awarding authority requests the author of each proposal to submit a firm price offer in respect of its proposal. The awarding authority selects the proposal of the company offering the lowest price or lowest evaluated price.

84. Negotiated methods generally afford a high degree of flexibility that some countries may find beneficial to the selection of the concessionaire. However, negotiated methods may have a number of disadvantages that make them less suitable to be used as a principal selection method in a number of countries. Because of the high level of flexibility and discretion afforded to the awarding authority, negotiated methods require highly skilled personnel with sufficient experience in negotiating complex projects. They also require a well-structured negotiation team, clear lines of authority and a high level of coordination and cooperation among all the offices involved. Therefore, the use of negotiations for the award of privately financed infrastructure projects may not represent a viable alternative for countries that do not have the tradition of using such methods for the award of large Government contracts. Another disadvantage of negotiated methods is that they may not ensure the level of transparency and objectivity that can be achieved by more structured competitive methods. In some countries there might be concerns that the higher level of discretion in negotiated methods might carry with it a higher risk of abusive or corrupt practices.

1. Circumstances authorizing the use of direct negotiations

85. In countries that generally prescribe the use of the competitive selection procedures as a rule for the award of privately financed infrastructure projects direct negotiations are usually only authorized in exceptional cases. For transparency purposes as well as for ensuring discipline in the award of projects, it might be generally desirable for the law

to identify the circumstances that may authorize the use of direct negotiations. They may include the following:

(a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the awarding authority nor the result of dilatory conduct on its part;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount.

86. In some countries, after a competitive selection procedure was initiated, situations might arise under which the awarding authority may prefer to change the selection method in favour of direct negotiations. This may be particularly the case when an invitation to prequalify or a request for proposals has been issued but no applications to prequalify or proposals were submitted, or all proposals were rejected by the awarding authority, and when, in the judgement of the awarding authority, issuing a new request for proposals would be unlikely to result in a project award. In such a case, the awarding authority might prefer to enter into negotiations with responsive proponents, as an alternative to having to reject all proposals and start another procedure with possibly uncertain results.

2. Unsolicited proposals

87. Unsolicited proposals may result from the identification by the private sector of a need that may be met by a privately financed infrastructure project. They may also involve innovative proposals for infrastructure management. The host Government may therefore have an interest in stimulating the private sector to formulate innovative proposals for infrastructure development. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other project consortia may expose the Government to serious criticism, particularly in cases involving exclusive concessions. Furthermore, in the absence of competition the host Government may deprive itself of objective parameters for comparing prices, technical elements and the overall effectiveness of the project.

88. Two basic approaches may be found for dealing with such unsolicited proposals: in some countries the Government is authorized to negotiate unsolicited proposals directly with the proponent; in other countries projects resulting from unsolicited proposals, too, need to be awarded pursuant to the generally applicable award procedures.

89. One possibility for taking advantage of the potential innovation that may result from unsolicited proposals may be to establish a transparent procedure for dealing with such proposals, such as the procedure described in the following paragraphs.

(a) *Submission of initial proposal*

90. The company or project consortia who approach the host Government with a suggestion for private infrastruc-

ture development may be requested to submit an initial proposal containing the following information: description of the company or companies concerned (references to previous projects, financial information); the project (type of project, location, regional impact, proposed investment, operation costs, financial assessment, resources needed from the host Government or third parties); the site (ownership and whether land or other property will have to be expropriated); a description of the service and the works.

(b) *Initial response and formal proposals*

91. Following a preliminary examination, the host Government should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. When the host Government reacts positively to the project, the company should be invited to submit a formal proposal which, in addition to the items covered in the initial proposal, has to contain a technical and economical feasibility study (including characteristics, costs and benefits) and an environmental impact study. The company submitting the unsolicited proposal should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected. In order not to discourage unsolicited proposals, it is advisable to provide that no proposals may be solicited concerning a rejected project for a certain number of years without the invitation of the company which submitted the original proposal.

(c) *Public proposal*

92. If the host Government accepts the proposal, the awarding authority should engage in public selection proceedings as described above in paragraphs 43-80, to which the company that submitted the original proposal should be invited. In such proceedings, the original proponent might be given, as a premium for submitting the proposal, a margin of preference over the final rating.

93. In the subsequent proceedings the awarding authority may need to make use of designs, plans and other documents that had been originally submitted with the unsolicited proposal. Thus, it is important to settle at this stage possible questions concerning the intellectual property rights in those designs, plans and documents, in the event that such intellectual property rights have not yet been acquired by the awarding authority. [*The Commission may wish to consider whether this issue should be elaborated further.*]

I. REVIEW PROCEDURES

94. An important safeguard of proper adherence to the rules governing the selection procedure is that project consortia have the right to seek review of actions by the awarding authority in violation of those rules. Essential features of a review procedure may be drawn, *mutatis mutandis*, from chapter VI of the UNCITRAL Model Law.

J. RECORD OF SELECTION PROCEEDINGS

95. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved project consortia to seek review of decisions made by the awarding authority, the law should require that the awarding authority keep an appropriate record of key information pertaining to the selection proceedings.

96. The record to be kept by the awarding authority should firstly contain, *mutatis mutandis*, such general information concerning the selection proceedings as is usually required to be recorded for public procurement (e.g. the information listed in article 11 of the UNCITRAL Model Law), including the following:

(a) A description of the project for which the awarding authority requested proposals;

(b) The names and addresses of the companies participating in project consortia that submitted proposals and the name and address of the members of the project consortium with whom the project agreement is entered into;

(c) Information relative to the qualifications, or lack thereof, of project consortia; a summary of the evaluation and comparison of proposals including the application of any margin of preference;

(d) The price, or the basis for determining the price, and a summary of the other principal terms of the proposals and of the project agreement;

(e) A summary of any requests for clarification of the prequalification documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(f) If all proposals were rejected, a statement to that effect and the grounds therefor.

97. In addition to the above information, it may be useful to require the awarding authority to include the following information in the record of the selection proceedings:

(a) A summary of the conclusions of the preliminary feasibility studies commissioned by the awarding authority and a summary of the conclusions of the feasibility studies submitted by the qualified proponents;

(b) The list of the prequalified project consortia;

(c) If changes to the composition of the prequalified project consortia are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of the new members or members admitted to the consortia concerned;

(d) If the awarding authority finds most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for such finding by the awarding committee;

(e) If the negotiations with the consortium that submitted the most advantageous proposal and any subsequent negotiations with remaining responsive consortia did not result in a project agreement, a statement to that effect and of the grounds therefor.

98. For selection proceedings involving direct negotiations (see paras. 81-86) it may be useful to include the

following information in the record of the selection proceedings:

(a) A statement of the grounds and circumstances on which the awarding authority relied to justify the direct negotiation;

(b) The name and address of the company or companies invited to those negotiations;

(c) If those negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor.

99. For selection proceedings engaged in as a result of unsolicited proposals (see paras. 87-93) it may be useful to include, in addition to the information the following information in the record of the selection proceedings:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description thereof;

(b) A certification by the awarding authority that the unsolicited proposal was found to be of public interest.

[The Commission may wish to consider the usefulness of including a discussion of what kind of information should be available to the public and what information should be reserved for the host Government and the proponents.]

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Chapter IV. Conclusion and general terms of the project agreement

LEGISLATIVE RECOMMENDATIONS

Legislative approach to the project agreement

1. It is advisable to limit the legislative provisions on the mutual rights and obligations of the host Government and the project company to those strictly necessary, such as provisions on matters for which prior legislative authorization might be needed, or that might affect the interests of third parties or that relate to essential policy matters (see paras. 2-4).

Conclusion of the project agreement

2. It is advisable to simplify the procedures for the conclusion of the project agreement and to identify in advance the authority or authorities competent to approve and sign the project agreement on behalf of the host Government (see paras. 5-6).

The project site

3. Where the land for the project site has to be acquired by the host Government through expropriation, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the most expeditious proceedings available under the laws of the host country (see paras. 8-12)

4. Easements that might be needed by the project company may be provided in sector-specific legislation (see paras. 13-16).

Exclusivity

5. It is advisable for the law to leave it for the host Government and the project company to agree on whether the host Government needs to undertake not to facilitate or support the execution of a parallel project that might generate competition to the project company (see paras. 17-21).

Legal status of the concessionaire

6. The host Government may wish to require that project consortia establish an independent legal entity with a seat in the country. Where deemed to be in the public interest, the law may authorize the host Government to award projects to foreign companies (see paras. 26-27).

7. It may not be advisable to set forth the legislative requirement of a fixed sum as minimum capital (see paras. 29-30).

8. The law might require that the activities of the project company be limited to the development and operation of a particular project or projects awarded to the project company. The law might further require that fundamental changes in the statutes and by-laws of the project company or the transfer of effective control over the project company need to be approved by the host Government (see paras. 31-34).

Assignment of the concession

9. The project company should not have the right to assign the concession without the consent of the Government. The conditions under which an approval to the assignment of a concession prior to its expiry may be granted may include:

(a) acceptance by the new concessionaire of all obligations under the project agreement;

(b) evidence of the new concessionaire's technical and financial capability as necessary for providing the service (see paras. 35-36).

10. The concessionaire may be authorized to award subconcessions, subject to prior approval by the host Government (see paras. 37-38).

Security interests

11. Where the physical assets comprised in the infrastructure are not owned by the project company, it is advisable for the law to clarify whether and to what extent the project company may create security interests over those assets (see paras. 40-42).

12. It is useful for the law to enable the project company to create security over the rights arising out of the project agreement, provided that the enforcement of such security does not affect the obligations of the project company under the agreement (see paras. 43-44).

13. It is further useful for the law to authorize the creation of security interests over the shares of the project company, subject to the approval of the host Government (see below, para. 45).

Duration

14. Where it is found desirable to adopt legislative provisions limiting the duration of concessions to a maximum number of years, it is advisable to provide a period sufficiently long to allow the project company to repay its debts and to achieve a reasonable revenue, production or usage level (see paras. 46-47).

NOTES ON LEGISLATIVE RECOMMENDATIONS**A. GENERAL CONSIDERATIONS**

1. The "project agreement" between the Government and the project company is the central document in an infrastructure project. The project agreement defines the scope and purpose of the project, the rights and obligations of the parties; it provides details on the works to be performed by the project company and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services.

1. Legislative approaches

2. Three main approaches have been used by national legislation with regard to the content of the project agreement. The laws of some countries scarcely refer to this type of agreement, while the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those national laws that list a number of issues to be addressed in the project agreement without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing at the outset of negotiation a general framework for the allocation of rights and obligations between the parties. They may be intended to provide legislative guidance to the public authorities involved in the preparation of project agreements at different levels of Government (national, provincial or local). Such guidance may be found particularly useful by public authorities lacking experience in the negotiation of project agreements. Some countries may further consider that legislative provisions on certain elements of the project agreement may enhance the Government's negotiating position vis-à-vis the project company. Lastly, legislation may sometimes be required so as to provide the Government with the authority to agree on certain types of provisions.

4. The possible disadvantage of legislative provisions dealing in detail with the rights and obligations of the parties is that they might deprive the Government and the project company of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of legislative provisions concerning the project agreement to those strictly necessary, such as, for instance, provisions on matters for which prior legislative

authorization might be needed or those that might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. Conclusion of the project agreement

5. Privately financed infrastructure projects are typically carried out pursuant to written agreements between the Government and the project company. The negotiation and signature of a written agreement is often expressly required by the law. Some national laws prescribe certain formalities for the conclusion and entry into force of the project agreement. In some countries the terms of the agreement negotiated between the awarding authority and the selected project consortium may be subject to approval by a higher authority. Sometimes the entry into force of the project agreement is subject to an act of parliament or even the adoption of special legislation.

6. With a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable, in some countries the authority to bind the host Government is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid unnecessary delay. It is important to bear in mind that the risk of the project being frustrated by lack of approval after negotiations have been completed is not one that the project company would be ready to assume. Where approval requirements are perceived as arbitrary or cumbersome, the host Government might be requested to provide sufficient guarantees to the project company and the lenders against such risk. In some countries where those approval requirements exist, Governments have sometimes agreed in the project agreement to compensate the project company for all costs incurred in the event the final approval of a project is withheld for reasons not imputable to the project company.

B. GENERAL TERMS OF THE PROJECT AGREEMENT

7. Project agreements are typically lengthy documents that deal extensively with a wide variety of general and project-specific issues. Possible legislative implications of what in national laws appear to be core provisions are discussed in this section.

1. The project site

8. Where a new infrastructure facility is to be built on land owned by the host Government, or an existing infrastructure facility is to be modernized or rehabilitated (such as in "modernize-operate-transfer" or "rehabilitate-operate-transfer"

projects), it will normally be for the host Government, as the owner of such land or facility, to make it available to the project company. The host Government may either transfer to the project company title to the land or facilities or retain title thereto, while granting the project company a right to use the land or facilities and build upon it.

9. Both in cases where the infrastructure facility will be transferred back to the host Government or will be permanently owned by the project company, it is advisable that the parties establish the condition of such land and facility at the time it is handed over to the project company. Such determination may reduce disagreements at the time the infrastructure facility is returned to the host Government. Therefore, the project agreement should provide for the inspection, measurement and demarcation of such land and existing facility prior to its being transferred or made available to the project company. Further matters which would be typically dealt with in the project agreement include procedures for handing over the land or facilities and the submission of required documentation.

10. The situation may become more complex when the land is not already owned by the host Government and needs to be purchased from its owners. In the case of projects that originate from an unsolicited proposal from the private sector (see chapter III, "Selection of the concessionaire", paras. 87-93) or infrastructure facilities of relatively high commercial potential that are not deemed to be a national priority, the host Government might not see a compelling reason for undertaking to acquire the land and make it available to the project company. In most cases, however, the project company may not be in the best position to assume the responsibility for purchasing the land needed for the project. The project company may fear the potential delay and expense involved in negotiations with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Therefore, it is typical for the host Government to assume the responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in the project cost as a result of the acquisition of land. The host Government may purchase the required land from its owners or, if necessary, acquire it through expropriation.

11. Where expropriation procedures are required, various preparatory measures may need to be taken to ensure that construction works are not delayed. In countries where the law contemplates more than one type of expropriation proceedings, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the more expeditious of those proceedings, such as the special proceedings that in some countries apply for reasons of compelling public need (see chapter I, "General legislative considerations", paras. 36-37).

12. The right to expropriate private property is usually vested in the Government, but the laws of a number of countries also authorize public utilities or public service

providers (e.g. railway companies, electricity authorities, telephone companies) to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. Particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, it has been found useful to delegate to the concessionaire the authority to carry out certain acts relating to the expropriation, while the host Government remained responsible for accomplishing those acts that, under the relevant legislation, are conditions precedent to the initiation of expropriation proceedings. Upon expropriation, title to the land is often vested in the host Government, although in some cases the law may authorize the host Government and the project company to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property.

2. Easements

13. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the project company's access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. The nature of the project may also be such that it requires the project company to enter property belonging to third parties (e.g. to place traffic signs on adjacent lands; to instal poles or electric transmission lines above third parties' property; to instal and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property). The right to use another person's property for a specific purpose or to do work on it is generally referred to in the *Guide* by the word "easement".

14. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Except for cases where the required easements affect only a small number of adjacent properties, it is usually not an expeditious or cost-effective solution to leave it to the project company to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are acquired by the host Government, through expropriation procedures carried out simultaneously with the expropriation of the project site.

15. A somewhat different alternative might be for the law itself to provide the type of easements given to the project company, without necessarily requiring the expropriation of the property to which such easements pertain. Such an approach might be used in respect of sector-specific legislation, where the host Government deems it possible to determine, in advance, certain minimum easements that might be needed by the project company. For instance, a law specific to the power generation sector may lay down the conditions under which the concessionaire obtains a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties. Such a right may be needed for a number of measures, such as establishing or placing underground and overhead cables, as well as establishing supporting struc-

tures and transforming and switching equipment; maintaining, repairing and removing any of those installations; establishing a safety zone along underground or overhead cables; removing obstacles along the wires or encroaching on the safety zone.

16. Under some legal systems, the project company might be under an obligation to pay compensation to the owner, as would have been due in the case of expropriation, should the nature of the easement be such that the use of the property by its owner is substantially hindered.

3. Exclusivity

17. One of the central issues dealt with in project agreements is whether the right to operate the infrastructure or to provide the service is exclusive or whether competing infrastructure will be allowed to operate. Exclusivity may concern the right to provide a service in a particular geographical region (e.g. a communal water distribution company) or embrace the whole territory of the country (e.g. a national railway company); it may relate to the right to supply one particular type of goods or services to one particular customer (e.g. a power generator being the exclusive regional supplier to a power transmitter and distributor), or to a limited group of customers (e.g. a national long-distance telephone carrier providing connections to local telephone companies).

18. For countries wishing to adopt general enabling legislation on privately financed infrastructure projects, a flexible approach to deal with the issue of exclusivity may be for the law to provide that the Government is authorized to grant exclusive concessions when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for reasons of technical or economical viability. The awarding authority may be required to state the reasons for granting an exclusive concession for each particular case. Such general legislation may be supplemented by sector-specific laws regulating the issue of exclusivity in a manner suitable for each particular sector (see chapter II, "Sector structure and regulation", ___).

19. An additional issue that may be raised in some projects is whether the project company may be given an assurance that no competing infrastructure will be allowed to operate. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the project company. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the project company without the project company's consent. In other countries, such an undertaking may be implied in general rules applying to concessions or in general principles of administrative law, particularly where the relevant activity is or used to be the object of a State monopoly.

20. Provisions of this type may be intended to foster the confidence of project company shareholders and lenders that no parallel competing project will be carried out or

that the basic assumptions under which the project was awarded will be respected. However, they may limit the ability of the host Government to deal with changed circumstances as the public interest may require. For instance, the required tariff level to allow profitable exploitation of a toll road may exceed the paying capacity of low-income segments of the public. Thus, the host Government may have an interest in maintaining open to the public a non-toll charging road as an alternative to a new toll road. These arrangements are not unusual for road transportation projects.

21. Therefore, it may be preferable for the law to authorize the host Government and the project company to find a suitable solution in the project agreement, rather than regulating the matter in the same fashion for all projects. The possibility of subsequent changes in the host Government's policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure, could further be dealt with by the parties in the provisions dealing with changes of circumstances (see chapter VIII, "Delays, defects and other failures to perform", ___).

4. Legal status of the concessionaire

22. Project agreements typically contain provisions on the legal status of the concessionaire and deal with the question whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to a project consortium. Provisions on these matters are often contained in national legislation on privately financed infrastructure projects as well.

23. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia. They may fall under different contractual categories provided in national laws and the legal status of consortia as well as the rights and obligations of their members vary in different legal systems.

24. Forming a project consortium may present some advantages, such as more flexibility in dealings among the consortium members and with their business partners than in a separate project company. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their residence for taxation purposes. There might also be instances where the host Government would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all consortium members jointly liable for the entire project.

25. For those countries that wish to retain such possibility, the law might give the awarding authority the option to award the project to a consortium or to require that a separate legal entity be established by the selected project consortium, depending on the needs of the project. However, a number of issues would need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the host Government, as well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project.¹

26. More common, however, are legislative provisions requiring that the concessionaire be established as an independent legal entity. From the perspective of the host Government, an independent legal entity facilitates coordination in the execution of the project and may provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the consortium members. This aspect may be of particular importance where significant portions of the services or supplies required by the project are to be provided by members of the project consortium. Since a substantial part of the liabilities and obligations of the project company, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated.

27. The host Government may further wish to require that the project company be established under the laws of the country. The host Government may consider that the exercise of its regulatory and monitoring functions in respect of the services provided by the project company might be hindered if the project company were subject to the laws of a foreign jurisdiction. Furthermore, given the public interest in the project company's activities, the host Government may wish that the project company comply with national accounting and publicity provisions (e.g. publication of financial statements; publicity requirements concerning certain corporate acts). However, such a requirement emphasizes the need for the host Government to have adequate company laws in place (see chapter I, "General legislative considerations", paras. 46-49). The ease with which the project company can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

¹A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the *UNCITRAL Construction Legal Guide* (chapter II, "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, *mutatis mutandis*, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim against consortium members from different countries, should a dispute arise, may be overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the host Government and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by the Government; whether there are any mandatory rules of the law governing an agreement with a group of contractors.

28. The appropriate time for the establishment of the project company is a matter to be considered in the light of the different interests involved in a typical project. Moved by the interest to start the implementation phase as soon as possible, some host Governments might be inclined to require that the project company be established at the earliest possible stage. However, it should be borne in mind that firm and final commitments by the lenders and other capital providers typically may not be available prior to the final award of the concession, particularly where a separate legal entity is the envisaged vehicle for raising funds for the project, such as in a "project finance" transaction (see "Introduction and background information on privately financed infrastructure projects", paras. 68-71). Therefore, it is generally advisable to require that the project company be established within a reasonably short period after, but not before, the award of the project.

29. Another important issue in connection with the establishment of the project company concerns the equity investment required for the establishment of the project company. The host Government has a legitimate interest in seeking an equity level that ensures a sound financial basis for the project company and guarantees its capability to meet its obligations. Such interest may be satisfied by requiring that the project company be established with a certain minimum capital. In some countries, that issue is dealt with in the law itself, by prescribing a fixed sum or establishing a percentage of the total project cost as the minimum capital of the project company. In other countries, these issues are not addressed in the legislation and are left for the procuring entity to decide, sometimes after negotiations with the selected project consortium.

30. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, it may be undesirable to provide a legislative requirement of a fixed sum as minimum capital for all companies carrying out infrastructure projects in the country. A more flexible approach might be to establish individual requirements taking into account the particular circumstances of each project or type of infrastructure. Where the total expected cost of the project cannot be estimated in advance by the awarding authority, the minimum capital required for the establishment of the project company could be indicated in the solicitation of tenders or request for proposals. Where it is not feasible to estimate in advance the project cost, or in the event the host Government prefers to negotiate the amount or ratio of equity investment offered by the selected project consortium, the awarding authority might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process. In countries where the project is awarded by a formal act of the host Government, such as a decree or notice of award, the required minimum capital of the project company could be indicated in such act.

31. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the project company has to be organized. Some laws specifically require that the project company be incorporated as a certain type of company, while other

laws make no provision on this subject. In cases where it is considered important to specify the form in which the project company is to be established, it is desirable to bear in mind the interest of the consortium members in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the project company's debts, its shareholders will normally prefer a corporate form in which their liability is limited to the value of their shares in the company's capital, such as a joint stock company. They would be unwilling to carry out a project that would require them to assume unlimited liability for the project company's debts.

32. Some laws contain provisions concerning the scope of activities of the project company, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project's accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities. At the same time, however, the host Government might be interested in reserving the possibility of integrating other projects under a common management, in the event the same project company is awarded a complementary project in a separate selection process.

33. The host Government might also be interested in ensuring that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the project agreement, and that no decision will be made that might hinder the execution of the project. Therefore, the law may provide that changes in the statutes and by-laws of the project company require prior authorization by the host Government. In other countries such a level of control is achieved by requiring the participation of the host Government, as a privileged shareholder, in the project company, with the proviso that certain decisions necessitate the positive vote of the host Government in the shareholders' or board's meeting. In requiring governmental approval for modifications of the statutes and by-laws of the project company or for other corporate decisions, it is desirable to weigh the public interests represented through the State against the need for affording the project company the necessary flexibility for the conduct of its business. The daily management of the project would be impaired if even minor matters concerning the company's internal affairs routinely required prior governmental clearance. One possible solution might be to limit the right of the host Government to object to a proposed amendment to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which could be identified in the project agreement.

34. The host Government may have a legitimate interest in ensuring that the original members of the project consortium maintain their commitment to the project throughout its duration and that they will not be replaced by en-

tities unknown to the host Government. Thus, the law may provide, in addition to the matters mentioned above, that the transfer of effective control over the project company requires the prior approval of the host Government.

5. Assignment of the concession

35. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Therefore, national laws frequently prohibit the assignment of the concession without the consent of the Government, which may also be required for a transfer of the right to control the project company. General legislative provisions of this type may promote the confidence of the public in the control being exercised by the Government in respect of the qualifications of infrastructure operators or public service providers.

36. Some countries have found it further useful to mention in the legislation the conditions under which an approval to the transfer of a concession prior to its expiry may be granted, such as, for example, 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. General legislative provisions of this type may be supplemented by specific provisions in the project agreement setting forth the scope of those restrictions, as well as the conditions under which the consent of the host Government may be granted.

37. Unlike a full assignment, a subconcession involves the transfer, to another entity, of the responsibility to carry out one particular activity falling under the concession. In cases where the project company is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the project company may wish to engage another entity to carry out some of those activities by way of a subconcession. Where the concession itself is not transferable, there may be obstacles to a subconcession without legislative authorization. Under normal circumstances, however, the host Government would have no compelling reason for excluding altogether the possibility of subconcessions, provided that it can be satisfied of the reliability and the qualifications of the subconcessionaire. It may therefore be desirable for the law to clarify that the concessionaire is authorized to award subconcessions, subject to prior approval by the host Government.

38. Another related issue concerns the method for selecting a subconcessionaire. Some countries have special rules governing the award of contracts by public service providers, and in some countries the law expressly requires the use of tendering proceedings for the award of subconcessions. Rules of this type were often adopted at times where nearly all infrastructure was owned and operated by the State, with little or marginal private sector investment. Their purpose was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of infrastructure projects implemented by privately-owned entities, there may no

longer be a compelling reason or public interest for prescribing to the concessionaire the procedure to be followed for the award of subconcessions.

6. Security interests

39. The financing documents for privately financed infrastructure projects typically include extensive security arrangements. Even in cases where the potential market value of the infrastructure might be less than the cost of the investment, security in the form of tangible assets might cover at least part of the sums borrowed by the project company. Security over negotiable instruments, receivables and intangible rights might also be important factors for reducing the lenders' exposure to the project risks and possibly enhancing the terms of the loans. Thus, the project company will normally have an interest in being able to pledge to the lenders all or some of the assets, property and rights that arise out of the concession.

(a) Security over the physical assets

40. Legal obstacles to the creation of security interests over the physical assets comprised in the infrastructure may arise where those assets remain in the property of the State throughout the project term. If the project company lacks the title to the property it will in many legal systems have no (or only limited) power to encumber such property.

41. However, in some countries the creation of some form of security may be possible, particularly where the project company is granted a leasehold interest or right to use the relevant property. Such security would not attach to the property itself, but to the rights and interests granted to the project company under the project agreement. Furthermore, security interests may also be created where the concession encompasses different types of State property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure.

42. It is advisable that the law expressly clarify the extent to which the project company may create security interests over the physical assets comprised in the infrastructure, for instance by indicating the types of assets in respect of which such security interests may be created or the type of security interests that is permissible. However, the Government will be interested in that security interests created by the project company do not adversely affect the project. Therefore, the law may require the approval of the Government, usually to be reflected in the project agreement, in order for the project company to create such security interests.

(b) Security over intangible assets

43. The right to operate the infrastructure is in most cases not transferable without the consent of the Government, a circumstance which usually precludes the creation of security interests over the concession or licence. However,

even if the concession itself may not be pledged, the law in some countries authorizes the project company to create security interests over the rights arising out of the concession or licence or the proceeds therefrom. Those proceeds typically include the tariffs charged to the public for the use of the infrastructure or the price paid by the customers for the goods or services provided by the concessionaire. They may also include the revenue of ancillary concessions. Security of this type is a typical element of the financing arrangements negotiated with the lenders.

44. Security interests in the form of assignments or pledges of the proceeds of the concession do not affect the Government's title to the physical assets of the concession and usually do not raise the same policy concerns that might be raised by mortgages or similar charges. However, since the enforcement of some of such security might lead to situations where creditors substitute for the concessionaire in the exercise of certain rights arising out of the concession agreement, such security interests may affect the Government, the public or the project company's contracting parties or customers. Therefore, it may be useful for the law to provide that, for the purpose of financing the construction or operation of the facility, the project company may, with the consent of the Government, create any form of security over the rights arising from the project agreement, provided that the enforcement of such security does not affect the obligations of the project company under the agreement with regard to the project or its operation.

(c) *Security over shares of the project company*

45. The establishment of security interests over the shares of the project company raises, in principle, concerns similar to those raised by an assignment of the concession. Where the concession may not be assigned or transferred without the consent of the host Government, the law sometimes prohibits the establishment of liens or other security over the shares of the project company. It should be noted, however, that security over the shares of the project company is a type of security commonly required by lenders in project finance transactions and that general prohibitions on the establishment of such security may unnecessarily limit the project company's ability to raise funding for the project. As with other forms of security, it might therefore be useful for the law to authorize the project company to create such security subject to the host Government's prior approval.

7. Duration

46. The desirable duration of a project agreement may depend on a number of factors, such as the operational life of the facility or the time needed for the project company to repay its debts and amortize the initial investment. Therefore, it might not be feasible for the law to establish

a duration period that would be appropriate to all types of projects. However, a number of countries have found it desirable to adopt legislative provisions limiting the duration of infrastructure concessions to a maximum number of years. Some laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession once the debts of the project company have been fully repaid and a certain revenue, production or usage level has been achieved, subject to a maximum limit of a fixed number of years. Where it is found desirable to adopt legislative provisions limiting the duration of concessions to a maximum number of years, the limitation should permit fixing a period sufficiently long to allow the project company to fully repay its debts and to achieve a reasonable profit.

47. With regard to the method for calculating the duration of the concession period, national laws offer different solutions. Some laws expressly include the construction phase, as well as any extension given for reasons of *force majeure*, as part of the concession period. Other laws, however, expressly provide that the time necessary for the execution of the project is not taken into account when calculating the duration of the concession period. Some laws achieve the same result by providing that the period of concession begins to run upon completion of the construction. The rationale for including the construction period in the total concession period is to encourage the project company to complete the construction works ahead of schedule, so as to benefit from a longer period of exploration of the facility. This element of encouragement is not available in case the law excludes the construction from the overall concession period.

C. SPECIFIC TERMS

48. In addition to the essential provisions discussed in the preceding section, project agreements typically deal with a wide variety of other issues which are discussed in the following chapters of the *Guide*, such as the extent of Government support provided to the project (see below chapter V, "Government support"); schedule of works (see chapter VI, "Construction phase"); conditions of operation of the infrastructure, level and quality of services, tariff structure and price adjustment provisions (see chapter VII, "Operational phase"); provisions and remedies in the event of default or breach of the project agreement, provisions dealing with changes of circumstances and unforeseen events, performance guarantees and insurance obligations of the project company (see chapter VIII, "Delays, defects and other failures to perform"); transfer of the facility at the end of the project period, possibility of extension and causes of early termination of the project agreement (see chapter IX, "Duration extension and early termination of the project agreement"); provisions on applicable law and dispute resolution mechanisms (see chapter X, "Governing law" and chapter XI, "Settlement of disputes").

IV. CASE LAW ON UNCITRAL TEXTS

1. The secretariat of UNCITRAL continues publishing 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.

2. So far, 18 sets of abstracts have been published (A/CN.9/SER.C/ABSTRACTS/1 to 18). These documents may be obtained from the UNCITRAL secretariat

UNCITRAL secretariat
P.O. Box 500
Vienna International Centre
A-1400 Vienna
Austria

Telephone: (43-1) 26060-4060 or 4061
Telex: 135612 uno a
Telefax: (43-1) 26060-5813
E-Mail: uncitral@unov.un.or.at

3. They may also be accessed through the UNCITRAL homepage on the worldwide web (homepage:<http://www.un.or.at/uncitral>).

4. 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.

V. STATUS OF UNCITRAL TEXTS

Status of conventions and model laws: note by the Secretariat (A/CN.9/449)

[Original: English]

[Not reproduced. The updated list may be obtained from the UNCITRAL secretariat or found on the Internet Home Page (<http://www.un.or.at/uncitral>).]

VI. TRAINING AND ASSISTANCE

Training and technical assistance: note by the Secretariat: (A/CN.9/448) [Original: English]

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I. INTRODUCTION

1. Pursuant to the decision taken at the twentieth session of the Commission (1987), training and assistance activities count among the high priorities of UNCITRAL.¹ The training and technical assistance programme carried out by the secretariat under the mandate given by the Commission, particularly in developing countries and in countries whose economic systems are in transition, encompasses two main lines of activity: (a) information activities aimed at promoting the knowledge of international commercial law conventions, model laws and other legal texts; and (b) assisting Member States in their efforts towards commercial law reform and towards the adoption of UNCITRAL texts.

2. This note sets out the activities of the secretariat subsequent to the thirtieth session of the Commission (12 - 30 May 1997) and discusses possible future training and technical assistance activities in the light of the trends in the demand for such services from the secretariat.

II. TRENDS IN TRAINING AND TECHNICAL ASSISTANCE

3. There is a continuing and significant increase in the importance being attributed by Governments, domestic

and international business communities and multilateral and bilateral aid agencies to the improvement of the legal framework for international trade and investment. UNCITRAL has an important function to play in this process because it has produced and promotes the use of legal instruments in a number of key areas of commercial law which 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 Goods and the United Nations Convention on the Limitation Period in the International Sale of Goods;

(b) In the area of dispute resolution, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (a United Nations convention adopted prior to the establishment of the Commission, but actively promoted by it), the UNCITRAL Arbitration Rules, the UNCITRAL Conciliation Rules, the UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Notes on Organizing Arbitral Proceedings;

(c) In the area of procurement, the UNCITRAL Model Law on Procurement of Goods, Construction and Services;

(d) In the area of banking, payments and insolvency, the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the UNCITRAL Model Law on International Credit Transfers, the United Nations Convention on International Bills of Exchange and Inter-

¹Official Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17), para. 335.

national Promissory Notes, and the UNCITRAL Model Law on Cross-Border Insolvency;

(e) In the area of transport, the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade;

(f) In the area of electronic commerce and data interchange, the UNCITRAL Model Law on Electronic Commerce.

4. The upsurge in commercial law reform represents a significant and crucial opportunity for UNCITRAL to significantly further the objectives of substantial coordination and acceleration of the process of harmonization and unification of international trade law, as envisaged by General Assembly resolution 2205 (XXI) of 17 December 1966.

III. TECHNICAL ASSISTANCE TO STATES IN PREPARATION AND IMPLEMENTATION OF LEGISLATION

5. Technical assistance is provided to States preparing legislation based on UNCITRAL legal texts. Such assistance is provided in various forms, including review of preparatory drafts of legislation from the viewpoint of UNCITRAL legal texts, technical consultancy services and assistance in the preparation of legislation based on UNCITRAL legal texts, preparation of regulations implementing such legislation, comments on reports of law reform commissions as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL legal texts embodied in national legislation. Another form of technical assistance provided by the secretariat consists in advising on the establishment of institutional arrangements for international commercial arbitration, including training seminars for arbitrators, judges and practitioners in this area.

6. With a view to maximizing the benefit that recipient countries derive from UNCITRAL technical assistance, the secretariat has taken steps towards increasing cooperation and coordination with development assistance agencies. Cooperation and coordination among entities providing legal technical assistance has the desirable effect of ensuring that, when United Nations system entities or outside entities are involved in providing legal technical assistance, the legal texts prepared by the Commission and recommended by the General Assembly to be considered are in fact so considered and used. The secretariat is continuing its efforts in this regard.

7. From the standpoint of recipient States, UNCITRAL technical assistance is beneficial owing to the secretariat's accumulated experience in the preparation of UNCITRAL legal texts. It helps establish legal systems that not only are internally consistent, but also utilize internationally developed trade law conventions, model laws and other legal texts. The resulting legal harmonization maximizes the ability of business parties from different States to successfully plan and implement commercial transactions.

8. States that are in the process of revising their trade legislation may wish to contact the UNCITRAL secretariat in order to obtain technical assistance and advice.

IV. UNCITRAL SEMINARS AND BRIEFING MISSIONS

9. 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, 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, e.g. Uniform Customs and Practice for Documentary Credits and INCOTERMS (International Chamber of Commerce); Factoring Convention (International Institute for the Unification of Private Law (UNIDROIT)).

10. Lectures at UNCITRAL seminars are generally given by one or two members of the secretariat, experts from the host countries and, occasionally, external consultants. After the seminars, the UNCITRAL secretariat remains in 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 legal texts.

11. Since the previous session, the secretariat organized seminars in a number of States. The following seminars and briefing missions were financed with resources from the Trust Fund for UNCITRAL Symposia:

(a) *Stellenbosch, South Africa (11 March 1997)*, seminar held in cooperation with the University of Stellenbosch, Faculty of Law; attended by approximately 90 participants;

(b) *Cartagena, Colombia (14-15 April 1997)*, seminar held in cooperation with the Ministry of Justice and the Chamber of Commerce; attended by approximately 70 participants;

(c) *Bogotá, Colombia (17-18 April 1997)*, briefing of 20 officials of the Ministries of Justice and Trade;

(d) *Quito, Ecuador (21-22 April 1997)*, seminar held in cooperation with Crespo Abogados; attended by approximately 40 participants;

(e) *Lima, Peru (24-26 April 1997)*, seminar held in cooperation with the Iberoamerican Institute of International Economic Law and the Bar Association of Lima; attended by approximately 100 participants;

(f) *Nicosia, Cyprus (9-10 October 1997)*, seminar held in cooperation with the Office of the Attorney-General of Cyprus; attended by approximately 100 participants.

12. The following seminars and briefing missions were financed by the institution organizing the event or by another organization:

(a) *Thessaloniki, Greece (12-13 September 1997)*, seminar held in cooperation with the Faculty of Law, Aristotle University of Thessaloniki, the Thessaloniki Bar Association and the Technical Chamber of Greece; attended by approximately 100 participants;

(b) *Dubai, United Arab Emirates (10 December 1997)*, seminar held in cooperation with the Dubai Chamber of Commerce; attended by approximately 200 participants;

(c) *Valletta, Malta (24-25 February 1998)*, seminar held in cooperation with the Malta External Trade Corporation; attended by approximately 30 participants.

V. OTHER SEMINARS, CONFERENCES, COURSES AND WORKSHOPS

13. Members of the UNCITRAL secretariat have participated as speakers in various seminars, conferences and courses where UNCITRAL legal 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:

Symposium on International Bankruptcy Law: Comparative and Transnational Approaches, sponsored by the Texas International Law Journal/University of Texas School of Law and the Texas International Law Society (Austin, Texas, 20-21 March 1997);

International Trade Law Post Graduate Course sponsored by the International Training Centre of the International Labour Organization (ILO) and the University Institute of European Studies (Turin, Italy, 14 April 1997);

International Conference on the New German Law on Arbitration sponsored by the German Institution for Arbitration (Berlin, 23 April 1997);

Meeting of the United States Study Group on Standby Practices sponsored by the Institute of International Banking Law and Practice (Chicago, Illinois, 7-9 June 1997);

International Science Colloquium - Issues of Insolvency Law sponsored by the Institute for Commercial Law of Maribor (Maribor, 24 June 1997);

Meeting of the Joint Committee of the Algerian Agency for the Promotion of Foreign Investments, World Bank and UNIDO sponsored by the Government of Algeria (Algiers, 21-22 July 1997);

FOBAPROA Workshop: "Key Issues in a Successful Insolvency Resolution Programme for Mexico" sponsored by FOBAPROA and *Valuación y Venta de Activos (Mexico)* (Mexico City, 5-6 September 1997);

Jubilee International Conference: "Settlement of International Commercial Disputes" sponsored by the Arbitration Court at the Chamber of Commerce and Industry (Moscow, 25 September 1997);

Second International Conference on Build-Own-Transfer (BOT) Projects sponsored by the Cairo Regional Centre for International Commercial Arbitration and the International Law Institute (Cairo, 7-9 October 1997);

Arbitration Law Workshop sponsored by the Korean Academy of Arbitration (Seoul, 24-25 October 1997);

Fifty-third Annual Convention: "Asset-Based Financial Services Industry" sponsored by the Commercial Finance Association (Philadelphia, Pennsylvania, 5-7 November 1997);

Post-Graduate Course at the University of Maribor, Faculty of Law (Maribor, 7-8 November 1997);

Chartered Institute of Arbitrators Arbitration Course (New Delhi, 8-11 November 1997);

International Entry and Special Fellowship Courses on Arbitration sponsored by the Chartered Institute of Arbitrators and the Cairo Regional Centre for International Commercial Arbitration (Cairo, 12-17 December 1997);

Internet Law and Policy Forum (ILPF) International Conference: *Releasing the Internet Economy — Content and Electronic Commerce* (Seattle, Washington, 7-8 January 1998);

ABA SONREEL/AIPN Symposium on Arbitration of International Energy Disputes sponsored by the American Bar Association and SONREEL/AIPN (Houston, Texas, 21-22 January 1998);

Swiss Arbitration Association Workshop (Ebnat-Kappel, 22-25 January 1998);

Meeting on International Standby Practices sponsored by the Institute of International Banking Law and Practice (New York, 26-29 January 1998);

International Law Institute/UNCITRAL Regional Conference: "The Legal Framework for BOO and BOT Projects" (Santo Domingo, 16 February 1998);

Seminar on Intellectual Property, Licensing and Dispute Resolution sponsored by the World Intellectual Property Organization (WIPO) and the Cairo Regional Centre for International Commercial Arbitration (Cairo, 9-10 March 1998).

14. The participation of members of the UNCITRAL secretariat as speakers in the conferences listed below was financed with resources from the United Nations regular travel budget:

UNCITRAL/INSOL Second Multinational Judicial Colloquium and the INSOL International Fifth World Congress sponsored by INSOL (New Orleans, Louisiana, 22-26 March 1997);

Pan American Surety Association (PASA) XIII International Seminar sponsored by PASA (Buenos Aires, 7-9 May 1997);

The International Lawyer Symposium (Austin, Texas, 16-18 June 1997);

Eighth Annual Workshop: "The Arbitration of Global Projects" sponsored by the Institute for Transnational Arbitration (Austin, Texas, 19-20 June 1997);

XLI Congress of the *Union Internationale des Avocats* (Philadelphia, Pennsylvania, 4-7 September 1997);

UN/UNCITRAL/*Union Internationale des Avocats* Day at United Nations Headquarters (New York, New York, 8 September 1997);

Arbitration Conference of the Indian Council of Arbitration (New Delhi, 30-31 October 1997);

London Court of International Arbitration Arbitrators Symposium (Agra, 1-2 November 1997);

International Bar Association, Section on Business Law, 1997 Conference (New Delhi, 3-7 November 1997);

International Law Weekend 1997 sponsored by the American Branch of the International Law Association (New York, New York, 8 November 1997);

1997 Fall Meeting of the Section of International Law and Practice of the American Bar Association and the Inter-American Bar Association Council Meeting (Miami, Florida, 13-16 November 1997);

“Dismantling the Barriers to Global Electronic Commerce” Conference sponsored by the Organization for Economic Cooperation and Development (Turku, 19-21 November 1997);

Symposium on New Arbitration Rules sponsored by the German Institution of Arbitration (Cologne, 26 November 1997);

Second 1997 London Court of International Arbitration European Council Symposium and the International Council for Commercial Arbitration Council Meeting (Paris, 28-29 November 1997);

United Nations Conference for Trade and Development (UNCTAD) Commission on Enterprise, Business Facilitation and Development (Geneva, 1-5 December 1997);

Fifth International Arbitration Conference sponsored by the Croatian Chamber of Commerce (Zagreb, 4-5 December 1997);

European Law Students Association (ELSA) Trade Law Seminar and lectures at the International Maritime Law Institute (Valletta, 16-17 February 1998).

VI. INTERNSHIP PROGRAMME

15. 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 14 interns from Austria, Bulgaria, Canada, Germany, Italy, Mexico, the Netherlands, the United Kingdom of Great Britain and Northern Ireland 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. As no funds are available to the secretariat to assist interns to cover their travel or other expenses, interns are often sponsored by an organization, university, Government agency or they meet their expenses from their own means. The Commission may wish, in this connection, to invite Member States, universities and other organizations, in addition to those that already do so, to consider sponsoring the participation of young lawyers in the United Nations internship programme with UNCITRAL.

16. In addition, the secretariat occasionally accommodates requests by scholars and legal practitioners who wish to conduct research in the Branch and in the UNCITRAL Law Library for a limited period of time.

VII. FUTURE ACTIVITIES

17. For the remainder of 1998, seminars and legal-assistance briefing missions are being planned in Africa, Asia, Eastern Europe and Latin America. Since the costs of training and technical assistance activities is not covered by the regular budget, the ability of the secretariat to implement these plans is contingent upon the receipt of sufficient funds in the form of contributions to the Trust Fund for UNCITRAL Symposia.

18. As it has done in recent years, the secretariat has agreed to co-sponsor the next three-month International Trade Law Post-Graduate Course to be organized by the University Institute of European Studies and the International Training Centre of the International Labour Organization in Turin. Typically, approximately half of the participants are drawn from Italy, with many of the remainder being drawn from developing countries. This year's contribution from the UNCITRAL secretariat will focus on issues of harmonization of laws on international trade law from the perspective of UNCITRAL, including past and current work.

VIII. FINANCING PROGRAMME IMPLEMENTATION

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 the twentieth session (1987) 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 that are funded by funding agencies such as the World Bank) have to be met by voluntary contributions to the Trust Fund for UNCITRAL Symposia.

20. Given the importance of extra-budgetary 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 Trust Fund for UNCITRAL Symposia, particularly in the form of multi-year contributions, so as to facilitate planning and enable the secretariat to meet the increasing demands in developing countries and newly independent States for training and assistance. The secretariat can be contacted for information on how to make contributions.

21. In the period under review, a contribution from Switzerland was made for the seminar programme. The Commission may wish to express its appreciation to those States and organizations that have contributed to the Commission's programme of training and assistance by providing funds or staff or by hosting seminars.

22. In this 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 for granting travel assistance to developing States members of the United Nations Commission on International Trade Law. The Trust Fund so established is open to voluntary financial contributions from States, inter-governmental organizations, regional economic integration organizations, national institutions and non-governmental organizations as well as natural and juridical persons.

23. At its thirtieth session, the Commission noted with appreciation that the General Assembly, in resolution 51/161, paragraph 10, had appealed to Governments, the relevant United Nations organs, organizations and institu-

tions 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 States members of UNCITRAL, at their request and in consultation with the Secretary-General.

24. It is also recalled that in operative paragraph 11 of resolution 51/161 of 16 December 1996, the General Assembly decided to include the Trust Funds for Symposia and Travel Assistance in the list of funds and programmes that are to be dealt with at the United Nations Pledging Conference for Development Activities.

Part Three

ANNEXES

**I. ADDITION TO THE UNCITRAL MODEL
ON ELECTRONIC COMMERCE:
PROVISION ON INCORPORATION BY REFERENCE
AND
ADDITION TO THE GUIDE TO ENACTMENT OF THE
UNCITRAL MODEL LAW ON ELECTRONIC COMMERCE**

UNCITRAL MODEL LAW ON ELECTRONIC COMMERCE

Addendum

Article 5 *bis*. *Incorporation by reference*

*(as adopted by the Commission at its thirty-first session, in
June 1998)*

Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is not contained in the data message purporting to give rise to such legal effect, but is merely referred to in that data message.

ADDITION TO THE GUIDE TO ENACTMENT

Article 5 *bis*. *Incorporation by reference*

46-1. Article 5 *bis* was adopted by the Commission at its thirty-first session, in June 1998. It is intended to provide guidance as to how legislation aimed at facilitating the use of electronic commerce might deal with the situation where certain terms and conditions, although not stated in full but merely referred to in a data message, might need to be recognized as having the same degree of legal effectiveness as if they had been fully stated in the text of that data message. Such recognition is acceptable under the laws of many States with respect to conventional paper communications, usually with some rules of law providing safeguards, for example rules on consumer protection. The expression "incorporation by reference" is often used as a concise means of describing situations where a document refers generically to provisions which are detailed elsewhere, rather than reproducing them in full.

46-2. In an electronic environment, incorporation by reference is often regarded as essential to widespread use of electronic data interchange (EDI), electronic mail, digital certificates and other forms of electronic commerce. For example, electronic communications are typically structured in such a way that large numbers of messages are exchanged, with each message containing brief information, and relying much more frequently than paper documents on reference to information accessible elsewhere. In electronic communications, practitioners should not have imposed upon them an obligation to overload their data messages with quantities of free text when they can take advantage of extrinsic sources of information, such as databases, code lists or glossaries, by making use of abbreviations, codes and other references to such information.

46-3. Standards for incorporating data messages by reference into other data messages may also be essential to the use of public key certificates, because these certificates are generally brief records with rigidly prescribed contents that are finite in size. The trusted third party which issues the certificate, however, is likely to require the inclusion of relevant contractual

terms limiting its liability. The scope, purpose and effect of a certificate in commercial practice, therefore, would be ambiguous and uncertain without external terms being incorporated by reference. This is the case especially in the context of international communications involving diverse parties who follow varied trade practices and customs.

46-4. The establishment of standards for incorporating data messages by reference into other data messages is critical to the growth of a computer-based trade infrastructure. Without the legal certainty fostered by such standards, there might be a significant risk that the application of traditional tests for determining the enforceability of terms that seek to be incorporated by reference might be ineffective when applied to corresponding electronic commerce terms because of the differences between traditional and electronic commerce mechanisms.

46-5. While electronic commerce relies heavily on the mechanism of incorporation by reference, the accessibility of the full text of the information being referred to may be considerably improved by the use of electronic communications. For example, a message may have embedded in it uniform resource locators (URLs), which direct the reader to the referenced document. Such URLs can provide "hypertext links" allowing the reader to use a pointing device (such as a mouse) to select a key word associated with a URL. The referenced text would then be displayed. In assessing the accessibility of the referenced text, factors to be considered may include: availability (hours of operation of the repository and ease of access); cost of access; integrity (verification of content, authentication of sender and mechanism for communication error correction); and the extent to which that term is subject to later amendment (notice of updates, notice of policy of amendment).

46-6. One aim of article 5 *bis* is to facilitate incorporation by reference in an electronic context by removing the uncertainty prevailing in many jurisdictions as to whether the provisions dealing with traditional incorporation by reference are applicable to incorporation by reference in an electronic environment. However, in enacting article 5 *bis*, attention should be given to avoid introducing more restrictive requirements with respect to incorporation by reference in electronic commerce than might already apply in paper-based trade.

46-7. Another aim of the provision is to recognize that consumer-protection or other national or international law of a mandatory nature (e.g. rules protecting weaker parties in the context of contracts of adhesion) should not be interfered with. That result could also be achieved by validating incorporation by reference in an electronic environment "to the extent permitted by law", or by listing the rules of law that remain unaffected by article 5 *bis*. Article 5 *bis* is not to be interpreted as creating a specific legal regime for incorporation by reference in an electronic environment. Rather, by establishing a principle of non-

discrimination, it is to be construed as making the domestic rules applicable to incorporation by reference in a paper-based environment equally applicable to incorporation by reference for the purposes of electronic commerce. For example, in a number of jurisdictions, existing rules of mandatory law only validate incorporation by reference provided that the following three conditions are met: (a) the reference clause should be inserted in the data message; (b) the document being referred to, e.g. general terms and conditions, should actually be known to the party against whom the reference document might be relied upon; and (c) the reference document should be accepted, in addition to being known, by that party.

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[Original: English]**

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ANNEX

UNCITRAL legal texts

Short title

Hamburg Rules 1978

Limitation Convention (1974/1980)

UNCITRAL Arbitral Proceeding Notes (1996)

UNCITRAL Arbitration Rules (1976)

UNCITRAL Conciliation Rules (1980)

UNCITRAL Credit Transfers Law (1992)

UNCITRAL Electronic Commerce Law (1996)

UNCITRAL International Countertrade Guide (1992)

UNCITRAL Electronic Funds Guide (1986)

UNCITRAL Construction Contracts Guide (1987)

UNCITRAL Model Arbitration Law (1985)

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Full title

United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)^a

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 Notes on Organizing Arbitral Proceedings (1996)^d

UNCITRAL Arbitration Rules (1976)^e

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UNCITRAL Legal Guide on International Countertrade Transactions (1992)ⁱ

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UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works (1987)^k

UNCITRAL Model Law on International Commercial Arbitration (1985)^l

UNCITRAL Model Law on Cross-Border Insolvency (1997)^m

<i>Short title</i>	<i>Full title</i>
UNCITRAL Model Procurement Law (1994)	UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994) ⁿ
UNCITRAL Bills and Notes Convention (1988)	United Nations Convention on International Bills of Exchange and International Promissory Notes (1988) ^o
United Nations Guarantee and Stand-by Convention (1995)	United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1995) ^p
United Nations Sales Convention (1980)	United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) ^q
United Nations Terminal Operators Convention (1991)	United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (1991) ^r

Notes

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IV. CHECK-LIST OF UNCITRAL DOCUMENTS

<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-first session		
1. General series		
A/CN.9/443	Provisional agenda, annotations thereto and scheduling of meetings of the thirty-first session	Not reproduced
A/CN.9/444 and Add.1-5	Draft chapters of a legislative guide on privately financed infrastructure projects: report of the Secretary-General	Part two, III
A/CN.9/445	Report of the Working Group on International Contract Practices on the work of its twenty-seventh session	Part two, I, A
A/CN.9/446	Report of the Working Group on Electronic Commerce on the work of its thirty-second session	Part two, II, A
A/CN.9/447	Report of the Working Group on International Contract Practices on the work of its twenty-eighth session	Part two, I, C
A/CN.9/448	Training and technical assistance: note by the Secretary-General	Part two, VI
A/CN.9/449	Status of conventions and model laws: note by the Secretariat	Part two, V
A/CN.9/450	Possible addition to the UNCITRAL Model Law on Electronic Commerce: draft provision on incorporation by reference: note by the Secretariat	Part two, II, D
A/CN.9/452	Bibliography of recent writings related to the work of UNCITRAL: note by the Secretariat	Yearbook Vol.XXVIII:1997, part three, IV
2. Restricted series		
A/CN.9/XXXI/CRP.1 and Add.1-19	Draft report of the United Nations Commission on International Trade Law on the work of its thirty-first session	Not reproduced
A/CN.9/XXXI/CRP.2	Note by the delegation of France	Not reproduced
A/CN.9/XXXI/CRP.3	Note by the delegation of France	Not reproduced
3. Information series		
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<i>Document symbol</i>	<i>Title or description</i>	<i>Location in present volume</i>
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1. Working papers		
A/CN.9/WG.II/WP.94	Provisional agenda	Not reproduced
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